THE LEGAL PERSPECTIVE TO CAPITAL RECONSTRUCTION OF BANKS IN NIGERIA.

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DECLARATION

I hereby declare that this work is solely the result of my personal efforts.

It has never to the best of my knowledge been presented or published anywhere. All quotations and references are indicated and their sources duly acknowledged.

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July, 2011.

CERTIFICATION

This thesis, captioned "The Legal Perspective to Capital Reconstruction of Banks in Nigeria" meets the requirement for the award of the degree of Masters of Laws, (LL.M), of Ahmadu Bello University, Zaria, and it is approved for its contribution to knowledge and literary presentation

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DEDICATION

This thesis is dedicated to Almighty God, and to my late father Chief Nnamani Nwankwoani.

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None of the people who in one way or the other assisted in the research is responsible for any error that may arise herein. There are entirely mine.

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TABLE OF ABREVATION

IST - Investment and Securities Tribunal.................................69,150

JCA - Justice of the Court of Appeal..88,108

JSC - Justice of the Supreme Court...87,101

LFN -Laws of the Federation of Nigeria 4,25,33,47-51,54,55,60,62,70,71,73,74,76,77,81,82,95-98,101,105,112,113,116,123,127,128,131,136,145,161,177,179-182,191,192,194.

NDIC -Nigeria Deposit Insurance Corporation.......8,27,69,77,84,86,89,99-105,107,111,12,125,134,136-139,153,163,197,214,218-220,222-226,229.

NSCC - Nigeria Supreme Court Case...11

NWLR- Nigeria Weekly law Report..8,86,88,98,103,105,107,109.110,111,112,114,137,151

SEC -Securities and Exchange Commission...............27, 68-69, 94,135-147,149-154,155,167,168,177-179,187-199,201-206,214-219,221-224.

WAIFEM -West African Institute for Financial and Economic Management.......................................81,241

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ABSTRACT

It is generally accepted that banks are inevitable component of an economic system and that the capital of a bank is the foundation on which it stands. This foundation has continued to witness dynamic changes leading to crisis that often threaten to rock the foundation of our banking system. At each of the point the crisis the depositors had always turned to the state and the central Bank of Nigeria (CBN) for help. Unfortunately the two have no coordinated resolution scheme that would punish those responsible for depositors and other creditor's woes and at the same time save money for the state or taxpayer from the cost of resolution of the crisis. It has therefore become necessary to examine the legal perceptive to rehabilitation of this basic aspect of our banks and the banking system particularly the challenges faced by the institutions responsible for bank's capital reconstruction during and after crisis

The major player in resolution of banking crisis –the CBN has just two major tools for crisis management namely the power of liquidation and the power of lender of last resort. The exercise of power of liquidation has a direct negative impact on the depositors' confidence especially where depositors have lost money to a failing or failed bank.

The power of lender of last resort guarantees that no depositors lose money to failing or failed bank but it leaves a lot of legal and moral issues unresolved. The first issue is that the cost of repaying the depositor fund is borne by the tax payers' money instead of the bank management that are often responsible for mismanagement of the bank's capital that lead to the crisis.

Secondly the criminal legal system often does not punish the perpetrators of fraud and mismanagement leading to either liquidation or spending of tax payers' money. The result is that

instead of strengthening the corporate governance culture in the banks in the system, the lender of last resort tends to encourage carelessness frauds and mismanagement in the banking system.

This therefore calls for extension of the roles of the regulatory institutions in the system from mere intervention to active participation in fashioning and implementing lasting capital reconstruction measures in the banks. The research proceeded on the assumption that banking crisis will continue to happen, there will continue to be need for resolution scheme that will reconstruct the bank's capital and beef up liquidity else panic will ensue in the system which may lead to total collapse of the banking system.

Therefore there is the need to harmonize the legal procedures and institutions necessary for capital reconstruction in the country.

CHAPTER ONE

GENERAL INTRODUCTION

1.0 BACKGROUND TO THE PROBLEM

In Medieval Latin, capital appears to have denoted the head of cattle or other livestock, which have always been important source of wealth beyond the basic meat, milk, hides, wool and fuel they provide[1]. Like the modern capital livestock has the potential to generate surplus value for accumulation. This principle of accumulation and preservation of wealth ran through ages. This probably was the reason Adam Smith stated that, "for accumulated asset to become active capital and put to additional production, it must be fixed and realized in some particular subject after its labour is past"[2]. Capital asset can be rented (for one off production) or acquired out rightly for joint input in series of production. This nature enable capital to command two prices i.e. the service price (rent) and or asset price[3].

Hernando, D. S. *The Mystery of Capital*, *Finance* and Development, March 2001 Vol. 38 No 1 p.29. also available at http:/www.imf.org/external/pubs/ft/frand/2001/03/Desoto.htm visited on 04/03/2010

[2] Ibid

[3] Yotopoulos ,J and Jeffery N. B. *Economics of Development Empirical Investigation* Harper Row publishers New York pp164-165

Today capital includes any asset that can be stored up for later use in the production of goods and services. Even some kind of labour has been classified as a specie of capital hence the use of the term "human capital" to differentiate human trained skill and entrepreneurship from primitive labour. Capital in a classical conception " is born when the economic potential of an asset is represented in writing- in titles as security, a contract, and other such records and when the most economically and socially useful qualities about the asset as opposed to the virtually more striking aspects of the asset is considered"[4] . The dynamic nature of capital underscores its importance and explains why it will continue to engage the minds of lawyers and economists.

It is obvious that in any market system, large proportion of wealth is concentrated in capital in the forms of interests held in share, securities, futures exchanges and deposit with banks and other financial institutions. Banks are also known to be the fulcrum upon which the capitalist system revolves. It is therefore important for the efficient operation of the market system that capital of banks and the banking system should be preserved

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[4] Hernado, D. S. op.cit

and periodically restructured to maintain safety and soundness in banking system.

Because of this nature of capital, capital accumulation will continue to be central issue for legal and economic development. In no other system is the multiplicative power of capital better exemplified than the banking system. Banks provide a vital channel through which credit is made available to the real sector of the economy for production of goods and services. Governments also use banks as medium to transmit and stimulate economic growth through their monetary polices. Government has through the Central Bank used monetary, regulatory and supervisory policies to strengthen the banking system.

1.1. JUSTIFICATION FOR THE RESEARCH

Numerous issues in corporate and banking sector restructuring that arise consistently during bank crises in Nigeria point to inherent conflict in banking business as shareholders attempt to achieve higher returns on their investment at the expense of depositors and other stakeholders in the banking system. As a result, all banks however well their risks are managed have the same inherent flaw in their balance sheets. Their liabilities are certain and short-term whereas their assets are uncertain in value and long-term in nature. This sameness of banks, results in a high tendency for known problems in one bank to spread rapidly to other banks and to the whole banking system if the problems are not checked.

Failure to strike a balance between profit motive of stakeholder in the banking system and protection of the depositors fund has resulted in failure of some banks in Nigeria. Our judicial and regulatory process appeared ill equipped to tackle these challenges.

While there are relatively available studies on corporate insolvency in general, there appear to be dearth of legal and related literature on capital reconstruction techniques short of liquidation and other terminal resolution procedure for corporate entities. The case is even worse for banks, which have relatively little legal literature in capital maintenance and insolvency. Available legal literature on the banking crisis concentrates on merger, outright acquisitions or liquidation. Little is known about restoring and growing the capacity of the economic entity concerned without terminating its life. Without sufficient local literature, it is difficult to measure, monitor assess and tackle recurrent problems that have bedeviled the banking industry. This has reflected in the philosophy guiding resolution of crisis in the industry, which has been more of treating symptoms than causes of problems. The aim of preventing a single or group of banks from compromising the stability and performance of the economic system as a whole is clearly hampered where the skill required in preventing bank runs and maintenance other depositors protective mechanism within the banking system including depositor's confidence is scarcely lacking.

This research studied the various ways capital reconstruction can be effected during bank crisis and so will be of immense benefit to bank depositors, creditors, and policy and decision makers in our banking industry. Directors and managements of bank will find this research useful in identifying, monitoring and tackling at early stage negative factors that erode the capital of banks. It will assist licensing and regulatory authorities in understanding alternative crisis resolution procedure that could reduce the rate at which banks are liquidated in times of crisis. Compensatory and deposit insurance agencies will benefit from this research as it will expose the risk they assume and prepare them to tackle the challenges of systematic bank failure. It will be of immense benefit to judges, lawyers and law students, legal academics and other people administering our laws. It will enable them understand how basic principle of economics is integrated to legal situations. Economics is a powerful tool for analyzing a broad range of questions of legal interpretation and policy. However, as has been observed, "most lawyers –even very bright lawyers- and most law students –even very bright ones- have difficulty connecting economic precepts to concrete legal problems[5]". The full understanding of the interrelationship between law and economics will provide lawmakers as well as individuals and institutions that administer law governing banking and other economic related activities sufficient financial and economic knowledge concerning the conducts they regulate.

1.2 PROBLEMS OF THE RESEARCH

Notwithstanding the availability of legislations and regulatory institutions, bank failure and its resultant crisis has continued to reoccur with potential systematic threat to the Nigeria banking system. The proximate cause of such failure has

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[5] Posner ,R .A. *Economic Analysis of Law* 2nd ed ,Brown & Co , Canada,1977.p3 See also Dimgba, N *A review of the competition law and policy framework in the united States, European Union, South Africa and the Nigerian draft competition law* . being a paper presented at the Nigerian Bar Association's Annual Conference Port-Harcourt August 29,2006p.111

always been the loss of the bank's capital to some extent that such bank's assets become insufficient to meet its liabilities. Insufficient capital has and will continue to be the first problem to begin with in resolving banking crisis because of the dynamic nature of capital and the high leverage nature of banking business.

Thus the question of what mechanism to put in place to prevent future collapse of banks and how to ensure that the prevention or resolution cost does not exceed societal benefit will continue to bother regulator and lawyers. The Central Bank of Nigeria (CBN) has liquidation and lender of last resort (otherwise known as bail out) as major tools for resolving bank crisis. In its implementation so far in the Nigeria banking system, liquidation does not seem to be the answer because it is arduous, time consuming and deprives depositor (insured or not) of prompt access to their fund and because of its irrational allocation of the crisis resolution cost[6]. Liquidation has continued to weaken instead of building confidence in the banking system. A threat or contemplation of the use of liquidation as a resolution technique by the regulatory authorities always lead to economic instability, litigations, threat to law and order and loss of confidence in the banking system[7].

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[6] Adeyemi Adepetun, Reform: CBN in Pursuit of Corporate governance The Guardian Vol.27 No 11277 Wednesday November 11 2009.p.23.

[7] See Savannah Bank Plc V CBN & 2 others [2009] 6 NWLR (pt 1137) at 237.

The application of lender of last resort and some other resolution tools in capital reconstruction of banks (ranging from liquidity support, restriction on lending deposit mobilization[8], change of management[9], mergers, acquisition and takeover) as at now are not providing equitable and timely solution expected to restore stability and confidence in the banking system[10]. Lack of innovativeness or dynamism in purist of collective preventive strategy by some of the regulatory institutions has caused avoidable delay and cost in utilizing other alternatives short of liquidation in resolution of banking crisis. There is still an underlying fear that a major crisis may propel panic and run that may lead to systematic failure of Nigerian banks.

There is therefore a gap to be filled by finding and harmonizing the roles of the regulatory institutions, the existing laws and mechanisms, to prevent future collapse of banks and instill stability and confidence in the system at costs that would not exceed societal and economic benefit to Nigeria.

1.3 OBJECTIVE OF THE RESEARCH

[8] Section 13(2)(3) ,and S. 37 of BOFIA 2004
[9] S. 7 BOFIA ,S.37 BOFIA S. NDIC Act
[10] S.118 Investment and Securities Act 2007

This research examined from the legal perspective, reconstruction mechanisms available for crisis resolution for bank distress and failures in Nigeria. In specific terms, the research examined factors responsible for erosion of the capital of the Deposit Money Banks (DMB) in Nigeria and the effectiveness or otherwise of statutory and institutional provisions available for managing and preventing collapse of banks in Nigeria.

Secondly, it examined the legal and institutional frameworks for crisis resolution where a bank is unable to settle its liability or is unable to continue its operation. It appraised the effectiveness of remedies available to stakeholders in the banking system during distress resolution process and advice on measures that can be put in place to sustain safety, soundness and stability in the banking industry.

Thirdly, it advocated for some system that would make bank crisis less likely and where it becomes inevitable, make the impact of damages to the banking system limited. Attempt was made to contribute to filling the gap in these respects and most importantly to creating awareness of the role the law and lawyer can play in the study and implementation of monetary and other related policies that determine the direction of economic activities in the Nigeria.

1.4 METHODOLOGY OF RESEARCH

The research adopted general doctrinal approach to solving identified research problem. It explored the economic, historical, political and social background from which the identified problem of the research emanated. It gathered data from textbooks, newspapers, periodicals, official reports, seminar and conference papers, administrative decision and rulings, rules and regulations of regulatory institutions, unpublished theses, dissertations, project and judicial authorities. This approach assisted the researcher in identifying some legal and institutional loop-hole in the regulatory framework for banks in Nigeria and how they contribute to increase the research problem[11]. Reports of tribunals, fact-finding committees, and information from statutory, regulatory as well as administrative authorities were consulted and utilized in the course of the research.

1.5 SCOPE AND LIMITATION OF THE RESEARCH.

Numerous issues in corporate and financial sector restructuring arise during bank crises. The issues normally border on how best to eliminate legal and regulatory impediments, strengthen institutional and prudential frameworks for regulating

[11] Gasiookwu, M U Legal Research And Methodology Fab Educational Books Jos 1994. p86 See also Aboki ,Y Introduction to Legal Research Methodology Tamzaza Publishing Co ltd p.55

and improving supervision of the institutions. It may require establishing procedures for improving financial disclosure and corporate governance. This research deals with resolution of crisis during loss of capital asset of banks with the above scenario in view. Capital in this context includes all assets of the bank human and material. It emphasized on the causes of prevalent crisis in the banking industry as it affects capital, liquidity, insolvency and how it can be resolved to the benefit of the society. The research was limited to Deposit Money Bank (DMB) in Nigeria though where necessary it made comparative reference to the experience of other countries and jurisdiction. Among the deposit money bank, only banks enumerated in part II of the Bank and other Financial Institutions Act, (BOFIA), 2004 was considered[12]. Thus, community banks and other development banks covered in BOFIA were not the major concern of this work.

1.6 LITERATURE REVIEW

Due to competitive, regulatory and statutory forces, commercial banking in Nigeria is undergoing substantial restructuring. Mergers and acquisition have become major mode of this reconstruction in the banking industry. The CBN recently mandated banks to raise their minimum capital base from N 2 billion to N25 billion . Only merger or outright acquisition was allowed for the

[12] Cap B3 LFN 2004. Part II of the Act covers the regulation of None Bank Financial Institutions like insurance companies.

purpose[13] . The consolidation exercise aims at curtailing systematic instability plaguing the banking industry, restore depositor's confidence in the banking system and to grow the national economy. Some of the banks that failed to meet the minimum capital requirement were liquidated while some of them have been acquired by stronger banks. However, those that failed even before the commencement of the consolidation program, remain closed with depositors fund trapped in them. This method of capital reconstruction in the banking system has heightened interest in its functionality for resolving bank crisis and its consequence to depositors, the shareholders and the economy. Literature in this field of research is reviewed below.

Irukwu[14] postulates that most of the problem of bank failure in Nigeria is attributable to inadequate or imprudent management of asset of the banks. His discussions focused though on causes and effects of undercapitalization on banks, abuse of corporate responsibilities by directors and principal officers of banks, did not cover the problem inherent in using liquidation as a means of resolving bank failures in Nigeria. The method adopted in resolving banking crisis and how it

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[13] See Central Bank of Nigeria Guidelines and Incentives on Consolidation of The Nigerian Banking Industry August 5,2005 p.3

[14] See Irukwu, J .O, *Corporate Responsibility in a world of Risk and Uncertainties*, Witherby & co Ltd London 202 p.2. See also Soludo, C .C *Consolidating the Nigerian Banking Industry to meet the development of challenges of the 21st Century* , Being an address delivered to the special meeting of the Bankers Committee held on July 6 2004 at the Central Bank of Nigeria Head quarters Abuja.p2

affected bank's capital reconstruction determines whether the depositors who provides his savings with which banks trade has confidence as to the safety of his deposit in the banks, and whether he will continue to leave his money with the bank for a long time.

