

**EXPOSURE DRAFT
REVISED FRAMEWORK
FOR DIFFERENTIAL
PREMIUM ASSESSMENT
SYSTEM IN NDIC
2023**



Exposure Draft: Revised Framework for Differential Premium Assessment System in NDIC

Document Control Page

Version	2.0
Document Division	Executive Director, Operations
Document Author	Nigeria Deposit Insurance Corporation
Document Owner	Nigeria Deposit Insurance Corporation
First Version Issue Date	2008
Dated Reviewed	April 2023
Next Review Date	April 2028
Current Status	Exposure Draft
Document Classification	Confidential
Frequency of Review	Five Years

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Approval

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1.0 Introduction

The adoption of **Differential Premium Assessment System (DPAS)** by the Nigeria Deposit Insurance Corporation (NDIC) aims to differentiate premiums payable by insured financial institutions based on their respective risk profile. A DPAS is premised on classifying banks into various risk buckets and applying different premium rates depending on the perceived riskiness of each bank. Hence, institution with higher risk profile would have a higher premium rate.

Prior to the adoption of DPAS, the Corporation implemented a Flat-rate Premium System from 1989 to 2007 for Deposit Money Banks (DMBs); 2006-2016 for Primary Mortgage Banks (PMBs); and 2006-2020 for Microfinance Banks (MFBs). The premium payable to NDIC was assessed at a uniform rate across all insured banks.

In 2008, the NDIC transited from flat rate premium assessment to DPAS which was applied to Commercial and Merchant banks (DMBs). Subsequently, it was adopted for Non-Interest Banks (NIBs) in 2012; PMBs in 2017; and MFBs & Payment Service Banks (PSBs) in 2021.

The Initial DPAS Framework of the NDIC was issued in 2007. This Revised DPAS Framework seeks to document the key elements of the NDIC DPAS which have been reviewed to make it more risk sensitive due to significant changes that have taken place in the Nigeria banking system and conform with the recommendations of the International Association of Deposit Insurers (IADI) and other global best practices.

2.0 Objectives of the Framework

The specific objectives of risk-based pricing of deposit insurance and this DPAS Framework are:

- i. To introduce fairness into the premium assessment process;
- ii. To encourage effective risk management practice in insured institutions;
- iii. To apply a risk differential approach in the deposit insurance premium assessment of banks;

- iv. To allow banks in the lower risk categories to pay relatively lower premium rates;
- v. To charge banks in the higher risk categories additional premium for their extra risks;
- vi. To incentivise regulatory compliance; and
- vii. To mitigate moral hazard.

3.0 The Framework Principle and the IADI Essential Criteria

The NDIC risk-adjusted deposit insurance pricing is anchored on the premise that the cost of deposit insurance premium and the coverage level should neither over-burden the banking system nor be largely subsidised by public funding (tax payers money).

IADI Core Principle 9 “Sources and Uses of Funds” provides that a deposit insurer should have readily available funds and all funding mechanisms necessary to ensure prompt reimbursement of depositors’ claims and that the responsibility for paying the cost of deposit insurance should be borne by banks. The essential criteria recommended that if the deposit insurer uses differential premium systems:

- i. The system for calculating premiums is transparent to all participating institutions;
- ii. The scoring/premium categories are significantly differentiated; and
- iii. The ratings and rankings resulting from the system pertaining to individual banks are kept confidential.

4.0 Legal Basis of the Framework

- i. Section 16 of the NDIC Act 2006, provides that all deposits of a licenced bank or any other financial institution shall be insured with the Corporation with the exception of the following:
 - a. Insider deposits, that is, deposits of staff including directors of the insured institutions;
 - b. Counter-claims from a person who maintained both deposit and loan account, the former serving as a collateral for the loan; and

- c. Such other deposits as may be specified from time to time by the Board.
- ii. Furthermore, Section 17 (2) has given the Corporation the power to vary the rate or basis of assessment of the premium payable to the Corporation by insured institutions or to charge an insured institution or any class of insured institutions premium at a rate or rates which reflects risk posed to the Corporation's deposit insurance funds. Hence, the adoption of the Differential Premium Assessment System in NDIC.
- iii. Sections 23 (1), (2d) (3) and 25 empower the Corporation - where an insured institution is in default with its payment of annual premium or special contribution as provided in section 17 of the NDIC Act - to terminate the insured status (remove an institution from its register of insured institution) after a warning notice.

5.0 Scope of Application

The Revised Framework shall be applied to all insured banks in Nigeria which include Commercial Banks (CBs), Merchant Banks (MBs), Non-Interest Banks (NIBs) and Non-Interest Windows; Microfinance Banks (MFBs); Primary Mortgage Banks (PMBs); Payment Service Banks (PSBs) and such other insured deposit taking institutions in Nigeria.

6.0 Rationale for the Review of Extant DPAS Framework

The need to periodically review, up-date and fine-tune DPAS cannot be over emphasised to ensure the sustainability of the system and comply with best practice. This review was necessitated by the need to address observed gaps in the extant DPAS framework, challenges of operationalising the framework; align with Risk Based Supervisory Rating/Approaches; and for a more robust calibration of a Risk Adjusted Premium Assessment of the NDIC.

7.0 Methodology of the Framework

7.1 Assessment Model for the NDIC DPAS

The IADI recommended four models for pricing deposit insurance which includes the Structural Option Pricing Model, Empirical Expected Loss Model, Bucketing Approach, and Fund Size Calculations. In the Revised Framework, the NDIC adopted the **Bucketing Approach** for its DPAS.

7.2 DPAS Structure

7.2.1 DPAS Template

The NDIC DPAS Template uses two primary stages of deposit insurance pricing (determination of premium rate), namely:

- i. Determination of a Base Premium Rate (R_0) for banks in the best (lowest) risk category; and
- ii. Determination of add-ons based on the individual bank's risk profile using both quantitative and qualitative factors. The add-ons are dependent on the Composite Risk Rating (CRR) of the individual insured financial institution.

The premium rate would be computed quarterly and the average for the four quarters would be used to determine the premium payable by multiplying each institution's premium rate by its total assessable deposits reported in the external auditor's certified statement of total deposit liabilities or the returns as at 31st December of the preceding year.

The Template is based on the CAMELS parameters with the quantitative criteria carrying 75% of the total add-ons score (0.30) or 0.225 of the add-ons and the qualitative criteria accounting for 25% or 0.075. The quantitative factors are Capital Adequacy, Asset Quality, Earnings & Profitability, Liquidity & Funds Management and Sensitivity to Market Risk; while the qualitative factor is Management & Corporate Governance.

Below is the summary of parameters and the accompanying weights as used in the CBN/NDIC Composite Bank Rating that is expected to feed into the DPAS Template:

Table 1: Composite Risk Rating Computation

Parameters	Weights (%)	Credit points	Weighted Credit Points
Capital Adequacy	20	CP1	$WCP1 = CP1 * WEIGHTS / 100$
Asset Quality	15	CP2	$WCP2 = CP2 * WEIGHTS / 100$
Earnings & Profitability	20	CP3	$WCP3 = CP3 * WEIGHTS / 100$
Liquidity & Funds Management	15	CP4	$WCP4 = CP4 * WEIGHTS / 100$
Sensitivity to Market Risk Management	5	CP5	$WCP5 = CP5 * WEIGHTS / 100$
& Corporate Governance	25	CP6	$WCP6 = CP6 * WEIGHTS / 100$
Total	100		$\Sigma WCP = COMPOSITE RATING$

Weighted Credit Points = component points x weights/100; Composite Rating = sum of weighted credit points = ΣWCP . Ratings (Low, Moderate, Above Average and High Risks) are assigned to banks based on the Total Composite Score, where COMPOSITE SCORE is the Summation of all the Weighted Credit Points for all items in the Bank Rating Computation.

Table 2: Composite Risk Rating Categorisation

S/No	Score	Rating	Risk Category
1	$80 \leq X \leq 100$	Low Risk	A
2	$60 \leq X < 80$	Moderate	B
3	$50 \leq X < 60$	Above Average	C
4	$0 \leq X < 50$	High Risk	D

Rating A – Low Risk the highest (best) rating. It is an indication that the institution is very sound in all respects. Rating D – High Risk is the lowest (worst) rating. An institution rated in this category has high immediate probability of failure.

7.2.2 Premium Base Rate and Add-ons Computation for Different Categories of Insured Institutions

7.2.2.1 Premium Base Rate and Add-ons Computation for DMBs

The DPAS Template for DMBs is made up of the Base Rate (Ro) of 0.35% and maximum Add-ons of 0.30%. The estimated add-on for a DMB is dependent on the CRR of that individual insured DMB, as shown in Table 3.

Table 3: Premium Base Rate and Add-ons Computation for DMBs

PARAMETER	FORMULA
BASE RATE (%)	=0.35
MAXIMUM ADD-ON (%)	=0.30
ESTIMATED ADD-ON PER DMB (%)	= 0.30 * [1-(CRR/100)]
PREMIUM RATE	= {0.35 + (0.30*[1-(CRR/100)])}/100

NOTE: 1. Base rate is 0.35 irrespective of the DMB's Rating.
 2. CRR – Composite Risk Rating of individual DMB derived from the CBN/NDIC Bank Rating Matrix.