Nnanna[15] examined the regulatory and supervisory instructions responsible for preventing banking crisis. He raised vital issue on the cost of preventing or managing bank failures in banking system and who should pay for it. The theoretical basis of his paper assisted us in appraising the effectiveness of some institutions responsible for crisis resolution in Nigeria banking system and in buttressing the importance of capitalization in banking business. He pointed that banks capital deficiency has contributed to bank failure in Nigeria since the early 1930s and blamed undercapitalization for spate of bank failure of the early 1930s prior to the establishment of the Central Bank of Nigeria, 1951. Umoh[16] pointed out some close correlation between qualities of loan assets banks creates and the solvency of a bank. His work assisted us and provided support to the view that most of the distress experienced in the banking industry is attributable to poor loan asset resulting from unprofessional practice in loan and credit administration

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[15] Nnanna, O. J opcit. But see Wariboko N *Principles and Pratice of bank Analysis and* valuation Spectrum Books Limited Ibadan p. 3

[16] Umoh N P. *Bank Liquidation activities in Bank deposit insurance in Nigeria* published by Pager publisher co ltd Lagos for Nigeria Deposit Insurance Corporation of Nigeria, 1997 p.143

of the banks and insiders abuse. This finding has strong implication on the prospect of success of capital reconstruction as a crisis resolution option for a bank because of the increasing volume of credit risk undertaken by banks in Nigeria today.

Campbell[17] explained why banks are required to keep an amount of their total capital account to a given percentage of their deposit liability. The aim he emphasized is to protect depositors because capital account acts as a buffer to bad loan. He stated that the adequacy or not of capital affects the quality of loan or risk asset a bank creates and that when loan quality is bad it can lead to bank failure just like a sudden decline in securities held by a bank or other contingencies can reduce bank capital to insolvency or zero value.

Bermanke and Lown[18] also observed that decrease in bank capital could cause credit crunch in an economy. Hancock[19] stated that shortage of capital either as desired by a bank or as a minimum statutory requirement can cause reduction in lending which may lead to systematic bank failure and that systematic bank failures have negative effect on bank lending because crisis because crisis in one

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[17] Campbell DC and Campbell R G, Introduction to Money and Banking Rinehart & Winston Inc, London 1968 p.107 .

[18] Bermanke , B S and Lown C S "The credit Crunch Brookings Papers on Economic Activity" 2 (1991),205-247.

[19] Hancock D and Wilcox J *Bank* *<u>Capital and the Credit Crunch</u>* Journal of America Real Estate and Urban Economic Association Vol 2(1994), 59-94

bank can easily affect the business of other banks. [20]. Generally, bank crisis that has its route cause in capital deficiency makes acquisition or merger of failed or failing bank by a healthy bank difficult because such acquisitions absorb the fund that would have been available to borrowers in the acquiring institution thereby reducing such institutions lending capacity. The economy loses value where such situation results in termination of credit to some previously creditworthy borrowers[21].

Van der Vossen[22] asserts that bank capital cannot be completely relied on to promote banks financial resilience. His paper viewed banks capital reconstruction beyond formulating framework that strengthens soundness and stability of the banking systems. By studying the experience of banks in the Asian countries in the late 1990s, he discovered that the supervisory authorities focused on capital rules and ratios in monitoring lending as against proper prudential measures.

These literatures did not explore the extent to which the interrelationship between capital and lending in banking can be strengthened or how to manage this relationship to avert bank failure. In addition, they neither addressed the seemingly vicious cycle caused by fear and often times the fact that while a bank

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[20] .Rosengren,E S and Simon K , *Failed Bank Resolution and Collateral Crunch: The Advantage of Transferable Puts* Journal of American Real Estate and Urban Economic Association Vol 22 (1994)pp135-137.
[21] Baer H and J McElravery, Capital *Shock and Bank Growth -1973 to 1991" Economic Perspectives* Federal Reserve Bank of Chicago (July-August 1993)2-21.
22Van der Vossen J. *The new Capital Proposal for Banks*, Finance and Development IMF publication March 2001 p. 32..

asset can not be certain its liabilities may not be determinable in the short run nor did they suggest how restructuring could be organized in the event of crisis caused by situations. Nevertheless, one lesson is clear from their works and that is that in lending banks must relate their capital requirements closely to actual risk involve in their lending which in fact is the basic concept covered by Basel II Capital Accord which shall be discussed later.

That bank failures negatively affected people and institutions is obvious from these literatures. Nevertheless, there are varied opinions on the rationale for allocating the cost associated with such failure to stakeholders in the society[23]. There is controversy as to how and to what extent taxpayers' money should be expended in facilitating bank capital reconstruction or crisis resolution in the banking system. It has been suggested that in the face of unusually large numbers of bank failures, policy makers and regulators should consider not only the resolution cost flowing through the government agencies to surviving banks but also the loss to tax payers , bank borrowers, and their local communities, loss of investment by shareholders, employment opportunities by the active population, borrowing opportunity by entrepreneurs and loss of deposit by

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[23] Akume . A A *The Phenomenon of Corporate Collapse and its impact on developing Economies* ABU Journal of Commercial Law Volume 1 No.1 September 2002.p.40

depositors as well as loss of tax revenue by government. The ability to understand the impact of these costs is fundamental in determining the method of capital reconstruction to be adopted. Appraisal of these costs to the society shows that the economy loses more through unemployment and loss of depositors' fund than they do where taxpayers' money is employed to reconstruct a bank's capital or to salvage an ailing bank24.

Goodhart[25] is of the view that a dying bank should not be rescued as to do so would constitute serious drain on taxpayers. He noted that government rescue of ailing banks create a feeling of "implied guarantees which" tends to make bank management risk-prone, rather than risk-averse. He examined bank insolvency and the effect of full deposit insurance scheme on the banking system and concluded that 100% deposit insurance cover for depositors fund encourage banks to adopt riskier and expansionary strategy to obtain additional funds simply by paying small margin of premium. To counter this predilection for risk taking by banks he advised regulatory authorities to impose controls on structures of the

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[24] See Banking *Sector Consolidation: Special Incentives to encourage weaker banks*. Press Release April 11,25 CBN Governors office Abuja p.2. *Here the special forbearance package granted weaker banks during the consolidation program was subject to recovery of insiders related non-performing loan and recapitalization of such banks to solvency status, CBN prepared to forebear 80% of such banks exposure to it. It was even prepared not only to convert the remaining 20% of such debt to a long-term loan of up to 7 years with 2 years moratorium, but also to forbear the balance of the debt to a new* investor capable of bringing the equity of the weak bank to the N25 billion minimum capital requirements.

[25] Goodhart C.A.E *Bank Insolency and Deposit Insurance: A Proposal. Money and Banking Issues for the 21st Century* ed Philps Arestis Macmillan London 1993. 88

asset portfolios of banks. The problem with the above opinion is that it did not consider the cost of monitoring banks by regulatory authority to ensure regulatory balance sheet compliance which will ultimately be borne by the taxpayers. There is also a false presumption that the banks are rendering reliable and timely report or information on which the regulatory authorities can base their judgment. In Nigeria, the integrity of report of some of our banks is known to be doubtful.

Longino[26] on his part is in support of minimum deposit insurance notwithstanding the universal concern over it and the equally universal distaste of taxpayer backstop for banks. He acknowledged the importance of deposit insurance in maintaining the confidence of the depositors in the banking system, curtailing disruption to the economy and serving as a vehicle for implementing failure resolution for badly managed or ailing bank. He reasoned that it is the depositors and not the bank or the investors that is insured by deposit insurance; that depositors are merely seekers of safety and liquidity who will accept commensurate return for the use of their money; that since banks are not free entrepreneurs in the real sense but regulated fiduciaries, deposit insurance should be left at the barest minimum. Longino’s position has been vindicated by

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[26] *Longino J* *Financial Servicer Regulation-Back to Basics*. The Banking Law Journal Vol. 109 N0 3 p..203

the massive support rendered to banks in the recent global financial system by governments all over the world.

A common underlining view from the above is that deposit insurance is an important tool in bank capital reconstruction and that market discipline is incapable of regulating banks in issues of deposit insurance hence the call for direct regulation by government to ensure that small depositors are protected and that contagious bank run is avoided during crisis. However, if the idea of barest deposit insurance is adopted, it will be difficult to protect depositors outside the band of insurable deposit. In Nigeria, for instance deposit by this group constitutes a substantial proportion of fund in the banking system. There is also the issue of the efficiency and capacity or dynamism of deposit insurance institution in timely meeting the challenge of periodic increase in bank deposit liability. This was not addressed by the above literature.

Mako pointed the role governments should play in developing adequate safety net in situations above[27]. The objective should be to ensure proper link between corporate strengthening and sustainable economic growth. This cannot be achieved in a banking system where the bank depositors are exposed to the danger of inadequate insurance. In Malaysia, banks that failed to make the

[27] Mako P .W, Corporate Restructuring in East Asia Promoting Best Practices *Finance* and Development, March 2001 Vol. 38 No 1 p.3.

minimum capital requirement during their banking sector consolidation were not liquidated. They were amalgamated and reconstructed by the government to avoid loss of job, depositor's money and other negative consequences. Britain for instance applied the so-called London approach to their consolidation in the 1970s. The London approach, promoted by the bank of England during the U.K. recession of the mid-1970s, encourages creditors and debtors to follow certain principles –for example to minimizing losses to creditors, avoid liquidation and encourage out-of-court restructuring agreements.[28]

The experience of the Asian countries in the late 1990s was varied as was distinguished by Mako. Indonesia, Korea, Malaysia, and Thailand all adopted some variant of the "London approach" to out –of-court restructurings of unsustainable corporate debt with Southeast Asia having a feature of more comparative ownership structure compare to South Korea.

In the United States of America, the Federal Deposit Insurance Corporation (FDIC) adopted the option of purchase and assumption agreement (P&A) in resolving bank failures of the 1980-1989 crises[29]. In resolving the financial crises of 2009 the United Sates also released billions of dollars as a life line to failing banks and

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[28] ibid
[29] Ibid. p 30.

has reduced interest rate almost below one percent to enable banks in the economy to get out of the credit and financial crisis. The Swiss Federal council through the Swiss Federal Bank Commission (SFBC) in the event of the risk of bank insolvency, resort to protective measures as against outright liquidation. Their law does not contemplate a formalized proceeding but rather, merely specifies guiding principles such that bank can only be liquidated if capital reconstruction plan has no prospect of success or has failed[30],

However, hosts of legal and traditional issues need to be considered in sorting out reliable criteria for commencing reorganization and deciding whether a bank should go into liquidation. No matter the challenges or method chosen to resolve it, the impact it will have on the economy should be considered and adequate strategy should be put in place before the crisis[31]

Nigeria lacks comprehensive framework for distress and crises management in banks. The available remedy though aimed at minimizing delay and financial loss to customers and timely resumption of operation for banks is still harsh to

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[30] Ruggle P. S, *Simplified Capital reconstruction and liquidation of Banks* Wenger Vieli Belser on http://www.wengerlaw.ch visited 20th August2008

[31] Mako opcit p.30

depositors[32]. This has prompted the call from various quarters for the creation of a commercial court that would have specialized jurisdiction to handle commercial cases[33]. The success of the erstwhile Failed Banks Tribunal under the Failed Bank Decree[34] and the Investment and Securities Tribunal[35] under the Investment and Securities Act has been cited as an example of how the enforcement of similar law can instill confidence on the banking system[36].

Lord Irvine's immense contribution in exploring the foundation of law as it relates to commercial activities will be of immense assistance to our search for a viable banking system[37]. The author's work extolled the role of the law as an engine of trade in proactively facilitating robust and sensitive regulatory institutions that balances the need of commerce with that of the society as a whole. Though focused on the uniqueness of English legal system and the high regard to which is held in settlement of international commercial dispute, it provides background to

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[32] Nnanna O J Today's Banking Risk and current Regulatory and Supervisory Framework The Bullion Vol. No 27 July –September 2003 p34.

[33] Dimgba N. A review of the competitive law and policy framework in the United States, European Union, South Africa and the Nigerian draft completion law. A paper presented at the Nigerian Bar Association Annual Conference held in Port Harcourt on 29th August 2006 p.131

[34] Failed Bank (Recovery of Debt) and Financial Institutions Act, Cap F2 vol.6 LFN 2004.

[35] . S.1 Securities and Investments Act Cap 124 Vol. 8 Revised (Laws of the Federation of Nigeria LFN 2004) established the Investment and Securities Tribunal

[36] Failed Banks (Recovery of Debts) and Financial Malpractices in Banks Decree No 18 of 1994. S1 of the Decree empowered the judge with civil and criminal jurisdiction to try cases under the Decree or any offence in any other enactment.

[37] Lord Irvine of Lairg *The Law:An Engine for Trade*.Modern Law Review Vol. 64 No 3 May 2001 p.344

evaluate the functionality of the legal and regulatory institutions in the development of the banking system.

He stated that English law is clear and predictable. That the legislature and the court provides genuine and innovative lead by making body of rules from which trade derives its strong capacity to uphold agreements, meet the needs of the society as a whole and lead the market economy forward . Three key principles were identified as being responsible for this uniqueness of their legal system: Free incorporation, limited liability and minimum external interference. Free incorporation implies that individuals must incorporate as companies before they can operate as a bank[38]. Limitation of liability implies that the liability of shareholders shall be limited to the unpaid value of their shares[39] and minimum external interference implies that regulatory institutions must exercise restrain in interfering with the affairs of banks.

As shall be discussed later free incorporation and limitation of liability has been a novel device through which business has been successfully carried on in modern times[40]. This has made some writers to argue that the functionality of law in a

[38] See Section 2(1)(2). Bank and Other Financial Institution Act BOFIA Cap B3 LFN 2004

[39] Ogunwewo. T. I. *Metric of Functionality: Nigeria Corporate Law and Wealth Creation* being a paper presented at the Nigerian Bar Association's Annual Conference Port-Harcourt August 29,2006p.55

[40] See Salomon V Salomon [1897] AC 22 were the principle of limitation of liability was established. In th at case, Salomon a sole properitror of a leather company (Salomon & Co) converted his one man leather business to a limited liability company (Salomon and Salomon & Co Ltd). He sold the assets of Salomon & Co to Salomon and

society could be assessed by the extent to which companies are used in doing business in the economy and the extent to which they can attract equity and loan financing. The implication for banking business lie in the fact that deposits with the bank are known to have always been greater than the bank equity or shareholder's fund thus placing a far more burden of regulation and control on the authorities. The same reason limits the degree or extent to which the principle of minimum interference can be allowed in a banking system.

1.7 ORGANIZATIONAL LAYOUT

We commenced the examination of the topic by a general introduction in the first chapter. In the same chapter we presented the problem identified by the research, the justification for engaging in the

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Salamon & Co ltd for 39,000 pouds sattisfied by 10,000 debentures (held by him) on all assets of the company, 20,000 shares fully paid and the rest in cash. He held all the shares of the company except 6 shares held by his wife and children. Shortly after , the company went into liquidation. The debenture was realized on the asset of the company and there was insufficient asset to pay the unsecured creditors.
The court Court was faced with the choice of either to protect public investor in absolute term by holding Salomon liable for the debt of Salomon and Salomon & co Ltd, or to create a legal principle that will pervade all circumstance by not holding him liable for the debt of the company. The court of Appeal took in an unanimous decision took the first view based mainly on the ground of public policy. They were overruled by the House of Lords which took the second view and held that Salomon is not liable for the debt of the company on the ground that Salomon is a distinctive person from the company. By their judgment the Lords created an enabling environment for corporate property ownership upon which capital accumulated from number of investors is deployed for use by arranged managerial system.

research, the scope and methodology adopted in carrying out the research. The first chapter ended with a review of previous literature on the subject.

Chapter two the concept of capital was analyzed with emphasis on the component of banks capital, its role in capital formation and the significance of legislating minimum capital requirements for banking business. Chapter three is an examination of the major legal and institutional frameworks for maintenance of bank capital namely the Central Bank of Nigeria (CBN), the Nigeria Deposit Insurance Cooperation (NDIC) and , the Securities and Exchange Commission(SEC). In chapter four the emphasis is on liquidity and distress management in the banking system as it affect banking sector consolidation and restructuring with particular emphasis on mergers and acquisitions and other aspects of business combinations. Chapter five is the conclusion of the research.

CHAPTER TWO

THE CONCEPT OF BANK CAPITAL

2.0 INTRODUCTION

Capital maintenance and growth is a fundamental concept that will continue to engage the attention of lawyers, economists and bankers[41]. Almost every aspect of banking is either directly or indirectly influenced by the availability and or the cost of capital. Capital is one of the key factors to be considered when the safety and soundness of a bank or banking system is assessed. An adequate capital base serves as a safety net for a variety of risks to which a banking institution is exposed to in the course of its business. Gower states that capital is what "companies use to back their credits as a result it must be maintained when raised[42]". A major role of capital in banking is to absorb possible losses, and to provide basis for maintaining depositor confidence in a bank. Capital as Gower stated "has ceased to be a name given to the fluctuating net worth of the business and has become a rigid yardstick fixing the minimum value of the net assets which must be raised initially and so far as possible retained in the

[41] Gunttentag J etal ,The lender-of –Last-resort Function in an International Context ,Essay in international finance ,No 151 Princeton university press New Jersey May 1983 p 8

[42] Gower LCB Modern Company Law 4th edn. Stevens & sons London 1979,p.216

business"[43].

The availability of capital can consequently be asserted to be a determinant of the capacity of a bank to contribute to the development of the economy it operates in. Capital is the ultimate determinant of a bank's lending capacity. In fact a bank's balance sheet in principle cannot be expanded beyond the level statutorily determined by its capital. Again, when capital is raised its cost, amount, availability and uses determine a bank's competitive position and affect its capacity to meet expectation of its stakeholders.