7.2.2.2 Premium Base Rate and Add-ons Computation for PSBs

The DPAS Template for PSBs is made up of the Base Rate (Ro) of 0.10% and maximum Add-ons of 0.10%. The estimated add-on for a PSB is dependent on the CRR of that individual insured PSB as shown in Table 4.

Table 4: Premium Base Rate and Add-ons Computation for PSBs

PARAMETER	FORMULA
BASE RATE (%)	=0.10
MAXIMUM ADD-ON (%)	=0.10
ESTIMATED ADD-ON (%)	= 0.10 * [1-(CRR/100)]
PREMIUM RATE	= {0.10 + (0.10*[1-(CRR/100)])}/100

NOTE: 1. Base rate is 0.10 irrespective of the PSB's Rating.
 2. CRR – Composite Risk Rating of individual PSB derived from the CBN/NDIC Bank Rating Matrix.

7.2.2.3 Premium Base Rate and Add-ons Computation for PMBs

The DPAS Template for PMBs is made up of the Base Rate (Ro) of 0.30% and maximum Add-ons of 0.25%. The estimated add-on for a PMB is dependent on the CRR of that individual insured PMB as shown in Table 5.

Table 5: Premium Base Rate and Add-ons Computation for PMBs

PARAMETER	FORMULA
BASE RATE (%)	=0.30
MAXIMUM ADD-ON (%)	=0.25
ESTIMATED ADD-ON (%)	= 0.25 *[1-(CRR/100)]
PREMIUM RATE	= {0.30 + (0.25*[1-(CRR/100)])}/100

NOTE: 1. Base rate is 0.30 irrespective of the PMB's Rating;
2. CRR – Composite Risk Rating of individual PMB derived from the CBN/NDIC Bank Rating Matrix.

7.2.2.4 Premium Base Rate and Add-ons Computation for MFBs

The DPAS Template for MFBs is made up of the Base Rate (Ro) of 0.20% and maximum Add-ons of 0.25%. The estimated add-on for an MFB is dependent on the CRR of that individual insured MFB as shown in Table 6.

Table 6: Premium Base Rate and Add-ons Computation for MFBs

PARAMETER	FORMULA
BASE RATE (%)	=0.20
MAXIMUM ADD-ON (%)	=0.25
ESTIMATED ADD-ON (%)	= 0.25 *[1-(CRR/100)]
PREMIUM RATE	= {0.20 + (0.25*[1-(CRR/100)])}/100

NOTE: 1. Base rate is 0.20 irrespective of the MFB's Rating.
2. CRR – Composite Risk Rating of individual MFB derived from the CBN/NDIC Bank Rating Matrix.

However, because of the large number of MFBs and the challenges of the sub-sector, not all the MFBs are examined annually, which may impede the effective execution of the DPAS Framework. In such instance, the rating of such MFB in its latest available examination report shall be used to compute the add-ons for that MFB in the premium assessment period.

7.3 Regulatory Returns and Reports

The following types of returns and reports, amongst others, are expected to be rendered by the insured institution for the determination of differential premium rate, assessment of financial conditions,

determination of the Composite Risk Rating of insured institutions, and other purposes:

- i. Monthly and Quarterly Statutory Returns
- ii. Approved Annual Audited Accounts and Reports
- iii. Certified Statement of Deposit Liabilities
- iv. Returns on Fraud and Forgeries
- v. Returns on Money Laundering
- vi. Risk-Based Examination Reports from CBN/NDIC

7.4 Filing of Returns by Insured Institutions

For the determination of applicable premium rate, every insured financial institution is required under this Framework to submit periodic returns in line with the Acts and circular below:

- i. **Section 27 (1) of NDIC Act 2006** requires every insured institution to submit to the Corporation such returns and information as may be required from time to time within the stipulated period.
- ii. **Section 24 (1) of BOFIA 2020** requires every bank to submit **not later than five days** after the last day of each month or such other specified interval, a Statements showing: (a) The assets and liabilities of the bank, (b) An Analysis of Advances and other assets. **Section 24 (2)** specifies that every bank shall submit such other information, documents, statistics or returns as the CBN may deem necessary. This is further clarified in the “iii” below.
- iii. **CBN Circular BSD/DIR/GEN/LAB/07/011** dated April 10, 2014 requires all banks to submit Daily, Monthly, Quarterly, and Semi-Annual returns via FinA Application. The timelines for submission of statutory returns by reporting institutions through FinA are:

Table 7: Statutory Returns Submission Deadlines

Statutory Returns	Filing deadline
Daily Returns	To be submitted on or before 10.00 a.m. of the following working day.
Monthly, Quarterly and Semi-Annual Returns	To be submitted on or before the 5th day after the month’s end. Where the 5th day happens to be a weekend or public holiday, returns should be submitted the previous day.

- iv. Where an insured institution failed to file returns as and when required and the previous examination reports of that institution are not available, the NDIC shall assign the maximum premium rate applicable to that institution type in determining the premium payable by it.

7.5 DPAS Rating Reports

- i. Each insured financial institution, upon a written demand, would be provided with its risk rating and other relevant supporting documents employed in the determination of its risk rating. Such rating report would assist the insured institution to re-evaluate its current level of risk, strengthen risk controls and deploy appropriate treatments to improve its risk score.
- ii. Each insured financial institution, its director, officer, employee or agent shall maintain confidentiality of its institution's risk score, risk rating, premium rates, the amount of premium payable or paid and are precluded from disclosing any of the confidential information to other insured institutions, unauthorised external parties and the general public. The confidential information shall not be published in any advertisement, annual report and prospectus so as not to cause disruption in the financial system or give an undue competitive advantage to any insured institution.

7.6 Premium Assessment Period

- 7.6.1 In line with Section 17 (1) of NDIC Act 2006, an eligible insured financial institution shall be assessed for premium on its eligible total deposit liabilities standing at its books as at December 31 of the preceding year in the following manner:
 - i. The deposit liabilities shall be as certified by the approved auditor of the insured financial institution;
 - ii. The Certified deposit liabilities shall be forwarded to the Corporation on or before January 31 of every year; and
 - iii. The annual premium shall be payable not later than two months from the date of the demand notice.
- 7.6.2 Section 17 (7) of NDIC Act 2006, any premium payable by an insured institution and which remains unpaid for more than three months

after a demand notice had been served on such institution, shall attract interest at a rate equivalent to the prevailing Monetary Policy Rate of the Central Bank of Nigeria.

7.7 Review of Insured Institution's Premium Rate

- i. The assessed insured financial institution may seek in writing for clarification or review of its premium rate within 10 days on receipt of the demand notice if it is not satisfied with its risk rating. The NDIC shall review the rating to either confirm or revise it.
- ii. If not satisfied with the review, the assessed insured financial institution may request in writing for a further review of its rating by the Senior Management of the Corporation.
- iii. Regardless of the application for a review, each insured institution shall pay its annual premium not later than two months from the date of the demand notice.
- iv. The Risk Rating Review at the instance of the assessed insured institution shall attract an administrative fee of ₦10,000,000 for DMBs and ₦1,000,000 for other deposit taking insured institutions, to cover associated costs. The fee is defrayed if the assessed insured institution's request is successful.

8.0 Compliance with Statutory and Regulatory Requirements

The Board and Senior Management of all insured financial institutions shall ensure compliance with all relevant statutes and regulations, such as NDIC Act 2006, BOFIA 2020, the CBN Supervisory Intervention Framework for the Nigerian Banking Sector, Prudential Guidelines, Corporate Governance Guidelines, and all CBN directives to avoid breaches of legal, statutory, regulatory obligations related to compliance with the requirement of the DPAS Framework.

Non-compliance with the provisions of this framework shall attract appropriate sanctions as may be determined by the NDIC in collaboration with CBN in accordance with the provisions of the NDIC Act 2006, BOFIA 2020 and CBN Act 2007.

9.0 Monitoring and Enforcing Compliance

The NDIC, in collaboration with the CBN shall monitor and enforce compliance with the provisions of this Framework, other extant laws & regulations and shall also establish appropriate processes and procedures in this regard.

10.0 Key Success Factors

The effective implementation of the framework is premised on the existence of the following factors:

- i. **Transparency and Confidentiality:** the system of differential premium determination adopted is transparent to insured institutions and the resulting risk rating of individual bank and premium rates are kept confidential by parties.
- ii. **Effective Supervisory Regime:** an effective on-site examination & off-site surveillance to ensure that an institution's risk profile is measured, monitored, and managed promptly, and where appropriate, supervisory intervention is swift.
- iii. **Availability and Quality of Data:** that insured institution renders timely, relevant, accurate and complete returns on their institutions and regulators/supervisors make risk ratings and supervision reports available to enhance differential premium computation.
- iv. **Accounting and Disclosure Regimes:** the existence of laws and regulations requiring insured institutions to file periodic and on-demand financial and other information with deposit insurer and regulatory authorities. Also, the deposit insurer possesses statutory inspection powers to verify the accuracy of data and documents related to the risk indicators reported by insured institutions.
- v. **Strong Legal and Institutional Framework:** that is perceived as fair & open and allows for insured institutions to appeal or request for review of their risk classification and assessment without undermining the effectiveness of the DPAS itself.
- vi. **Financial Industry Structure and Performance:** The premium structure should continually consider significant changes in the structure and condition of the financial sector including its performance and risk profile.