Stakeholders include all the various groups that have particular interest consisting of bundles of expectation from the bank. They include shareholders, employees, creditors and government. Shareholders expect returns on their equity; lenders including depositors would want to have their principal and interest unimpaired by losses; Government wants to continue to finance its obligation through taxes from the bank's profit and the staff are usually concerned with increased remuneration and secured employment. The method a bank employs in satisfying the above interests lays the foundation for the success or otherwise of its capital reconstruction in event of financial crisis.

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[43] opcit.

To grant loans and advances, a bank should normally be able to attract deposit from the public. This requires public confidence in the bank, which in turn can best be established and maintained by a capital buffer. If a bank suffers from a frequent shortage of capital, or if the cost of its capital is high, it stands to lose business to its competitors. It is therefore important that the characteristics of capital be thoroughly understood for any capital reconstruction in a banking system to be meaningful, especially now that modern banking has shifted from the traditional practice of receipts of deposits from customers and lending same to borrower to provision of sophisticated financial instruments and services that has high risk potentials to the lender's capital and the economy at large in event of crystallization of the risk.

Banks by nature are highly leveraged business. By nature, bankers have lower tangible stake in their business than the depositor. They also lend more to themselves in the form of inter-bank lending than they lend to their customers. Inter-bank lending is a potential source of shock in fragile banking systems because an unanticipated shock in one bank if not properly managed can wipe out a whole banking system especially where it causes a run on other banks. A run in one bank reduces the capacity of other banks to withstand shock as it increases depositor's suspicion of those other banks and weakens the whole banking system. The problem may be worsened if as is the case in Nigeria, the balance sheet obligations of the bank are more in short term than in long-term basis, such that depositors would be able to run once they suspect a crisis. Therefore, understanding the capital structure of a bank is imperative to possible capital reconstruction during or after bank crisis. It is indispensable in maintaining not only the confidence depositors and creditors have in the banking system but in understanding the behaviors during crisis.

This chapter sets out to define and evaluate the concepts involved in understanding various components of bank capital for the purpose of capital reconstruction.

2.1 <u>The component of Bank Capital</u>

One important financial concept that can provide a guide in the analysis and understanding of the component of a bank capital, assets and liabilities and hence the method of reconstruction to be adopted is the balance sheet. Through a balance sheet the strength of capital namely capital reserve, paid up capital profitability and liquidity is determined. Balance shows three major ingredients which determine the capacity of a bank to survive a crisis: deposit base of the bank referred to as liabilities which indicates the level of depositors confidence in the bank; profitability of or potential of the bank to make profit which assures the survival of the bank and finally the level of shareholders fund which depicts the willingness or otherwise of the shareholders to continue to finance the business of the bank. A study of the movements of these ingredients overtime would reveal the reaction of various stakeholders to the changes in state of health of a bank.

2.2 Bank Balance sheet

A bank's structure and changes overtime is better understood by an examination of its balance sheet. A balance sheet is a statement of the assets and liabilities of an organization at a particular date – usually the last date of their accounting period. It is one of the ten statutory financial statements required of a company to be prepared and published in Nigeria[44]. In Nigeria, company directors are mandated to prepare the company balance sheet as far as possible in the form and content prescribed by Part 1 Section C of the second schedule of the Companies and Allied Matter Acts[45]. In terms of accounting standard, the content and form of the balance sheet must comply with the requirement from time to time of the Nigerian Accounting Standard Board (NASB). A bank's balance sheet must also comply with the requirements of the circular and statement issued by the CBN from time to time. Failure to comply with the above requirements attracts penal sanction.[46]

Except with a prior approval in writing of the CBN, a bank must forward copies of its balance sheet and profit and loss account duly signed by its directors to the CBN not later than 4 months from the end of its financial year. The same copies are to be published in the national dailies and displayed in conspicuous position in each of its offices and branches[47]. In reality, a balance sheet is like a mirror showing the mixture of a bank's assets and liabilities. It does not necessarily show

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44 The rest are S.334 (2)(a) which is on statement of accounting policies,S.334(2)(c) the profit and loss account,S.334(2) (d) notes on the accounts, S.334(2)(e) the auditors reports, S.334(2)(f) the directors report, S.334(2)(g) statements of the sources and applications of fund, S.334(2)(c) a value added statement for the year, S.334(2)(c) a five year financial summary and S.334(2)(f) in the case of a holding company, the group financial statements.

45 See S.335 (1) and (2) CAMA CAP B3 LFN 2004. The content and form required by S.335 (1) and (2) of the Act seems to be wider in scope than similar provisions made in S28 (1)-(3) of BOFIA 1990.

46 See Sections 28(1) , 27(3) and (5) of BOFIA 1990.

47 See section 27 (1)(2)(c) of BOFIA 1990.

the whole or the realizable value of a bank because some intangible assets like brands, quality of management, market strength cannot immediately be discerned from the balance sheet. But a professional analysis of it will show how a bank has conducted itself through the laws and regulations guiding its operation in an economy and how the factors therein affected its state and continuous existence. Therefore balance sheet merely functions to show how the business has been financed and how the funds raised are being employed. It also reflects the impact of changes in economic, regulatory and legal environment in the business of the bank for a given period. A bank's balance sheet has two major parts viz: the asset side and the liability side. What the bank has is called assets and is shown at the left hand side of the balance sheet. While what the bank owes called liabilities are shown at the right hand side of the balance sheet[48].

2.2.1 <u>Assets and liabilities in a bank's balance sheet</u>

The CBN Act requires every bank to submit to the CBN, not later than 28 days after the last day of each month, the asset and liabilities of the bank. Failure to submit this reports attract a financial penalty of N25000 on daily basis of the

[48] Due also to various innovation by banks in introducing financial products there are complicated off balance sheet engagements and contingent liabilities that are not often apparent from the balance sheets of banks.

breach [49]. A typical bank's assets consists of economic benefits obtained or controlled by a bank which include treasury bills, overdraft bank, placement, finance lease, mortgages, consumer loans, commercial papers, bankers acceptance, term loans, staff loans, investment, cash reserve etc. The fixed assets consist of long-term assets, such as buildings, and vehicles. Included as fixed asset are long-term investments in other companies as well as the bank's goodwill which is an intangible but important asset. Fixed assets are necessary for the continuance of the banks business and are not purchased with the primary intension of resale at a profit.

A bank's liabilities consist of a collection of obligation to transfer assets in future to another entity. Typical liabilities of a bank includes interbank takings, banker's acceptance, rediscounted commercial papers, current or demand deposit accounts, savings deposits, fixed deposits, collections, non-Interest bearing loans and loan loss provisions. The long term aspects of liabilities include bond and debentures. There is also the stakeholders' equity consisting of share capital, capital reserve and retained earning generally called shareholders fund.

Depositors fund are liabilities to banks because it must be paid back sometimes with interest. The same liability (depositors' fund) is what the banks turn to assets

[49] See Sections 25 (1)-(3) of BOFIA 2004.

by lending it at higher interest than it pays on it. The net or difference between what they charge as interest for the loan they create and what they pay as interest to their depositors among other income forms their r profit.

Banks capital is shown as part of the liabilities in the balance sheet. It contains four intangible items namely share capital or equity capital, share premium, capital reserve or statutory reserves. We shall adopt the Basel II Accord definition of capital for the purpose of this section.

2.2.2 Basel II Capital Accord

In 1988, the Basel committee on banking supervision took the lead to develop a risk-based capital adequacy standard that would lead to international convergence of supervisory regulations governing the capital adequacy of internationally active banks[50]. The objectives for the framework were to strengthen the soundness and stability of the banking systems globally based on the understanding that banks have relatively low capital-to-liabilities ratio and

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50 See Osadolor V Enterprises Management the Role of corporate Audit and compliance paper presented to committees of Auditor in UBA PLC Jan 2007. p.2
Basel committee on banking supervision was established by Central Banks of G-10 countries in 1974. The committee today consists of central bankers and supervisory regulators from 44 countries. It has the key function of fostering international monetary & financial cooperation and serve as a bank for central banks. It established the Basel Committee for Bank Supervision, which is responsible for creating the BIS Capital Accord The committee, has no super-national supervisory or legislative power. Agreements must be implemented within each country via local legislature and enforced by local supervision. The first Basel II proposals were introduced in June, 1999.The final framework was agreed on by member countries in June 2004.

that they need to be encouraged to prudently manage the risk associated with this structure. The Accord provided that banks should implement adequate information and risk management systems that will enable them reduce capital charges and increase their level of profits[51].

The Accord was primarily targeted at international banks, but the capital adequacy principles aspects of it has been adopted and implemented in many countries including Nigeria during the Nigeria banking sector reform in 2005. The Accord has three pillars. The first pillar deals with minimum capital requirement. It requires banks to bench mark their credit and market risk against adequate capital back up, to be measured if possible on their daily business decision. It requires also that the daily transaction files should show the assets and liabilities of the bank and the effect of the risk taken per day on the shareholder's funds net of losses, thus indicating whether or not a bank should start sourcing for capital funds to support its trading activities, or withdraw from some loss incurring investment. The second pillar emphasis the need for adequate supervisory review of the internal risk management systems and processes of banks. The third pillar concerns market discipline. It emphasizes the importance of implementing

[51] Capital charge means a reduction or an erosion of banks capital due to loss.

information system that can provide information to all stakeholders on the bank's capital structure and its risk exposures.

The Accord was later amended in 1996 when it was discovered that it did not provide an effective means to ensure that a bank's capital requirement match its true risk profile. Van Greuing thus states that:

> *'The world financial system has seen considered charges since the introduction of the Basel Accord. The volatility of financial markets has increased in the last decades, and there has been a significant degree of financial innovation. There also have been incidents of economic turbulence leading to widespread financial crisis; for example, in Asia in 1997 and in Eastern Europe in 1998. The risks that internationally active banks must deal with have become more complex'*[52].

The complex nature of the global changes reflected was due to competition, globalization, securitization, financial regulation and innovation, and technological advances in the industry[53].

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[52] Van Greuning H etal opcit

[53] The 1998 Accord has two pillars which in fact aim at enhancing supervisory process and effective use of market process.

Hitherto, national authorities applying the 1988 Accord specified the minimum capital required for banks that want to operate within their jurisdiction, which it enforces through licensing and other supervisory mechanism. The new Accord provides that banks that have established advanced risk management framework can determine and implement the amount of capital that supports their businesses, rather than complying with a common capital threshold for all banks as defined by national authorities in the past.

The new accord provides a more risk-sensitive approach to allocating capital and building capital reserves, thereby allowing banks equipped with an advanced internal risk management model, the latitude to measure and determine what kind of business or market it wants to trade in bearing in mind the consequences of such risk on its shareholders funds. A common threshold of 8 per cent was set for all banks[54] . This means 8% of the risk-weighted assets and off-balance-sheet exposures of the bank[55]. Depending on its credit, market or operational risk profile a bank can exceed or work within this threshold.

The policy ensured that adequate amount of capital and reserves are maintained to safeguard bank solvency by ensuring that bank's capital position is consistent with its overall risk profile and business strategy thus promoting safety and

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[54] See p.10 supra

[55] See P9 for further explanation of this .

soundness in the banking system[56]. The accord categorized bank capital into three tiers.

2.2.3 Tier I Capital

Tier I , core or primary capital are items of capital nature in a bank's balance sheet which is permanent and does not impose mandatory or fixed charges against banks earnings and which allows for their legal subordination to the rights of depositors and other creditors. An example of capital that qualifies as Tier-I capital includes equity shares, retained earnings or undistributed profit, non-redeemable preference shares and non-cumulative preference shares. Tier-1 capital is common in Nigerian banking systems and is always clearly disclosed in published financial statements because it has a crucial bearing on profit margins forecasting by some stakeholders and because of the buffer of the highest quality it afford to depositors and creditors. For a bank to increase its risk, it should be able to increase the amount of its tier-I capital.

2.2.4 Tier-II capital

[56] Van Greuning H etal opcit

The tier-II capital of a bank consists of instruments that have the same characteristics as both equity and debt although they do not have the permanence of core or tier1 capital[57]. These include asset revaluation reserves, general provisions and general loss reserves, hybrid capital instruments such as redeemable cumulative preference shares and subordinated term debt. These components include capital obligations that must ultimately be redeemed or that contain a mandatory charge against future income, whether or not earnings will be available.

2.2.5 Tier- III Capital

Tier III is product and innovations which allow banks to issue short-term subordinated debt to cover market risks derived from interest-bearing instruments in its balance sheet. It has maturity of at least two years and it is often subject to lock-in provision that stipulates that neither interest nor principal may be paid if such payment will result in a bank's overall capital amounting to less than the minimal capital required. Proliferation of financial capital product using tier III would have been rampant but for the condition that its creation is allowed only when there is an increase in tier-I. The proportion of

[57] Tier2 capital is included in banks capital base for the purpose of computing capital adequacy.

tier III that can be created is limited to 25 times of the amount by which tier-I has increased.

Basel II Accord sets the amount of capital for bank business at 8 percent of risk-weighted assets[58]. This is what translated to the minimum capital requirement of N25 billion introduced by CBN for Nigerian banks on December 31 2004. It also provides that core or primary capital element of the paid up capital should be at least 4 percent. Tier- II capitals may be substituted for tier-III capital up to same limit of 25 times.

2.2.6 <u>Share Capital</u>

Shares are representation of the interest or capital of its holders in a company. Share capital can be said to be the capital of the company shared by its members for contribution for the business of the company.[59] The authorized share capital of a bank in Nigeria is required to be set out in the memorandum of association of

[58] Risk weighted asset is calculated by assigning risk expected from each of a bank's assets into one of a four categories. Category one assets such as cash and government securities are assumed to have zero risk and are assigned 0% weight. Category two assets are assumed to have a higher risk than category one assets. They are therefore assigned between zero and 20% of the weighted asset of the bank. Assets like bank deposit, Government Agency securities and any loan or claim secured or backed by a borrowers claim on category one asset are included here.

[59] Akeju J.A,Accounting for Company Business 2nd ed, JBA Associates ltd, Lagos 2004.p4

the bank[60] . Not all the authorized share capital may be issued or called up[61]. The advantage of having reserve of authorized share capital comes in handy if a bank is to pay the consideration of acquisition of another bank by issuing its own shares to the shareholders of the target company. Without such reserve, an acquiring bank will be compelled to get its board to pass a special resolution to increase its authorized capital to enable it have sufficient shares to be issued to the shareholders of its target company. Whether issued or not, share capital can be valued at nominal or par value [62] . The book or nominal value relates to the value at which a share might be bought or sold irrespective of the par value[63]. The nominal value is the value or amount a bank has chosen to fix for a unit of its shares into which the share capital is divided. Two types of share capital are commonly used to raise capital by Nigerian banks. The ordinary share capital and the preference share capital. The nature of ordinary share capital allows a bank

[60] See section S.27(2)(a) CAMA CAP B3 LFN 2004 and Section S.3(1)(a) BOFIA 2007

[61] S. 134 CAMA Cap C20 Vol.3 LFN 2004 provides that a company may by special resolution determine that any portion of its share capital which has not been already called up shall not be capable of being called up except and for the purpose of events like winding up.

[62] This is the minimum amount a company is prepared to sell its shares to share holders. It is sometimes called the face value of the share. Nominal value of share is different from the book value which is total shareholders fund divided by the number of its issued share capital.

[63] If the book value increases, it means that the bank is getting larger relative to its liabilities and that the owner’s equity is getting larger too. The total value of capital stock, surplus and undistributed profit determines the stock value of the shares of the bank.

full discretion as to the amount and timing of distributions of dividend[64] . Ordinary share capital is the basis on which most judgments of banks capital adequacy are made. It provides an important source of discipline over a bank's management through the voting rights attached to the shares[65]. To maintain this capital it is provided that payment for it must be made in cash[66]. Where it is to be made in kind the amount and limit is well regulated[67] and that a reliable third-party valuation be made before it is accepted as consideration for share purchase[68]

2.2.7 Preference Share Capital

This is a type of share that is liable to be redeemed[69] but it shall not be redeemed except it is fully paid and can only be redeemed from a portion of profit that is otherwise available for dividend or proceed of a fresh issue of share made for the

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64 Apart from the provision that dividend are not payable except it is declared by the directors, S.17 BOFIA 2007 restrict the payment of dividend except contingent liabilities preliminary expenses and the provision regarding capital ratios has been complied with.

65 Share holders are expected to vote out incompetent bank management in the annual general meetings of a bank.

66 See SS135-137 CAMA Cap C20 Vol.3 LFN 2004 which limits the amount of a bank's maximum exposure to a single obligor to a maximum of being 33% of the core capital or shareholders fund. See also s.61 BOFIA which define share holders fund to mean "the aggregate of paid- up share capital, statutory reserve and all other reserves".