11.0 Effective Date

The Framework shall take effect from _____

12.0 Review Cycle

The Framework shall be reviewed every five years or earlier if the situation dictates.

13.0 Enquiries

For any further enquires on the Framework with respect to DMBs & PSBs, the insured institution may contact the Director, Insurance & Surveillance Department (ISD) on 09-460-1050. Similarly, for enquiries with respect to other deposit-taking financial institutions, the insured institution may contact the Director, Special Insured Institutions Department (SIID) on 01-271-2300.

NIGERIA DEPOSIT INSURANCE CORPORATION

April, 2023

Annexure

14.1 Definitions of Key Terms

The DPAS Framework has adopted the following operational definitions:

Terms	Definitions/Description
Add-on Premium Rate	Additional premium rate based on risk profile or risk rating of an insured financial institution.
Base Premium Rate	the lowest premium rate chargeable under a rating system to banks in the best (lowest) risk category.
Bucketing Approach	A model of pricing deposit insurance that allows a deposit insurer to follow a risk-weighting approach of bank's assets as the basis for setting premiums. It uses the examiner risk buckets as a metric for deposit insurance pricing.
CAMELS	CAMELS refers to Capital, Asset, Management, Earnings, Liquidity and Sensitivity to Market Risk. The (CAMELS) rating refers to the process of assessing the capital adequacy, asset quality, management efficiency, earning capability, liquidity sufficiency and sensitivity to market risk
Certified deposit liabilities	Statement of deposit liabilities certified by the approved auditor of the insured financial institution.
Composite Risk Rating	Represents the final" rating of the assessment of the safety and soundness of the institution by the supervisor.
Deposit Insurance	A system established to protect depositors against the loss of their insured deposits in the event that a bank is unable to meet its obligations to the depositors.
Deposit insurer	Refers to the specific legal entity responsible for providing deposit insurance, deposit guarantees or similar deposit protection arrangements.

Differential Premium Assessment System	<p>An assessment system of classifying insured financial institutions into various risk buckets and apply different premium rates depending on the perceived riskiness of each risk bucket or a premium assessment system which seeks to differentiate premiums on the basis of criteria such as individual bank risk profiles.</p>
Empirical Expected Loss Model	<p>A model of pricing deposit insurance based on the principle that expected loss is a function of probability of default (PD), exposure at default (EAD) and loss given default (LGD) of failing insured institution.</p>
Flat-rate Premium System	<p>A system of assessing premium payable to a Deposit Insurer at a uniform rate across all insured institutions.</p>
Fund Size Calculations	<p>A model of pricing deposit insurance that applies differential pricing by allowing parameters of the model (loss severity, for example) to vary with bank characteristics such as size. This estimates bank-specific expected losses (fund's credit risk) for a period, usually one year, and then aggregates across the portfolio of banks and estimates a loss distribution for the fund.</p>
Insured deposits	<p>Eligible Deposits that do not exceed the Maximum Coverage Level provided by a Deposit Insurance System.</p>
Premium	<p>The amount that a Member Institution pays to the Deposit Insurer in the manner and time frames prescribed by legislation.</p>
Structural Option Pricing Model	<p>A model of pricing that view deposit insurance as a put option, where shortfall in the value of bank's assets over its liabilities is put on the deposit insurance funds (DIF). That is bank owners purchase the right exercisable at a future time to surrender the remaining assets of the bank to the deposit insurer in exchange for payments to insured depositors.</p>

14.2 List of Abbreviations

ACRONYM	FULL MEANING
BOFIA	Banks and Other Financial Institutions Act
CBN	Central Bank of Nigeria
CBs	Commercial Banks
CRR	Composite Risk Rating
DMBs	Deposit Money Banks
DPAS	Differential Premium Assessment System
FinA Application	Financial Analysis Application
IADI	International Association of Deposit Insurers
MBs	Merchant Banks
MFBS	Microfinance Banks
NDIC	Nigeria Deposit Insurance Corporation
NIBs	Non-Interest Banks
PMBs	Primary Mortgage Banks
PSBs	Payment Service Banks
Ro	Base Premium Rate