67 S. 10 BOFIA provides that notwithstanding the provision of the CAMA Cap C20 Vol.3 LFN 2004 the voting right of every shareholder of a bank shall be proportional to his contribution of the paid up share capital of the bank. This is further strengthened by S116 of CAMA CAP B3 LFN 2004 which prohibit the issue by a company of shares with non- voting right or with double voting right. The exception to this situation is as provided by S.143(a-d) CAMA Cap C20 Vol.3 LFN 2004 is in the case of preference shares where a share may have more than one voting right in a pool as long as their dividend is due and unpaid for not more than 12 months ,or where there is a resolution varying the right attached to the shares as well as where there is a resolution to remove or appoint another auditor of the company or during resolution for or the winding up of the company

68 See S.137(1)-(6) CAMA Cap C20 Vol.3 LFN 2004

69 S.122 CAMA Cap C20 Vol.3 LFN 2004

purpose of its redemption[70]. When preference share to be redeemed is not redeemed from fresh issue of share, the law provides that the portion of profit available for such redemption must be first transferred to a capital redemption reserve fund wherein it shall in law be treated as paid up share capital[71]. The fund in the capital redemption reserve fund can also be applied for the payment of bonus shares to members'[72] .Dividend for preference share is due on the date specified in the Articles of Association or upon the day immediately following the expiration of the year whether or not such dividend shall have been earned or declared[73]. It is a sort of fixed interest expense or charge against the profit of the bank which may accumulate depending on the nature of the preference share.

2.2.8 <u>Share premium</u>

A typical bank's balance sheet shows the position of two claimants i.e. the owners of the bank and the creditors of the bank in the form of assets and liabilities. The capital sides of the liabilities consist of capital stock, undistributed profit if any. It is statutorily allowed for a bank to issue its shares at premium but an aggregate

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[70] .158(2)(a-b) CAP B3 LFN 2004
[71] S.1589(4) CAP B3 LFN 2004
[72] S.158(8) CAMA CAP B3 LFN 2004. There seems to be a difference between redemption of share as provided here and repurchasing of a company's own share as provided by S160-161. Section 161 (c) provides for instance that redeemable share shall not be purchased at a price greater than the lowest price at which they are redeemable or shall be redeemable at the next date thereafter at which they are due or liable to be redeemed.
[73] See S.143(3) CAMA CAP B3 LFN 2004

amount equal to the value of the premium shall be transferred to "a share premium account" which shall be treated as paid up share capital of the company[74]. Share premium therefore is the excess that results when a bank issues its share at a price above par or nominal value. Once transferred to share premium account it is converted to capital of the company and so ceases to be share capital proceed. The bank is bound to treat it as such in its balance sheet. Share premium is a common way of raising capital in Nigerian banks. All the banks that sourced fund through the Stock Exchange during the consolidation program of the CBN in 2005 made their issues at premium.

Share premium can be utilized to offset preliminary expenses of a new bank, or for paying for commission allowed in issues of a bank shares or for redemption of the company's redeemable shares. Payment for share premium like shares must be in cash or subject to the provision of the article of the bank by a valuable consideration other than cash or by both. Where payment for share is in a form other than cash the bank is bound to employ the services of an independent valuer to determine the true value of the consideration[75]

[74] See generally section 120 CAMA Cap C20 Vol.3 LFN 2004. Of equal importance is the provision of Section 105 of CAMA Cap C20 Vol.3 LFN 2004 which requires special resolution on reduction of share where liability is to be extinguishing in an unpaid shares or where share capital lost or un represented by assets is to be cancelled, Or where a company wants to pay off paid up shares in excess of its capital need.

[75] See generally Ss 135-137 CAMA Cap C20 Vol.3 LFN 2004

2.2.9 Reserves for bad and doubtful loans

Bad loan can cause depletion of capital and erode the buffer and protection available to depositors and creditors of a bank and may bring the capital to insolvency or zero value[76]. Therefore, providing for loan loss reserve is aimed at protecting banks from failure and by ensuring quality risk or loan asset for a bank. It is critical in banks capital adequacy assessment to provide for the impaired value of any of the bank's assets through adequate reserve.

Before 1991, bad loans are carried on indefinitely on the books of Nigerian banks. Today, banks are required to make 10% provision for performing loan, 50% for non performing loan and 100% for bad or lost loan.[77] Implementing or enforcing this policy on classifications of loan asset is crucial to preventing, managing or arresting bank distress. To provide means to reduce bad loans from total asset notwithstanding that the loan may be recovered[78]. This has the effect of reducing the undistributed profit reserve and in effect the net worth of the bank to the shareholder. It also reduces the capacity of the bank to lend out from depositors

[76] Campbell D C etal opcit .107
[77] But the CBN came out with prudential guideline on capital adequacy, loan loss provisioning and interest income recognition. The guideline classified loans into two: performing and none performing loan.
[78] Wariboko N supra

fund. If not checked to a stage where the banks classified loan asset exceeds 100% of its shareholders fund, the bank is said to be distressed[79].

2.3 Minimum capital requirements

There are three major provisions relating to minimum capital requirements. The first covers minimum paid up capital which is presently governed by S.9 BOFIA 2004[80]. The second aspect deals with the minimum amount or ratio thereof a bank must maintain or keep before it can create loan asset or other liabilities from depositor's fund. And the third aspect which centers on liquidity deals with the ratio of bank's asset that must be kept in cash or near cash form to meet sudden cash requirement by depositors

Minimum paid up capital refers to statutory minimum proportion of capital fund to be contributed by the bank owner for the bank business. Applied to individual shareholder, paid up share capital determines the shareholders voting right in a

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[79] Van Greuning H etal, Analyzing and Managing Banking Risk a framework for Assessing Corporate Governance and Financial Risk 2nd ed. The World Bank Washington DC p.120
[80] CAP B3 LFN 2004

bank[81]. Government adopt minimum capital requirement to ensure that a bank's capital is adequate to hedge against the risk involved in its business. It is also a way of preventing banks from overtrading[82]. The minimum paid up-share capital for banking business in Nigeria is prescribed by the president on the recommendation of the Central Bank of Nigeria[83]. Failure to comply with this prescription constitutes a ground for revocation of banking license[84].

Unlike their continental and Japanese counterparts, Nigerian banks following the precedent of the British colonial masters hardly provide long-term finance for borrowers. Majority of their lending activities are to finance the short requirements of their customers. This is due to the nature of the fund that is available to the bank. Most depositors are not prepared to leave the deposit with some of the bank in the industry for more than a short period due to the problem of insecurity that had ravaged the industry in the past. The situation compels the banks to follow the principle, that short-term funds should only be used to finance short-term loan. Consequently mainly short term investment can be funded by most banks in the economy because the funds banks lent out are

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[81] S.9(1)-(3) BOFIA 1990 covers the minimum paid up share capital required for banking business. S.10 BOFIA provides tat shareholders voting rights shall be proportional to contributions to the paid up share capital of the bank notwithstanding anything to the contrary contained in CAMA Cap C20 Vol.3 LFN 2004.

[82] Oguma P A The Growth of Banking Industry in Nigeria in Domestic and International Banking Service . A paper presented at the Nigeria Institute of Bankers Annual Seminar held at lagos Airport Hotel Wednesday August 4 1980 p.130

[83] See S.9 CBN Act. The minimum paid up capital is now N25 billion. See

[84] See S.12 BOFIA Cap B3 LFN 2004

monies deposited by the banks' customers, which are repayable on demand or short notice.

2.3.1 Minimum Capital Ratio

The second aspect of minimum capital requirement deals with the ratio of a bank's capital that must be maintained against the assets and liabilities or a combination of such asset and liabilities created by the bank using depositor's fund as provided by Section 13 BOFIA 2004. [85]. Failure to comply with the minimum capital ratio may result in revocation of the erring bank's license in accordance with S.14 of the same Act. Banks are required to keep the amount of their total capital to a given percentage of their deposit liability. In fact they are to maintain at all times capital fund unimpaired by losses in such a ratio to all or any liabilities or to both such assets and liabilities as may be specified by the CBN. Failure to comply with this provision may lead to prohibition of the bank from accepting new deposit, granting credit and making investment as well as paying cash dividend to the shareholder. It may equally lead to revocation of banking license. This means that if a bank's deposit liability is increasing part of the capital should necessarily be reserved to meet this ratio or in the alternative additional shares should be issued to raise the required capital backup. The aim of this

[85] See s. 13-14 BOFIA

provision is to protect depositors against erosion of banks capital because capital act as a buffer to bad loan.

2.3.2 Liquidity or cash reserve ratio

The third, though not strictly on capital requirements but very essential to maintenance of capital deals with liquidity and cash reserve ratio. It cover the minimum holding of cash reserves, specified liquid assets, special deposits and stabilization securities that must be maintained by banks at the CBN[86] .

It can be inferred from the above provisions that in general term, capital adequacy and the ability of a bank to raise capital in the future is the principal objective of the provisions on minimum capital requirements. It is important for a bank to have adequate capital to meet both its regulatory requirements and its own internal capital requirements, taking into account its risk profile. It is also important that the capital a bank holds should be permanent, of high quality and readily available to absorb losses. Furthermore, it is important for a bank to have in place adequate plans to ensure that it can raise sufficient capital to meet future

[86] See section 15 BOFIA

growth or to absorb operational losses. Therefore, adequate capital is not only a sign of shareholders confidence and stake in a bank, but it is a reflection of the capacity of the bank to remain in business as a going concern.

2.3.3 <u>Historical background of minimum capital requirement</u>

The history of legislation on minimum capital requirement in Nigeria is synonymous with attempt by the government to ensure adequate capital base for banks in the industry and to avoid proliferation of banks in the country. The first banking legislation in relation to minimum capital requirement for banking business was the Banking Ordinance of 1952[87]. Banks have already operated for over half a century in Nigeria before the ordinance came into force[88]. The objective of the ordinance was to avoid bank failures and to stop proliferation of banks in Nigeria[89]. The ordinance prescribes (₦ 12,500) minimum capital for the then existing local banks and (₦ 10,000) for expatriate banks. In addition, it required banks to maintain a reserve fund (statutory reserve) into which a minimum of 20% of their annual profits had to be paid until the balance on that reserve fund is equal to the paid-up capital.

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[87] S.6 Banking Ordinance 1952
[88] Ituwe C E Elements of Practical Banking ,University Press limited Ibadan 1983 P.8
[89] See Umezurike HAC <u>An Appraisal of the supervisory role of the CBN over commercial Banks under BOFID 1991</u>. A seminar Paper presented at the National Seminar on Banking at the University of Nigeria Enugu campus July 1996. P.8

The 1952 Banking Ordinance was replaced by the Banking Ordinance of 1958[90] (as amended in 1962)[91]. The minimum paid-up capital did not change for indigenous banks but it was raised to ($200,000) for foreign banks[92]. The reserve requirement was also raised to 25% in addition to a requirement that 25% of the net profit before dividend is to be transferred to a statutory reserve annually until the balance of the reserve fund equals the paid-up capital of the bank and thereafter 12.5% until any past losses have been made good. Single obligor limit was pegged at maximum of 25% of the shareholders fund.[93]

The Banking Act of 1969 replaced the 1958 Banking Ordinance[94]. Under the 1969 Act, the minimum capital requirement for indigenous banks was increased from ₦ 500, 000 to N600, 000 while the paid-up capital for foreign banks or its Nigeria subsidiary was raised to ₦ 1, 500,000[95]. The 1958 provision regarding statutory reserves was retained in the 1969 Act.

The Banking Act of 1969 was replaced with the Banking (Amendment) Act 1979. The minimum capital requirement for banks was not changed but that of merchant banks was placed at ₦ 2, 000,000.

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[90] Banking Ordinance 1958 Cap 19 LFN 1958
[91] Banking Ordinance 1958 Cap 19 LFN 1958
[92] S.4 Banking Ordinance 1958 Cap 19 LFN 1958
[93] S.7 Banking Ordinance 1958 Cap 19 LFN 1958
[94] The 1958 Banking Ordinance was amended in 1962 .The amended Ordinance of 1962 was repealed by the 1969 Banking Act.
[95] S.6 Banking Act 1969 CAP 28 LFN 1990

A major change occurred in 1990 with the promulgation of the Bank and other Financial Institutions Decree (BOFID) 1990.Under BOFID

1990[96] the minimum paid-up capital was[97]:

1. ₦50,000,000.00 for a commercial bank and profit and loss sharing bank

2. ₦ 70, 000,000 for Merchant bank.

3. =₦ 250,000 for a community bank.

The Decree mandate banks to maintain statutory reserve fund. If the statutory reserve fund is less than the paid-up share capital, the bank must transfer to the reserve annually, a sum not less than 30% of the net profits. But if the statutory reserve is more than the banks paid up share capital, the bank must increase its statutory reserve annually by at least 15% of its annual profit.

2.3.4 <u>Capital Adequacy.</u>

[96] Bank and other Financial Institution Decree 1990.
[97] S.5(1) BOFID 1990

The purpose of analyzing the bank's balance sheet above is to explore its link to banks capital with a view to understanding how a change in one element affects the other and why certain laws and regulations are enacted to protect the bank depositors. Liquidity and capital adequacy are therefore the major pivots on which depositors protection and capital reconstruction in banks revolves in times of crisis. For a bank to run into crisis the tendency is that one or more of the elements discussed above must have been mismanaged. The law therefore frowns at any changes in capital structure or operational arrangement that would affect capital adequacy provisions. Where there is a contravention, the regulatory authorities are expected to invoke appropriate sanction, obtain explanation for the infraction and ensure that the bank takes measures to avoid its reoccurrence.

However, the major challenge facing capital reconstruction of banks through legislating for capital adequacy and minimum capital requirement for banking businesses is the dynamic nature of capital and banking itself. This is due mainly to changes in macro economic variables like inflation, exchange rates fluctuations. Real capital volume in some banks are often not in concert or commensurate with the bank's risk profile or exposures. Consequently, in periods of economic downturn or deterioration in banks operating environment, pressure is brought to bear on the board and banks management's skill and capability to procure or maintain adequate capital for the bank[98]. Apart from management capacity and capital adequacy of the bank, the shareholding or capital structure of the bank is another important factor to be considered in this respect.

2.3.5 Share holding structure and capital Adequacy

Shareholding structure and the role of major shareholders in the bank are important in capital or bank reconstruction. The shareholding structure should not only have a diversified spread of shareholders, but should have key shareholders that would be available to support the bank in times of need. Of importance, however, is that preferably, no single shareholder should have the ability to exert an overwhelming influence over the bank. In addition, the shareholding structure should be transparent and allow the regulatory authority to supervise the banking group effectively. A widespread ownership of banks has the potential benefit of reducing the possibility of abuse by owners of banks, for instance, the owners using the bank to fund other activities. On the other hand, the absence of a large shareholder means that the regulators will find it difficult to identify a party with sufficient interest to stand by the bank in times of

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[98] Van Greuning H etal, Analyzing and Managing Banking Risk a framework for Assessing Corporate Governance and Financial Risk 2nd ed. IBRD Washington 2003 p.120

difficulty. This may result in eventual liquidation of such banks.

A general problem in capital reconstruction is the inability of legislation to provide, with certainty, against negative impact which changes in economic indices like inflation and currency depreciation may have on statutory prescribed capital requirement for banking business. Legislation can provide *dejure* within its jurisdiction, the minimum capital requirement for bank business. Most often such legislation becomes outdated with passage of time. Capital requirement being dynamic often move at a rate faster than the legislated minimum capital requirement which tend to justify cases against non intervention and to make law makers presume that based on the principle of lazez farie or minimum interference in market system, once the statutory minimum capital threshold is established and supervisory and regulatory framework put in place, banks should be able to imbibe market discipline and move their capital requirement in proportion to the risk they take. This has not been the case in practice as most legislation in this respect lack effective updating mechanism to accommodate the dynamisms of capital adequacy requirement. Effort at resolving this divergence in practice and economic reality is the reason behind the Basel II capital Accord[99].

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[99] Van Greuning H etal, opcit.

2.4 Capital Reconstruction and Financial Need of Nigerian Economy

An economic system shapes the feature of banks that operates in it. If serious institutional weaknesses are found to exist in the economic environment it will affect the banking system. Banks are instruments for creation of wealth, generation of employment and reduction of poverty. In times of economic crises banks forms an important tool to facilitating economic recovery and ensuring growth and development. Banks are expected to play active role in providing support required to achieve this objective[100]. Nigeria appears to have one of the weakest economies among countries of its peer in the world which made it difficult for banks to play significant role in the development of the economy. The business environment is not conducive due to poor infrastructural base, particularly road networks and electricity, lack of security, law and order. Thus decaying infrastructure base and weak institutional capacity for economic policy management characterize the environment in which Nigerian banks operates.

Presently bank funding to the real sector of Nigeria's economy is inadequate because banks focus on short term lending which constitute the core of bank lending in Nigeria. Most of the credit available to the private sector is of this nature though it may be structured to be rolled over to create the impression

[100] See S. 16 C23-C23 CFRN Cap 23 Vol.3 LFN 2004.

that it is of a long term nature. This is due to unpredictability and turbulence of the economic environment in which banks operate in the country. Another reason is that some tier of government borrow a larger portion of the available bank credit within the banking system which otherwise would have been available to the real sector of the economy for productive activities. Apart from crowding out fund available for development of the real sector the situation is creating problem for the CBN in managing liquidity in the economy and for the government in realizing the economic objective stated in the 1999 Constitution of Nigeria[101].

2.5 <u>The role of banks in capital formation in the economy</u>

The origin of banking in Nigeria is traceable to England where in the seventeenth century customers deposited money bullion and other valuable with the gold smith for a receipt, which progressively acquired negotiability and became the precursor of the negotiable bill of exchange of today. As such deposit accumulated, the goldsmith acquired the capacity to lend to other customer to the extent that he was able to maintain a margin of safety as between deposit

[101] See the economic objective in the Fundamental objectives and directive principle in chapter 4 of the Constitution of the Federal Republic of Nigeria Cap 23 LFN 2007

and advance[102]. It can therefore be said that traditionally, banks play two major roles in an economy. Mobilization of savings and provision of credit, which can be, described as financial intermediation payment and settlement services. Facilitation of international trade and investment banking activities are other functions but they are inherent in the first two major traditional services. This major traditionally function of bank enable it to have the bulk of the stock of money or wealth in any economy. Government utilizes this nature of bank as an instrument for controlling money flows to achieve predetermined monetary and economic objectives. There are 24 Deposit Money banks (DMBs) authorized to accept deposit subject to cheques in Nigeria which engages in intermediation process in Nigeria banking system[103]. The 24 banks apart from serving as administrators of the payment system, also serve as a channel through which money is transmitted in the economy. They are supposed to pivot the flow of credit to the productive sector of the economy. However, despite the consolidation of the banking sector and the consequent increase in their capital base, the funding gap in the private sector of the nation's economy persists. Consequently, there appears to be no solution in sight to some of the economic

[102] Onosode G Decades of Development Crises in Nigeria Mathouse Press Ltd Lagos 1993 p.186.
,[103] Adesida Seun ,''There will be fewer banks in 2008---Soludo, The Sun News-online, The Sun Publishing 2008,01,04 http://www.sunnewsonline.com/webpages/news/businessnews/2008/jan/04/business-04-01-2008-003.htm

problems earlier discussed. Filling the gap is one of the major roles of banks in an economy using intricate intermediation processes and depositors fund. The direct beneficiaries of the banks intermediation are the borrowers. Major borrowers in the country are the households[104], business organizations[105], state and local governments[106]. These set of borrower in the early seventies had difficult times in accessing bank loan. Thus Oguma in 1980 posited that "until the arrival of the oil boom, banks in Nigeria had not recorded a rapid growth considering the fact that the advent of the banking industry in Nigeria dates back to the nineteenth century.

He attributed the problem to crises of confidence in the industry and that the "expatriate banks did not fully identify with aspiration and problems of growing the economy of Nigeria. That their service was geared toward satisfying the needs

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[104] The borrower here is mainly for consumption purpose and for investment in securities. Lending to these categories of customer is termed as consumer financing by banks. It is highly profitable with relatively very low risk of default compared to lending to business unit especially SMEs.

[105] Borrowing by business organization in the country is limited unfortunately to financing of working capital as the banks are not often willing to lend on long term basis. .Most business organization have access to other sources of financing like retained earnings raising fund through the stock market. But the capital market is not well developed in the country.

[106] Lending to state and local government as well as government parastatals is profitable but risky. Its abuse has contributed to macroeconomic instabilities in the country. Much of the money borrowed by this tier of government is either siphoned out of the country or embezzled by government officers. The loan had been properly channeled to funding of infrastructural developments like schools road and power there would have been reduction in the level of poverty in the country. Banks in Nigeria have abandoned their primary role of lending to the real sector of the economy to lending to government to finance deficit spending

of the foreign country, merchants and their subsidiaries .They could not initiate policies that were at variance with their parent's banks overseas[107].

Over two decades later, the issues enumerated by Oguma are still persistent in the Nigeria banking system but in a different dimension. Nigerian citizens are taking decision on credit financing and other related issues in Nigerian banks but the economy remains underdeveloped. The banks are not willing to lend to the manufacturing sector because they later is operating in an inefficient environment that makes it difficult for it to pay back fund lent to it. There is no basic infrastructure like energy and road network to enable the industries function efficiently . Efficiency, it should be noted, is at the core of development of capitalist economic system as it determines whether an economy, a firm or an industry will grow or stagnate over time. The degree of efficiency in an economy depends on a host of other factors such as the amount, availability and quality of human capital, technological know how as well as market structure and the degree of competition in the economy[108]. If the economy must be made strong and reliable, it must be diversified to enable the country achieve sustainable

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[107] Oguma opcit p. 139

[108] Munaar I , Islamic and conventional Banking in the Nineties A comparative Studies ,Islamic Economic studies Vol. 1.8 No 2 April 2001 pp1-27. See also Hossain M A and Karucarnte N D , Trade Liberalization and Techinical Efficency: Evidence from Bangladesh Manufacturing Industries. The Journal of Development Studies Vol.4 No 3 February 2004 pp87-106.

development and the banking sector to support the economy fully. Banks therefore must be properly equipped not only with capacity to mobilize and channel fund to the real sector of the economy in accordance with national need but must be assured that money lent to such sector shall be paid on maturity of the loan. The energy sector therefore must be revamped to encourage productive manufacturing activities in the economy. This will make investors and banks to embrace long-term lending in the economy. This will also enable banks to make fund available to borrowers at a low and reasonable interest rate.

CHAPTER THREE

LEGAL AND INSTITUTIONAL FRAMEWORK FOR CAPITAL MAINTENANCE.

3.0 INTRODUCTION

The last chapter analyzed the concept of bank capital with emphasis on the component of bank balance sheet, the need for banks to maintain adequate capital and liquidity as prescribed by the regulatory authorities. It was shown that the objective of capital maintenance is to ensure that shareholders fund is not impaired by losses to enable it serve as a buffer against possible loss. It was seen that the bank's assets consist of loans and advances which are used to generate income to compensate depositors and other providers of fund and that banks are largely funded by deposit and not capital ,hence the need to protect the depositors; That where capital is not maintained losses made by bank will fall directly on depositor's fund. It was also seen that liquidity and loan reserves ratio prescribed by the CBN indirectly promote fiscal and macroeconomic stability in the economy and directly ensure that losses are not made through uncontrolled creation of loans and advances by banks. It was shown that capital maintenance policy demands that where loans are lost, it has to be provided from the bank profit failing which it is charged against the shareholders capital or fund. But since bank capital is usually small compared to loans and advances banks create, in times of crisis, it becomes necessary to grow or restructure capital to serve as buffer against bad loans. Where persistent losses erode the share holders' capital below the minimum prescribed, steps are taken to ensure that the situation is reversed. It was shown that the genesis of most banks' insolvency crisis starts from the point the bank fails to prevent its capital from erosion by sudden or persistent losses and where consequently it cannot readily recapitalize sufficiently to meet business exigencies and regulatory requirements.

This chapter examines the legal and institutional framework available for capital maintenance and crisis resolution in Nigerian banks. It traces the resolution mechanisms that can be utilized by regulatory authorities from the time a bank's capital becomes insufficient to meet its liabilities to the point it passes through the process of rehabilitation, reconstruction, revocation of license, forced closure or liquidation.

The philosophical and prudential basis for failure resolution, deposit protection and insurance are examined with a view to determining how they enhance stability and confidence in the banking system. Consequently, the roles of three principal institutions namely: the Central Bank of Nigeria (CBN); the Nigeria Deposit Insurance Corporation (NDIC; the Security and Exchange Commission (SEC) and the legal instruments that established them are examined. The role of NDIC in deposit insurance and bank liquidation is examined and a case made for its strengthening to enable it acquire adequate financial capacity and expertise to play innovative roles in crisis resolution . The chapter ended with an appraisal of the role of the Investment and Securities Tribunal (IST) in capital reconstruction.

3.1 THE CENTRAL BANK OF NIGERIA (CBN)

Created by the Central Bank of Nigeria Ordinance of 1958[109], the Bank[110] has an eleven (11) member board headed by a chairman called the Governor.[111]The

[109] See Section 4 of CBN Act Cap C4 LFN 2004.
[110] Central Bank of Nigeria. Organizationally, the bank is structured along the Governor and his Deputies. The Governor's office is run with a secretary and internal audit department. One of the Deputy Governors heads the economic policy of the bank. One heads operation while the remaining two takes care of financial sector surveillance and corporate services respectively. The Deputy Governor in charge of Policies is responsible for

board is responsible for policy formulation and implementation in the Bank[112]. The Bank's policy objectives guides its principal functions namely:

i. To issue legal tender currency

ii. To maintain external reserve so as to safeguard the international value of the currency;

iii. to act as the banker to the Federal Government ;

iv. to promote monetary stability and sound financial system in the country[113].

The major legal instruments that guide the board in the implementation of its objectives are the Central Bank of Nigeria (CBN) Act[114] and the Bank and other Financial Institutions Act (BOFIA)[115]. Generally, BOFIA was Promulgated in 1991 but was repealed and reenacted as Act No & in May 29, 2007 to regulate the activities of banks and other financial institutions and

corporate strategy, information technology, international economic relation, research, trade and exchange. The Deputy Governor operation is in charge of bank operations, branch operations, currency operations, finance and foreign operation.. The Deputy Governor financial sector is in charge of bank examination , bank supervision, development finance, other financial institutions and performance improvement while the Deputy Governor corporate services is in charge of administrative services, general services, human resource and the legal department.

111 S 6 CBN Act Cap C4 LFN 2004.

112 See Section 6(1) of CBN Act Cap C4 LFN 2004

113 Section 2 CBN Act Cap C4 LFN 2004

114 Cap C4 LFN 2004.

115 Cap B3 LFN 2004

matters connected thereto. The 1991 Act which came into force on the 20th of June 1991 conferred some powers and functions on the CBN Governor in addition to his powers and functions under the CBN Act[116]. Section 1(1) of BOFIA introduced in 1997 provides that the Central bank of Nigeria shall have all the functions and powers conferred and the duties imposed on it under the Act subject to the overall supervision of the Minister of Finance[117].

3.2 REGULATORY FUNCTION OF THE CBN

The CBN Act contains the philosophy and policy frame work that guides the Bank in maintaining stability in the banking system while the BOFIA contains the operational and regulatory guideline for attainment of the CBN policy objective. Section 2 of the CBN Act mandates the Bank to promote monetary and price stability a s well as sound financial system in Nigeria among other objectives. To achieve these objectives, the CBN Governor is empowered among other things to appoint a director for banking supervision and other examiner to examine the books and affairs of banks under condition of confidentiality [118]. The purpose of examination by the CBN is to ensure that banks comply with the rules and

[116] S.1 BOFIA Cap B3 LFN 2004.
[117] Cap B3LFN 2004
[118] S.31 (1) –(7) BOFIA Cap B3 LFN 2004

regulations enacted to safeguard and protect the capital of banks[119]. Banks are generally required to make periodic report to the CBN on their assets and liabilities. The report normally cover the detailed position of advances made by each bank, placement and takings from other banks, negotiable certificates of deposit issued and held, statement of total credit granted, structure of deposit held, performing and non performing credits and assets, non performing off balance sheet engagement, credit and loans availed to the bank's officers and directors, fraud and forgeries incidences experienced by the bank *inter alia*. The report is analyzed for accuracy and consistency and used in what is called offsite examination to evaluate the capital, assets, management, earnings and liquidity[120] of the banks and to detect early warning signal of distress that may call for an onsite examination. Where an onsite examination is conducted, the findings of the examiner and any recommendation made thereto must be tabled by the bank to their Board of Directors within two weeks of the examination for implementation[121]. The Governor may also carry out a special examination of a bank if he is satisfied that a bank has been carrying on its business in a manner detrimental to the interest of the bank's depositors and creditors; has insufficient

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[119] By the provision of S.31(8) of BOFIA, it is an offence for a bank not to furnish or to furnish the examiner with false information.

[120] Capital, Asset, Management, Earning and liquidity is known with the acronym CAMEL. In the case of capital, banks are required to maintain 8% of their risk weighted assets as capital 50% of which must be in Teir1 or primary form (that is in paid up capital and reserves)

[121] S.32(1) (2) BOFIA Cap B3 LFN 2004

asset to cover its liabilities or has been contravening the provision of the BOFIA . An examination may also be carried out by the CBN on application made by a director or depositors of a bank[122] .

3.3 Capital Reconstruction

To reconstruct is to rebuild either in fact or idea or to model. To form again or as new in imagination or to restore again as an entity the thing which was lost or destroyed[123] . The act of reconstruction presupposes that the thing to be reconstructed has lost its entity. When applied to a failing bank, or the capital of a bank, it implies that the capital of the bank is lost and so need to be replaced. The relevant statutes[124] neither define the term 'reconstruction' nor prescribe any particular mode of reconstruction for a bank that has lost its capital. The BOFIA merely stated it as an offence and prescribes fine for any bank that embarked on capital reconstruction without the consent of Governor[125].

Section 7 of BOFIA also did not mention the aspect of the capital of a failing bank that is to be reconstructed. Thus section 7 (1) (d) of BOFIA must have to be read *ejudis generis* with the rest of the section and the relevant

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[122] S.33 BOFIA Cap B3 LFN 2004. The Governor is however not bound to carry out the special examination on application by the depositor or director if he is satisfied that it is not necessary to do so.

[123] Black, H.C, Black Law Dictionary 6th ed.St Paul Minn.West Pub.co 1979.

[124] CAMA Cap C20 Vol.3 LFN 2004, BOFIA CAP B 3LFN 2004., CBN Act CAP C 4 LFN 2004.

[125] See S. 7(1)(d) CBN Act CAP B 3LFN 2004.

provisions of the Act, for it to be clear that reconstruction as used in the section refers to capital or capital fund of a bank.

Okonkwo[126] states that reconstruction of a company occurs when a company transfers its business and assets to a new company formed for that purpose in consideration of the issue of the shares of the new company to the members of the old company . If the debenture of the old company has not been paid off, then the share and debenture of the new company are issued to debenture holders of the old company to satisfy their claims. The result is that substantially the same business is carried on by the new company as did the old company, and substantial the same person holds interest in the new company as in the old company. Since the old company no longer has business of its own it is put into liquidation.

Reconstruction of a company through the method described above is often as a result of merger or amalgamations. It should be noted that it is not always the case in capital reconstruction that a new company must be formed to take over the business of the old company and that the objective of capital reconstruction

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[126] Okonkwo opcit

as envisaged under S.13 of BOFIA is to reconstitute the capital fund of the bank and not just the alteration of the form under which the business is carried on . An arrangement that enable the same or substantially the same persons to carry on the same or substantially the same business of an old company through a new company bank or without more may not offer prompt solution to challenges contemplated under S.13 BOFIA for capital reconstitution. It can be said that capital reconstruction seems not to have acquired a definite legal meaning because it is a commercial and not a legal term. It emerged because development in commerce compelled some changes in legal and insolvency related practices [127]. As noted by Keenan,[128]reconstruction does not enable a company to compel its shareholders to sell or otherwise dispose off their shares except as part of capital reduction or

takeover . It also does not permit the right of creditors to be affected nor does it enable the liability of shareholders to be increased without their individual consent.[129] Applied to a failing bank, a bank in distress or in need of capital reconstitution under sections 7 and 13 of BOFIA will not without agreements or legal backing compel depositors or creditors to accept less than the fund

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[127] See Cobbaut R etal Corporate Governance An Institutionalist Approach Kluwer Law International The Hague 2003,p.241.
[128] Denis Keenan, Smith and Keenan's Company Law for Students. London Financial Times Pitman publishing 1996.p.427.
[129] S.538 CAMA CAP C20 VOL.3 LFN 2004

deposited with the bank. Capital reconstruction ordinarily should not result in the loss of depositors fund but it is difficult to get the depositors fund intact at a point such a bank find itself in a position where it has insufficient liquid assets or securities to meet its obligations.

3.3.1 Capital reconstitution in banks under section 13 of BOFIA

One of the ways the CBN maintains stability in the banking system is by

enforcing capital maintenance provisions provided in the Banks and Other Financial Institution Act (BOFIA)[130]. Section 15 of BOFIA prescribes the holding of cash reserves, specified liquid assets, special deposits and stabilization securities that must be maintained by banks. Section 40 of CBN Act reinforces this duty[131] . Thus it is a duty on banks not to allow holding of these asset to be less than prescribed and to provide information regarding their compliance in reports to the CBN[132].

In addition, section 13 (1) BOFIA states that "A bank shall maintain at all times, capital funds unimpaired by losses, in such ratio to all or any liabilities or to both assets and liabilities in the bank and all its offices in and outside Nigeria as may be specified by the Bank.

[130] Cap B3 LFN 2004
[131] The section is short entilted "Power to issue directives on cash reserve ratio.
[132] S.15 BOFIA CAP B 3LFN 2004.

(2) Any bank which fails to observe any such ratios may be prohibited by the Bank from—

(a) advertising for or accepting new deposit;

(b) granting credit and making investment;

(c) paying cash dividend to shareholders;

(3) In addition, the bank may be required to draw up within a specified time, a capital reconstitution plan acceptable to the Bank".

It is not clear from this provision, what CBN would do with or would expect the bank to do with the plan and whether the plan is to be taken as a self rescue plan by the bank or as a blue print to enable CBN or NDIC understand the financial predicament of the bank beside the regular report the bank is obliged to be providing to CBN under S.31 of CBN Act. It is also not clear whether the plan to be drawn under this section will be implemented as an on-going capital maintenance process or as an emergency rescue measure[133]. The later seems to command more acceptances in view of the use of the word "reconstitute" in the section. To reconstitute something means to bring it back to its original state, to give it a new

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[133] See Rajak H, Insolvency Law Theory and Practice Sweet and Maxwell Ltd London (1993) p.293 .The author stated that broad definition of rescue seems to rest solely on the fact of company distress. He proposed steps to reconcile extreme views of economic rationale for company rescue . His approach is to adopt legal rescue procedure that does not involve all management activities and outside intervention processes in assessing distress. Taking rescue as a major intervention to rescue avert eventual failure of a company he portrayed the usefulness of restructuring modes like takeover ,sell-off and management buyout .

form or to alter its form. Applied to capital of a bank reconstitution would mean to bring back the capital of a bank to its original state in terms of its form. The general meaning that can be inferred from the reconstitution of such bank capital is that the capital is complete or that it is intact but the form in which it exists needs to be modified. Capital reconstitution of a bank taken from that perception connotes that the concerned bank is solvent, that only the form or combination of its capital need be altered or changed to bring it back to soundness. It is submitted that the objective of Section 13 (3) is to extract business plan from a failing or undercapitalized bank on how such bank plan to reconstruct or recapitalize its capital to meet the statutory or regulatory prescribed standard. To hold otherwise will defeat the objective behind prohibiting such bank from taking deposit from the public, granting loan to borrowers or paying dividend to its shareholders which are the major business of a deposit money bank and which is being restricted from such bank because the condition of its capital is short of CBN requirements and probably unhealthy to its business.

Any condition that would demand that a bank be suspended from advertising for new deposit or creating new loan - the major or core business of a bank deserves more of capital reconstruction than reconstitution hence the importance of section 7 of BOFIA which provides that[134] :

(1) Except with the prior consent of the Governor, no bank shall enter into an agreement or arrangement—

which result in a change in the control of the bank;

(a) for the sale, disposal or transfer howsoever, of the whole or any part of the business of the bank;

(b)for the amalgamation or merger of the bank with any other person;

(c) for reconstruction of the bank

(d)to employ a management agent or the transfer of its business to such agent.[135]

Agreement or arrangement to sell, transfer, amalgamate, merge with another bank or changes in control of a bank or the reconstruction of a bank are acts that essentially have the potential to affect the stability of a banking system hence the need to obtain the consent of the Governor of CBN before implementing it.

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[134] S. 7(2) BOFIA CAP B3 LFN 2004

[135] The punishment for non compliance with this provision is N1, 000,000.00 and N10, 000.00 for each day which the offence continues.

Capital reconstruction in particular would require the consent of the parties to be affected in addition to the approval of the CBN. It is submitted that the reconstitution or reconstruction plan would be acceptable to the Central Bank where it is not prejudicial to major objective of the Central Bank which is to promote monetary stability and sound financial system in Nigeria and where it does not jeopardize depositor's confidence in the banking system.

An agreement requires the consent of two or more persons concurring respecting the transmission of some property ,rights, or benefits with the view of contracting an obligation or a mutual obligation[136]. Arrangement is a scheme under which the rights of a company's shareholders or creditors is altered. It has been described as any change in the rights or liabilities of members , debenture holders or creditors of a company or any class of them or in the regulation of a company other than a change effected under any other unanimous

agreements of all parties affected thereby[137]. An arrangement is often a art of reconstruction or merger schemes[138]. Changes in control, sale, disposal or transfer of the whole or part of the business of a bank are references to some of the effect or consequences of mergers and acquisition scheme .Acquisition is , achieved

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[136] Black, H.C, Black Law Dictionary 6th ed.St Paul Minn.West Pub.co 1979
[137] S,537 CAMA Cap C20 Vol.3 LFN 2004
[138] See Okonkwo C O Legal Framework For Mergers and Acquisitions being a paper presented on the Retreat on Merger and Acquisitions in the Nigerian Banking Industry Organized by Central Bank of Nigeria and West African Institute for Financial and Economic Management (WAIFEM) September 17th-19th 2004. p.1

through acquiring majority shares of the target company and the eventual disinvestment or paying off of the shareholders of the target company. Merger, amalgamation and acquisition are methods of reconstruction of banks which can be employed to prevent assets of a bank from being wiped out by distress. A persistently loss making bank may be merged or acquired by another bank to escape compulsory liquidation as a result of insolvency. Mergers and acquisitions will be discussed in Chapter four but it suffices to state that it is a less costly and efficient way to bring an insolvent or illiquid bank to viability instead of liquidating it. Although, some forced merger may result in the asset of a failed bank being acquired below its fair value which may be detrimental to the shareholders of a bank already in crisis, yet it should be adopted where it will rescue the depositors fund from the possible loss that may consequently follow from liquidation of such banks. The Central Bank of Nigeria (CBN) will readily consent to a merger or acquisition arrangement option for rescuing a bank as long as it will generate streams of profit above the liquidation value of the insolvent bank.

3.3.2 Capital reconstruction in banks under S.7 BOFIA

Section 7 of BOFIA opened with a condition precedent to reconstruction and other resolution mechanism thus[139] :

(2) Except with the prior consent of the Governor, no bank shall enter into an agreement or arrangement—

(a) which result in a change in the control of the bank;

(b) for the sale, disposal or transfer howsoever, of the whole or any part of the business of the bank;

(b) for the amalgamation or merger of the bank with any other person;

(c) for reconstruction of the bank[140]

(d) to employ a management agent or for the transfer of a banks business to such agent.[141]

Agreement or arrangement to sell, transfer, amalgamate, merge with another bank or changes in control of a bank or the reconstruction of a bank as contemplated by the section essentially have the potential to effect the stability of a banking system if not controlled hence the need to obtain the consent of the Governor of CBN[142]. Capital reconstruction in particular would require the consent of the parties to be effected in addition to the approval of the CBN. During reconstitution or

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[139] S. 7(2) BOFIA CAP B3 LFN 2004

[140] Emphasis is mine.

[141] The punishment for non compliance with this provision is N1, 000,000.00 and N10, 000.00 for each day which the offence continues.

[142] Requirement of consent of the Governor is further discussed below.

reconstruction the bank may not be allowed to create more loans, or dispose its fixed assets except with the approval of the CBN. This is aimed at compelling it to resort to restructure its business by embarking on aggressive loan recovery and reactivation of dormant business relationships and other measures that may enable it inject more fund into its system from its old business. It is often a time for a bank to strengthen its internal control system, by safeguarding and updating its records. The bank may be compelled to rationalize on or restructure its labor force.

3.3.3 Justification for Capital reconstruction of insolvent bank

It is important to note that management of distress in banks often results to apportionment of losses arising from failure of existing contract between a failing bank and its stakeholders and the creation of sets of remedial contract or agreement to be executed through institution like the Nigeria Deposit Insurance Corporation (NDIC) and the Courts. Andrew Sheng[143] categorized contracts in bank failure resolution process into three namely: the original contract existing between the banker and the depositor as a result of which fund was deposited

[143] Sheng A."Role of the central Bank in banking crisis: An Overview" in Bank Deposit Insurance in Nigeria ed by Peter N Umoh Lagos ,Page Publishers services Ltd. 1997 P.33

with the banker; the second one that is created between the banker and whoever borrows the fund from the banker (because it is the depositors money that banks lend to the borrowers) and the third one between the government and the depositors which arises when due to situation of exceptional or massive failure of the second contract or general economic emergencies , a bank or banks becomes unable to honor its obligation to the depositors. This third contract is a sort of an obligation flowing from the implied duty on government to provide for the well being of its citizens, the security of its

economy and its banking system. In this contract it is expected that government should not allow the depositors to suffer unduly as government is expected to use the regulatory agencies or its power of lender of last resort to mitigate or manage loss arising from the failure these contracts and to preserve the banking system[144]. In real terms, managing distress in banks may result to damages to other social elements of the society other than the depositors and other economic agents that commenced the initial contract. This may require that radical measures like change in management, workforce, financing arrangement or the scope of activities of the bank be made. Losses incurred by the bank may be shared to someone or some group of people who are not direct party to the

[144] See Umoh Opcit p.102

three contracts postulated by Sheng. It could be the management, the staff, the shareholders, secured or unsecured creditors, the depositors, the government or the economy.[145] Loss sharing consequently creates situations where some interests that coexisted mutually are suddenly set against each other or one another. In terminal resolution situations for instance, taking possession of the assets of an insolvent bank for liquidation could be frustrated with court injunction by a bank's management. The management of the bank in some case would want to rely on court injunction and litigation to prolong the life of the failing bank to see if it would eventually survive. The case of **Savannah Bank of Nig Plc vs NDIC** [146] is instructive. This is an action in which the appellant challenged the revocation of its banking license by the CBN and the appointment by theCBN of the NDIC as the liquidator of the bank via a notice published in the Federal Government Official Gazette No 16,vol 89 f

15th January 2002. On 18th January 2002, appellant filled a petition for winding up of the appellant. Upon an application exparte by the respondent trial court appointed her a provisional liquidator over the assets and properties of the appellant. Respondent with the help of the Nigerian Police took possession of the premises of the appellant nationwide. Appellant having made and lost an

[145] Ibid pg 237
[146] See Savannah bank of Nigeria Plc v NDIC [2004] 11 NWLR(Pt 883) 60

application to set aside the exparte order at the trial court appealed to the court of Appeal which on 9/1/2003 set aside the appointment of the appellant as the liquidator of the respondent on the ground that it was made prematurely before the advertisement of the winding up order. On 10/1/2003 respondent filled two motions. One on notice and the other exparte. The exparte motion sought and obtained an order appointing her as provisional liquidator of the appellant and directing the police to continue to secure the premises of the appellant. Hearing of the substantive motion on notice was adjourned to 15/1/03 but before that day the appellant filled a motion on notice on 13/1/03 praying the trial court for an order to discharge the exparte order arguing that NDIC has no power to deploy the Nigeria Police

Force to seal the premises. The trial court refused the application and the

appellant appealed to the Court of Appeal . The Court dismissed the appeal

stating per Oguntande JSC that All Courts of record, trial or appeal possess the power of preservation of the *res* in their custody. The primary duty of all courts having the custody of property, the subject matter of litigation is to preserve the *res* for delivery to the person who ultimately establish his title…the applicant was in business as bank and holding the funds of several depositors. I must ensure that the money or other assets of the depositors in the hands of the applicant are not placed in risk or jeopardy.

On the need not to pursue the process of appeal at the expense of the expeditious hearing of the substantive matter Onnoghen JCA said:

> *I must observe that though it is good to develop the law through the process of appeal, this should not be at the expense of the expeditious hearing of the substantive matter. Here is a case in which a preservative order was made by the trial Judge on 10/1/03 pending the hearing of a motion on notice adjourned to 15/1/03 but rather than go with the hearing of the motion on notice so as to enable the trial court deliver its ruling one way or the other, learned counsel chose to apply to set aside the exparte order , the refusal of which application(sic) has resulted in a delay in the hearing of the motion on notice for over a year now. I am not saying the counsel has no right to choose between applying to set aside the exparte order and filling his necessary process to enable the motion on notice to be heard and determined but that common sense demands that steps that would lead to an expeditious disposal of the matter ought to be preferred. This is a case involving the rights of the depositors, creditiors etc whose investments are tied down in the appellant following the revocation of its banking license. Meanwhile the winding up petition of the respondent is still in the cooler. At the end we hear of justice delayed is justice denied! How beautiful*[147]

Litigation as a delay tactics can be employed against the bank by loan defaulters during realization of collateral pledged by delinquent borrowers. The secured

[147] Savannah bank vs NDIC[2005] 11 NWLR 311 at 316.

creditors may look for a way of avoiding or minimizing potential loss that could result if less is realized from pledged assets at the point of liquidation.

The shareholders knowing that their investment will be lost as soon as the regulatory authorities head for liquidation on failure of rehabilitation of the ailing banks, would try to offload their share and mitigate their losses at the Stock Exchange Market. Some creditors of the bank may resort to litigation to either frustrate the effort of the bank at recalling loans or to realize the securities pledged against nonperforming loans especially where the loan is insider related loan , where the loan documentation is not perfected , where the loan is not adequately collateralized or where the borrower is insolvent .

The regulatory authorities and the deposit insurers sometimes would want an expeditious resolution of the problem to prevent the crisis from contagiously spreading to other healthy banks and to limit probably the cost of premium that will be paid to the depositors in the event of liquidation of the bank. Some depositors seeing premium payable by NDIC in the event of closure of a failing bank as insignificant to their total deposit with the failing bank would want to run before their funds are trapped. Some resort to unorthodox or illegal connivance with unscrupulous and fraudulent bank staff to withdraw their money from the bank. Some depositors are willing to accept half or less of their deposit from some of these fraudulent staff in full settlement of their deposit in order to avoid being trapped in the failing bank. Even those whose deposits are covered by the premium payable by NDIC would want to run before the bank collapse to avoid their fund being trapped and they having to wait until the protracted process of liquidation is completed before their funds could be accessed. The interval between when a bank's insolvency status becomes obvious to the public and when resolution mechanism is put in place to resolve it is therefore crucial and prone to high rate of fraud hence the need to preserve the assets and records of the bank from destruction. Prompt enforcement of economic rights and obligation of the parties as occasioned by the above situation is what the court is often called upon to adjudicate and which has to be done with impartial, honest and full knowledge of financial issues, circumstances and conditions of the parties involved. Before this period, measures could be taken to reconstruct the capital or business of the bank without necessarily allowing it to head to terminal stages like liquidation. This is necessary for in country like Nigeria where the banking habit of the populace is at the infancy stage. For instance in Nigeria, majority of bank customers are interested in transactional relationship with their banks, merely for receipt and payment

Services of banks[148].They are however compelled by the practice of banking to maintain their account in credit balances which link them inevitably to the fortunes of the banks by making them creditors of the banks. Unfortunately most depositors hardly get adequate and prompt information of the state or quality of capital of their banks to enable them mitigate their potential losses because such information before now is withdrawn from public knowledge by regulatory authorities on the ground that public knowledge of whether a bank has exceeded its lending limit or has failed to maintain prescribed ratio of asset to liabilities inter alia can cause a run in the banking system. It is submitted that banks should be issued with and compelled to display in their offices a certificate of capital compliances by CBN to guide depositors and creditors in monitoring their exposures to their banks. It will also control the banks in taking steps that jeopardizes the safety of its capital as it knows that such steps will make its depositors switch to another bank considered safer.

3.3.4. Capital reconstruction and the Governor's consent under section 7 BOFIA

It is not in doubt given the scenario above that orderly rehabilitation of banks in distress is far better than outright liquidation of such banks. It is also clear from

[148] Balogun v National Bank of Nigeria (1978) 1 ANLR 63

the above discussion that mergers and acquisitions are the principal tools that can be employed to reconstitute a bank's capital under Sections 7 and 13 of BOFIA. A literal interpretation of Section 7 of BOFIA which states that prior consent of the Governor must be obtained before a bank can implement capital reconstruction plan or other schemes enumerated in the section may be seen as a hindrance to capital reconstruction in banks because it creates the impression that obtaining such consent is a condition precedent to engaging even in negotiation for the doing of anything contained in the section.

The consent as required by Section 7 of BOFIA should be a vehicle rather than an obstacle to prompt insolvency resolution in banks. It is submitted that the language of section 7 BOFIA is not in consonance with the tone of urgency contained in the wordings of S. 13 (3) of BOFIA which S. 7 of BOFIA is supposed to complement. S.13 BOFIA requires that the bank must draw capital reconstitution plan acceptable to CBN within a specified time is aimed at preventing the affairs of the bank from deteriorating. The objective of most acquisitions or mergers is to take control of a bank. Therefore section 7 BOFIA appears to be the only provision available for effecting reconstitution or reconstruction of bank's capital in situations envisaged under S.13(3) BOFIA. Section 7 should be amended to complement the urgency in Section 13 BOFIA by providing for approval and not prior consent so that banks shall be free to explore all possible avenues to reconstruct their capital subject to the approval of the

CBN. Approval of the Governor under Section 7 of BOFIA is necessary due to the nature and importance of banking business to the economy but it should be sought simultaneously with the consent required by Securities and Exchange Commission for purpose of mergers and acquisition. It is further submitted that section of 7 BOFIA should be amended to include essential things that must be contained in a plan for capital reconstruction or reconstitution for it to secure the approval or consent of the CBN for

implementation just like the SEC Act provides that no approval shall be

given to scheme or arrangement which is likely to cause a substantial restraint in competition or likely to create a monopoly in the industry[149]. The amendment should prohibit any arrangement or plan that is capable of affecting negatively the funds of the depositor or likely to cause instability or distress in the banking system and should be made to have overriding effect on other legislation that covered the same ground like the provisions of the Investment and Securities Act (ISA) so as to reduce the time and cost of rescuing a failing bank under the BOFIA where the consent of SEC would be required.

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[149] See Investment and Securities Act Cap 124 LFN 2004.

3.4 Banking license as tool for capital reconstruction in banks

It is illegal to conduct banking business in Nigeria without a banking license granted by the Governor of Central Bank of Nigeria[150]. The purpose of subjecting banking business to licensing *inter alia* is to enable CBN have firm control of the banking system. Through licensing the CBN determines and controls the number, quality , qualification, condition precedent to entrance, exit, participation and the scope of activities allowed for banking business in Nigeria. By the provision of S.2 (1) of BOFIA the Governor can grant a banking license to a company duly incorporated in Nigeria. By S.3 (1) of BOFIA[151] "anybody desiring to undertake banking business in Nigeria shall apply to the Governor in writing". The license can also be revoked by the Governor under seven circumstances namely: where a bank fails to comply with the minimum paid up capital requirement prescribed by the Bank[152] or with the minimum capital ratio prescribed under S.13 BOFIA[153]; where a bank has insufficient asset to meet its liabilities or where a bank goes into liquidation or is wound up or otherwise dissolved[154] and where a bank fails

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[150] S.2 BOFIA Cap B3 LFN 2004.
[151] BOFIA Cap B3 LFN 2004
[152].S.9(2) BOFIA Cap B3 LFN 2004
[153] S. 14(1) BOFIA Cap B3 LFN 2004
[154] S.12 (d) BOFIA Cap B3 LFN 2004. See 3.4 below for full discussion of this condition.

to comply with any obligation imposed upon it by or under BOFIA or CBN Act[155].

The circumstances are briefly discussed below.

3.4.1 Where a bank ceases to carry on banking business

A bank may have its license revoked where it ceases to carry on banking business for six months or aggregate period of six months[156]. Except for insolvency and distress, it is unusual for an existing bank not to carry on business for a period of six months or to open and close shop intermittently for an aggregate of that period in one year. A period of 6 months is considered sufficient to enable a bank in distress to recapitalize or resolve any problem that would have made it to close shop and so return to business.

3.4.2 Failure to fulfill any condition subject to which the license was granted[157].

[155] S.12 (e) BOFIA Cap B3 LFN 2004
[156] S.12 (a) BOFIA Cap B3 LFN 2004
[157] S.12 (c) BOFIA Cap B3 LFN 2004

Banking license is issued with the condition that the licensee will continue to comply with any subsequent condition that may be imposed by the issuer failing which the license may be revoked. One of the instances where

the provision of this section has been invoked was during the last banking sector consolidation by the CBN . The CBN in 2005 increased the minimum capital requirements for banks operating in the country to N25 billion. Banks were given one year to raise their capital to that extent. At the expiration of that period banks that could not meet the new requirement had their licenses revoked. In fact, by Section 5 of BOFIA the CBN may vary or revoke the condition or any condition subject to which a license was granted or may impose fresh or additional conditions to the grant of a license[158]. The requirement imposes a duty on banks to comply with conditions attached to grant of banking license from time to time and in the spirit of section 2 (c)of CBN Act enables the CBN to achieve its objective of monetary stability and sound financial system in Nigeria.

3.4.3 <u>Failure to timely present capital reconstruction plan under S.13(3) of BOFIA</u>

[158] S.5(1) BOFIA Cap B3 LFN 2004.

One of the ways the CBN maintains stability in the banking system is by enforcing capital maintenance provisions as provided in the Bank and Other

Financial Institutions Act (BOFIA)[159]. Section 15 of BOFIA prescribes holding of cash reserves, specified liquid assets, special deposits and stabilization securities that must be maintained by banks. It is a duty on banks not to allow holding of these asset to be less than prescribed and to provide information regarding its observation to CBN[160]. Section 12(d) provides that the Governor may with the approval of the Board revoke any license granted under BOFIA where a bank has insufficient assets to meet its liabilities. To establish that a bank's assets is insufficient to meet its liability, it will be necessary to prove that such a bank has failed to maintain capital fund unimpaired by losses in the prescribed ratio of assets to liabilities. In **Savannah Bank of Nigeria Plc V Nigeria Deposit Insurance Corporation**[161] the Central Bank of Nigeria by a Notice No. 27 published in the Federal Government Gazette No. 16 Vol. 89 of 15th January, 2002 revoked the banking license of the applicant under Section 12 of the Banks and Other Financial Institutions Decree 1991(BOFID) and appointed the respondent the provisional liquidator of the bank. One of the averment of the bank in its affidavit in support

[159] Cap B3 LFN 2004
[160] S.15 BOFIA CAP B 3LFN 2004.
[161] [2004] 11 NWLR(Pt 883) 60

of its statement of claim is that it has the sum of N1.8 billion in reserve account with the respondent. The respondent contends that appellant has insufficient assets to meet its liabilities and that there will be a likely breach of peace if the law enforcement agents are not allowed to continue to be in the premises of the appellant for the purpose of securing its assets. The Court agreed with the presences of the police in the premises of the appellant will help to prevent a break down of law and order.

3.4.4 . Revocation of license On the recommendation of NDIC. Under S.39 BOFIA

A bank may have its banking license revoked by the CBN on the recommendation of the NDIC. Section 39 BOFIA with a short title "power of the Bank to revoke license or apply to court" provides that "In the event that the bank over which the corporation has assumed control cannot be rehabilitated, the Corporation may recommend to the Bank other resolution measures which may include the revocation of the bank's license". The powers and function of NDIC in managing bank crisis will be discussed in this chapter but it is necessary to make some observations on the section which empower the Corporation to recommend revocation of banking licensees. Firstly, it seems that section 39 of BOFIA did not come out with clear and sufficient legislative force required of an enactment that purport to empower the revocation of license of such an important institution in an economy like a bank. Read alone, section 39 appears to deal with resolution option that can be recommended to the CBN by the NDIC where the later has failed to rehabilitate a failing bank. The short title to section 39 BOFIA reads “Power of the Bank to revoke license or apply to court” but the provision of the section did not state with sufficiency and clarity what the CBN will be applying to court to do in respect of a failing bank with respect to revocation of a bank’s license. It is not the requirement of the law any more that the CBN should apply to court before the license of a bank is revoked The CBN therefore need not apply to court to exercise it. The power to apply to court provided in the subsequent section is in respect of the NDIC and for a situation where the CBN has revoked a banks license. Section 40 with short title “Application to the Federal High Court” states that “Where the license of a bank has been revoked pursuant to section 39 of this Act, the Corporation shall apply to the Federal High Court for a winding up order of the affairs of the bank” . Sections 39 and 40 of BOFIA should therefore be streamlined and merged for clarity purpose.

3.5 Procedural steps in revocation of banking license

The BOFIA has simplified the procedural requirement for revocation of the banking license of a bank. What is required of the CBN is that where it proposes to vary, revoke or impose a fresh or additional conditions on a license, the Governor before exercising such power should give notice of his intention to the bank concerned and give the bank an opportunity to make representation to him[162] . Where the CBN Governor propose to revoke the license of any bank for failure to comply with the minimum capital ratio the Governor shall give notice of his intention to the bank and the bank shall within 30 days make representation to CBN with respect thereof[163]. Where the license of a bank has been revoked on the recommendation of NDIC, NDIC shall apply to the Federal High Court for a winding up order of the affairs of the bank[164]. The first reported legal challenge of statutory power to revoke license in Nigeria was the case of **Merchant Bank Ltd v Federal Ministry of Finance**[165]. The appellant's banking license was revoked and an order made for its winding up by the Minister of Finance pursuant to the powers conferred on the minister by virtue of S.14 of

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[162] S. 5(1) BOFIA Cap B3 LFN 2004
[163] S.14(2) BOFIA Cap B3 LFN 2004
[164] S.40 BOFIA Cap B3 LFN 2004
[165] . 1961 NSCC 264

Banking Ordinance 1958. The court was called upon to determine whether a license granted by the Minister under the Banking Ordinance could be revoked by the minister. It was not the case of the appellant that the minister in revoking the license failed to comply with the provision of Section14 of the Banking ordinance 1958 but that its banking license by virtue of relevant statutory provision[166] has acquired the character of a civil right that can only be determined by a court. The Supreme Court upheld the trial court's decision that a license to engage in the business of banking under the Banking Ordinance is not a civil right within the meaning and context of the constitution and that such a license could be determined by ministerial order without recourse to the courts or tribunal and that a license to engage in the business of banking must be deemed to be revoked effectively by the minister when so revoked by him in accordance with the provisions of the Banking Ordinance. Since the powers under s. 14 of the Ordinance[167] are administrative powers properly vested in the minister, it was for the minister, not the court, to exercise these powers. In matters involving the

[166] . The relevant provision refers to Clause 5 of the Sixth Schedule to the 1954 Constitution which provides that "In the determination of his civil rights and obligations a person shall be entitled to a fair hearing within a reasonable time by a Court or other tribunal established by law and constituted in such manner as to secure its independence and impartiality".

[167] Section 14 provides that: If, in the opinion of the Minister , an examination shows that the license bank is carrying on business in a manner detrimental to the interest of the depositors and other creditors or has insufficient assets to cover its liabilities to the public or is contravening the provisions of this ordinance the Minister such one or more of the following steps from time to time as seems to him necessary:

(a) require that the bank forthwith to take such steps as he may consider necessary to rectify the matter; or
(b) appoint a person who in his opinion has had proper training and experience to advise the Bank in the proper conduct of its business and fix the remuneration to be paid by the bank to such a person

exercise of statutory administrative powers, the functions of the courts begin only and when it is alleged that the powers have not been exercised in accordance with the provisions of the statute which created them.

In **Savannah Bank of Nigeria Plc V Nigeria Deposit Insurance Corporation**[168] the Central Bank of Nigeria by a Notice No. 27 published in the Federal Government Gazette No. 16 Vol. 89 of 15th January, 2002 revoked the Banking license of the applicant under Section 12 of the Banks and Other Financial Institutions Decree 1991(BOFID) and appointed the respondent the provisional liquidator of the bank. To effectuate the liquidation, the respondent employed the service of the Nigerian Police to seal the branches of the applicant throughout the country. Applicant commenced an interlocutory action at the Federal High Court challenging the action of the respondent. It was held that NDIC cannot commence the process of liquidation of a bank without notice as required by the BOFIA. Apart from the issue of notice the case raised other issues regarding the need to guard against deterioration, depreciation or destruction of the assets and records of a bank in distress from the time its license is revoked to the time liquidation is concluded. NDIC had employed the services of Nigerian police to seal off the premises of the bank which was the main kernel of the subsequent appeal by the

[168] [2004] 11 NWLR(Pt 883) 60

bank. Though the court ruled in the first case in favor of the bank that proper notice to a bank is a condition precedent to commencing liquidation proceedings against it, it declined to make an order that the police should vacate the premises of the bank as requested by the appellant. It appears this is an endorsement of the use of reasonable force by the corporation in enforcing its statutory duties during banking crisis resolution. It is common among the failing banks to challenge the jurisdiction of the court to hear application for its liquidation than the procedure for revocation of license.

3.6 Preventing loss of the Asset of bank during liquidation

In winding up by the court the liquidator is empowered to take custody and control of all the property and chose in action of the bank. To avoid disposition of the asset of the company any disposition of company's asset made without an order of the court, during winding up is void[169]. The position covers attachment or sequestration of the property of the bank[170]. The case of **Federal Mortgage Bank of Nigeria v Nigeria Deposit Insurance Corporation**[171] is apposite here. One of the issues in the case was who as between appellant and the respondent is entitled to the goods and chattel of the defendant (United Commercial Bank Limited) which has already been attached by a bailiff of the Lagos High Court in favour of the appellant before the

[169]S. 413 CAMA Cap C20 Vol.3 LFN 2004
[170] 413 CAMA Cap C20 Vol.3 LFN 2004
[171] [1999] 2 NWLR (Pt 591) 333

appointment of the respondent as a provisional liquidator of the defendant. The issue in effect is whether execution can be carried out against a company in liquidation. The fact of the case are that the Appellant placed (Five Hundred Thousand Naira Only) N500, 000.00 for 90 days at interest rate of 40 percent per annum with United Commercial Bank Limited (UCB). After four rollovers appellant demanded and UCB defaulted in paying the principal and interest. Appellant took a writ of summons against UCB which failed to enter appearance whereby judgment was entered against them. Appellant took step to levy execution by attaching goods and chattel of the judgment debtor bank in satisfaction of the debt but had not conclude the process before the judgment debtor's banking license was revoked by CBN who appointed the Respondent as liquidators of the bank. Acting on the appointment , the Respondent took possession of the attached goods thereby preventing the Deputy Sheriff of the Court from concluding the sales of the same. In an action for an order to effect the sale of the said chattel, the supreme Court held that: *where execution and attachment of a company's goods and chattels have been carried out but before the lapse of the time permitted by law for sale thereof and before the sale a liquidator is appointed for the company, the execution will be deemed as having not been concluded and the judgment creditor cannot retain the benefits of the execution , unless the rights conferred on the company/debtor are set aside by the federal High court in favor of the plaintiff goods and chattels must be returned to* *the company* [172]. Apart from the issues canvassed and decided by the trial and appellate courts, the cases portrayed most of the problems encountered by depositors during bank liquidation. It commenced 31/5/94 when the plaintiff filed the writ of summons against the bank. Judgment was entered against the defendant bank 42 days later on (12/7/94) as it failed to enter appearance and file its pleadings. The bank did not also appeal the judgment until FMBN filed a motion to levy execution on its goods and chattels after which it entered a motion for an order of stay of execution of the judgment and to be allowed to liquidate the judgment debt in installment. It issued a banker's draft post dated 5/9/94 drawn on another bank for N2, 000,000 out of the N6, 252,245.13 judgment debt. Before the motion could be heard, CBN revoked its license and appointed NDIC its liquidator on 9/9/2007. The post dated draft

was returned unpaid on 14/9/94 causing the FMBN to file a motion on notice on 19/9//94 to compel NDIC to produce the attached goods and chattel at the Federal High Court and to direct the deputy sheriff to take

custody and control of thesame. The motion of 19/9/94 was heard on 23/9/94 and reserved for ruling on 14/10/94 but before the ruling, NDIC brought a motion on notice seeking for an order of the court to arrest the

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[172] Ibid p.343

ruling and for a stay of proceeding on the matter on the ground that the trial court had no jurisdiction to adjudicate on it. The case took series of adjournment and injunction before its determination. Time and cost of the litigation has chain effect on the society given the fact that the money placed by the applicant being a bank is also depositors money. Another case that would have had similar crisis effect on the depositor if not for the wisdom of the judges was the case of **CBN V Industrial Bank Ltd** [173] Plaintiff respondent brought an application at the trial court for an interim injunction to restrain defendant/ appellant from implementing the debit of N381, 163,992.59 in its account with the appellant. The debit arose from payment made on behalf of the applicant/ respondent in respect of a letter of credit by a customer who turned out to be a fraudster. The debit had thrown the respondent's account into deficit that prevented respondent from participating in foreign exchange bidding. Appellant's case was that its correspondence bank has reimbursed the exporter and debited its account. That reversal of the debit as prayed by the respondent is an act that has been concluded which cannot be restrained by an interlocutory injunction. The Court of Appeal held that though the debit entry was already made, the order of interlocutory injunction sought is to restrain the defendant/ appellant from

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[173] [1997] 9 NWLR (Pt 522) 536

allowing that entry to stand in the way of the plaintiff operating its current account. Ayoola JCA as he then was observed that "on the balance, the damage that will be occasioned to the respondent far outweighs the mere financial inconveniences that may be occasioned the applicant by refusing that application. Not to grant the application ***"may have the consequence of irremediably sweeping the respondent off from existence"*** which is another way of saying that if the court rules in favor of CBN the capital and depositors fund of the respondents would be wiped away .Some banks to recover loans from accumulated interest often adopt the wrong Procedure by consolidating account which though belonging to the same individual but different personalities in law. There are cases where without any agreement some banks consolidated the account of their customers to net off customers indebtedness from the customers other account with them.

In **Habib Nig Bank Plc v Ochete**[174] , Applicant attempted to offset debt owed by a company in which the Respondent is a shareholder and managing director without his prior express permission and consent. The loan was advanced to Belyn Pharmacy a sole proprietorship company registered by the respondent. Belyn pharmacy later incorporated to a imited liability which was fully

[174] [2001] 3 NWLR Pt 699 at 114.

communicated to the appellants who continued to extend overdraft facility to the company. The company defaulted in payment and Applicant purport to convert a cheque made payable to the respondent in settlement of the debt. Court held that applicant has no right to convert cheque issued in personal name of the respondent for debt owed by his company.

The position of law is that where a customer has separate account with implied or express agreement that they are to be kept distinctive, a bank has no right to consolidate it[175]. This does not mean that the bank has no right to combine accounts held by the same customer in his own right provided as stated by Igu JSC in the case of **Allied Bank v Akubueze** that they are held by the customer in the same character and capacity[176] . His lordship upheld the finding of the lower courts that the accounts in the instant case are neither in the name of the respondent nor in the same name. He found that the parties are in an implied agreement that the accounts are to be kept distinctive and the respondent had never mixed up the use of the two accounts. But for this finding, it is submitted

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[175] See Ogwuegbu JSC in Allied Bank Ltd V Akuueze [1997] 6 NWLRPT 509 at 374.

[176] See Igu JSC in Allied Bank Ltd V Akuueze opcit . The respondent operates two accounts with the appellant. One with the title Joe Brown commercial used for his international business which was in debit of N11,497.26 and the other with the title New world supermarket used for his local business that was in credit of N7,276.36. On ythe basis of the respondents debit balance in Joe Brown commercial account, appellant dishonored a cheque of N7100 issue by the respondent on New world supermarket account which was in credit at al material time wherein the respondent sued for damages. For detailed discussion on judicial authorities on bankers right of set of and combination of customers accounts see Goldface –Irokalibe IJ ,Law of Banking in Nigeria, Malthouse press limited Lagos ,2007 pp90-102

that on the ground of capacity the accounts could be consolidated as the law did not recognize a registered business name as distinctive from the owner. It is only with respect to character of the account that it could be said that the account is operated in a way that showed that it is not to be taken as meant for the same use even though they belong to the same legal person Joe Brown Akubueze. It appears from the supreme court decision in **Joe Golday ltd v Co-op Development bank Plc**[177] that even where the accounts belong to distinctive juristic persons, it could still be consolidated for the purpose of determining the totality of the customers indebtedness to the bank provided the customer suffers no damage or loss due to the consolidation. It seems that the major consideration is whether the customer suffers a loss or detriment due to the consolidation of his accounts by the court.

3.7 <u>Risk assets and loan interest in capital reconstruction</u>

Three principal factors: undercapitalization, poor cooperate management and bad loan or risk assets were identified to be responsible for the failure of most banks

[177] (2003) 2 SC 15. unlike the case of Allied Bank v Akubueze, this is a case where a director of the defendant bank used his position to influence the transfer of credit and debit entries to his associated companies account to cover the fact that the accounts does not have funds to pay for cost of foreign exchange and letters granted the companies from the CBN and NDIC. The accounts were consolidated to determine his actual indebtedness to the bank .

in Nigeria[178]. Undercapitalization has been discussed in chapter two. Corporate governance and loan management will be discussed shortly . For the economy to develop banks must advance credit to their customers. Interest on loan and fees and commission earned from loans and advances are the major factors that propel the desire of banks to create loan or risk assets. There is a symbiotic relationship and multiplier effect between loans created by banks and growths in the productive sector of the economy. The more developed an economy, the more bank play vital roles in financing business and credits through loan and advances because it earns more income there from. Notwithstanding this symbiotic relationship, default in loan and advances repayments has been a major factor that eat up banks capital in Nigeria[179] .There is no statutory provision guiding procedure for loan creation by banks[180]. The implication is that loans need not be secured by the borrower if the bank so wishes though good credit policy requires that loan should be adequately secured. Where loans are to be secured it could be done using real security like land or chattels[181] or personal

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[178] Umoh Opcit See also the case o Savannah Bank Vs Ajilo [1989] 1 NWLR pt 97 at 305

[179] See the case of Savannah Bank vs Ajilo [1989] 1 NWLR pt 97 at 305.

[180] See generally Ogunleye GA "The Nigerian Secured Creditor: In Deed And In Law" in Proceedings of the 2006 National Seminar on Banking & Allied Matters for Judges organized by the Chartered Institute of Bankers of Nigeria in Collaboration with the National Judicial Institute at Ritz Hotel Abuja on 4th December 2006. Page 53. where Prof. I O Smith's view in his work "Secured Credit Transactions: Current Trends and Challenges" 2002. P5 that all loan by banks must be secured was criticized as not representing the position of the law. Smiths view was based on S.19(1)(a) of the Failed bank {recovery of Debts) and other Financial malpractices in Banks Act Cap F2 vol 6 LFN 2004 .

[181] Ogunleye Ibid.

security like guarantee and indemnities. Real security is common in Nigeria due to the level of economic development and at the same time it is the fact that it provide fall back to lenders in case of default or insolvency and does not deprive borrower the right of use of the property. It is however expensive and tedious to create proprietary interest in favour of the lenders based on it because of the requirement of the consent of the Governor for any alienation of interest in land under Section 22 of the land Use Act[182]. Loan recovery, realization and enforcement procedure under the Act is cumbersome a disincentive to commercial lending because it overlooked speedy nature required by commercial transactions. Incoherence and lack of clarity in formulating loan agreement with customers has also contributed to loan defaults by borrowers. Interest charged by banks is determined in principle by the CBN through its monetary policy guideline but in practice determined by business exigency and the power of supply and demand in the market . The CBN interest rate determines the cost of fund in the economy and influences the income of conventional banks and other financial institutions. Some banks in structuring loan agreement or statement of claims in court fail to note that interest rate issued by CBN in occasional circulars is not a matter to be taken judicial notice of under the Evidence Act . A bank cannot

[182] Cap 202 Vol. IX LFN 1990

therefore rely on CBN's Guidelines released from time to time to increase interest rate charged on its loan, except it

is provided for in the loan agreement . In **National Bank of Nigeria Vs Arison Trading and Engineering Ltd**[183] ,it was stated that in the absence of agreement between a bank and its customer, a bank cannot vary the interest rate on a loan granted to a customer to accord with the CBN guideline .In **Ogunlade Vs Federal Mortgage Bank of Nigeria**[184] the Court of Appeal applied an exception and held that a bank is at liberty to vary interest rate it charges its customer from time to time because in that case the deed of mortgage between the appellant and the bank provides for the right of variation interest by the bank. A bank should therefore reserve to itself in any loan agreement with customers, the right to change or vary the interest charged from time to time. In fact, interest on loan can only be claimed as of right by a bank where contemplated by the parties under a mercantile custom or under a principle of equity such as in a breach of fiduciary relationship. CBN tariff and Guideline on Fiscal Policy is also not a subsidiary legislation which Courts should take Judicial notice so must be pleaded

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[183] [2006] 16N.W.L.R Pt 1605 210 at 215. In this case the interest rate was raised from 9,5% to 21%. But see the case of Habib- Nig. Bank Ltd vs Gift Unique Nig Ltd [2005 All FWLR Pt 242 419 where the issue of whether bankers tariff Guideline and fiscal policy of the Federal government is subsidiary legislation of which the court must take judicial notice.

[184] [2007] N.W.L.R Pt 10171 p16 at 21

in the statements of claims. In **Hausa Vs FBN**[185] is a case under undefended list where appellant's claim is for N769,796.64k being principal and interest on a N70,000 overdraft granted appellant in 1985 at the rate of 21% per annum. Appellant deposited title deed of a premises known as "Wura Howa " in Yola to secure the loan. Trial court entered judgment for the bank and awarded interest on the judgment debt at 9% per anum until the liquidation. Appellant challenged the award of the judgment interest and it was held that such interest can only be awarded based on the powers conferred by the court or by statute. The court came to the conclusion by distinguishing between prejudgment interest which can be claimed as of right based on the agreement of the parties and post judgment interest that is awarded where statute confer on the court the power to do so in exercise of its discretion.

3.8 Corporate governance

It was stated while discussing the use of banking license as a tool for capital reconstruction in chapter 3. 5 above that the issue of banking license by the CBN is a condition precedent to conducting banking business in Nigeria. The CBN issues and regulates the use of banking license on behalf of the Federal

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[185] [2000] 9NWLR (pt 671) 64

Government. Bank shareholders invest money and nominate a board of directors to run the business on their behalf. The bank directors as agents of the shareholder elect among themselves the managing and executive directors to run the business on behalf of the shareholders on day to day basis. They also develop, design and implement the bank's policies. The executive directors select the top management of the bank to execute the strategies and plan of the bank's policies. Corporate governance is then used generally to control the managers and directors by investors so as to get maximum return on their equities[186]. Government enforces corporate governance principle to maintain control of the activities of managers of entities that drive the private sector of the economy to avoid corporate collapse. Corporate governance therefore dictates norms on how a company should be run to protect investors outside the realm of their proprietary right[187]. It is a set of business norms and practice that regulate behaviors of managers outside laws and regulations prescribed by statute.

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[186] The philosophy of maximum return is antithetical the interest of the depositors in banking business because of the risk it expose the depositors fund.

[187] See Agilietta M and Cobbaut R 'Financialisation of the Economy , Macroeconomic Regulation and Corporate Governance'' Kluwer Law International The Netherlands 2003 p.102 , In Corporate Governance an Institutional Approach where the view was held that in business discourse it is normally used to connote a set of principles of sound management that aim to delimit the power of company managers and to align their interest with the interest of the shareholders .The interest was explained in a juridical context by another writer to mean just dividend which is something less than profit because profit is what normally accrue to a person acting as an entrepreneur who assumes four functions of : tackling uncertainties of managers by organizing the business; of a capitalist by owning the means of production; and of workers. The view is in consonance with the provision of CAMA Cap C20 Vol.3 LFN 2004 which state that dividend is paid only where declared by the Directors and the provision of BOFIA which prohibit payment of dividend from the capital of the company .The impersonal nature of profit in public

One major challenge to good corporate governance in Nigerian banks has been the problem of looting of bank's assets by some management staff of the banks. The case of **Federal Republic of Nigeria vs Odogwu**[188] decided by the defunct Failed Bank Tribunal Benin zone on 7th February 1996 is instructive. The accused was the Managing Director of Kapital Merchant Bank ltd (the 2nd accused) from its inception on December 1988 to revocation of its banking license on 21/12/94. A twenty- one- count charge was brought against him at the tribunal where it was alleged *inter alia* that he failed to declare his interest as a director of the bank and also of the companies to whom he extended credit facilities contrary to Section 45(1) of BOFID. That he permitted to remain unpaid, an unsecured advance of over N50, 000 to these companies contrary to Section 20 (2)(a)(ii) BOFID 1991. That he made false entry in the record of the bank by debiting the account of three customers to show that loan were made to them where as the loan was made to one customer contrary to Section 435(3)(b) of the Criminal Code .That he forged return on loans and advances made to the CBN showing that a cumulative sum of N60,763,190.00 loan was granted to three distinctive customer other than the one actual borrower thereby committing an offence

companies is one of the major reason for corporate governance and the strength of capital maintenance principle in limited liability companies .

[188] (1988) 4 Failed Bank Tribunal of Nigeria Law report .179

contrary to Section 456 criminal code Act. That he authorized loan in excess of the limit reserved by the bank's board contrary to S.12 (2) of the Banking Act 1969. That he stole $392,008.00 belonging to the bank by transferring same to the credit of another person with no naira equivalent of the sum paid to the bank prior to or at the time of the transfer contrary to section 390(7) of the Criminal Code Act. That he failed to keep control accounts of the profit accruing to the bank from foreign exchange transaction which enabled him to credit such profit to his companies.

The fact in **Federal Republic of Nigeria vs Odogwu** is similar to the case of **Federal Republic of Nigeria vs Mallam Bello Abubakar**[189] a decision on appeal from the Failed Bank Tribunal Lagos Zone delivered on 16/04/1996. The respondent the MD of Gamji Bank Plc was charged with 22 count charge one of which is that he diverted N15, 000, 000.00 meant for payment of brokerage by the bank to his private account in another bank contrary to Section 383(2(f) of the Criminal Code. There was no evidence from the record of the bank that the brokerage was paid.

The two cases illustrate the human factor and problems facing the banking industry in terms of corporate governance. Though the cases were decided over a decade ago, yet they remain a typical example of the problem of looting which

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[189] Ibid at pg 79

one economist noted took the centre stage in Africa in the mid 90s. In a comparative study conducted by Daumont in Nigeria, Kenya and Uganda , it was discovered that many of the banks liquidated during the period, were victims of looting by insiders lending that turned out to be irrecoverable[190].

No matter the amount of capital a bank has for its business, it can collapse in matter of time if its staff and directors continue to defraud it. Where loans are made or influenced by directors or officers of the banks to themselves or their companies with intention that the loans are not to be repaid, it will be difficult for such a bank to survive.

Looting is difficult to control because the looters operate at the margin of legality which makes it difficult for regulators to act even if they are aware of what is going on. A version of looting takes the form of using award of contracts to companies connected to the management or the directors to siphon the profit made by the bank. Where looting fails to satisfy the greed of some managers they may resort to fraud often at a higher magnitude in order to counter the risk of criminal sanction that may follow. To control looting and abuse of corporate powers stiff penalties must be meted to offenders. The provisions relating to punishment and sanction against regulatory infractions must have to be

[190] Daumont R etal Banking In Sub-Sahara Africa: What Went Wrong? IM F working PAPER wp/055.39

strengthened[191]. Inadequate punishment facilitates abuse of banking rules and regulations especially where application of monetary penalty or fine is preferred to other kind of punishment. Monetary penalty is not sufficient deterrence to banks flaunting the requirements of the laws because banks often make much profit from the infractions than the penalty they pay. It is suggested that where the impact on the society of non compliance with provisions of the law is far greater than the fine or monetary compensations prescribed against the infraction, punishing the hands that commits the offence will protect the industry better than imposing fine against the bank. However there is the danger that custodial punishment if unduly imposed will hamper the freedom of action which propels businessmen to think and act at their best. Solution to the problem lies in fashioning a kind of system that will deter and punish organization from breaching the regulatory provision without enabling them to benefit from the consequences of the actions.

As a result, suggestions have been made for review of the sentencing system as regards fine and penalties against breach of the provision of BOFIA and other

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[191] For instance failure to obtain the consent of the Governor before commencement of restructuring, reorganization , merger or disposal under S 7 BOFIA attract N1,000,000 and N10,000 for any day of continuance of the offence. This is not sufficient deterrent because a bank can afford to be paying the N10, 000 conveniently on daily basis. The same provision is provided against a foreign bank operating a branch in Nigeria without the approval of the Governor under S8 BOFIA. It could be argued that because the sections commences with the phrase "any person' that it the punishment is meant for the operators of the banks and not the banks however a look at section 3 of the BOFIA will show that the phrase as used by that section is referring to a limited liability company as a natural person cannot be bank in Nigeria by virtue of the provisions of that section .

related financial matters. C J Coffe, though not writing in respect of our banking system, advocates that instead of sentencing a company to pay fines, the corporation should be made to issue a number of share to the state in lieu of fine [192]. The assumption is that the company has to forfeit a portion of its ownership and possibly its control to the state as a result of its act of omission or commission. It follows that more of such control or ownership will continue to be forfeited as long as the regulatory infractions continue. There is also the assumption that the company is a healthy going concern otherwise it will amount to the state sharing the misfortune of a failing concern in the form of a dying company. A part from that, the suggestion suffers the difficulty of compelling Government to compulsorily acquire interest in the running of a company outside its role of providing enabling environment for business to grow. There is the" superadded liability "recommendation by Kennedy which advices that where a company cannot pay a fine, the shareholders should liable to the unpaid balance[193] . Implicit in the suggestion is that fine should be heavy and where it cannot be paid by the management acting as agent of the shareholders, the

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[192] Coffe, J C "Making the Punishment Fit The corporation: the problem of funding. An Optimum Corporate Criminal Sanction (1980) 1 Northern Illinois University law Review 3 at 21 quoted from [192] Omoniyi I O <u>Corporate Criminal Responsibility</u> : Problems and Solutions in Modern Practice Journal of Finance and investment ,Law Nigeria and International A comparative Review of Law and practice. Vol. 10 No 5 -1-2 January/April 2006. P75.

[193] Kennedy, C Criminal Sentencing for corporations Alternative Fining Mechanism (1985) 73 Fornia Law review 443 at 488-478. Quoted from Omoniyi Ibid.

shareholder as principal shall be made to pay. Super added liability runs against the currency of limitation of liabilities in corporation and if followed would introduce risk beyond the contemplation of a reasonable man or investor[194].

There is the remedial fine system suggested by Omoniyi[195] which in effect amount to a company making financial restitution to cover the cost of solving the problem it created as a result of breach or regulatory infraction committed. This suggestion is similar to the present practice where such fines are paid to the Consolidated Revenue Fund or shared between the NDIC and the CBN. The suggestion assumes that offenders have the capacity to pay the fine otherwise a case should be made for Government nationalization or liquidation of such bank. It is also the assumption that such fine would serve as sufficient deterrence to the bank. Finally, there is the recommendation of withdrawing the bank or company's license for a certain period in order to restrain it from business or criminal activities. While this suggestion commends itself to a service oriented company it certainly should not be applied to a bank in order not to jeopardize depositor's confidence. A bank under suspension will certainly suffer a run anytime it opens its door for business which may spread to other banks in the system.

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194 See the principle in Salomon v Salomon [1897] AC22.

195 Omoniyi I O, Corporate Criminal Responsibility : Problems and Solutions in Modern Practice Journal of Finance and investment Law Nigeria and International A comparative Review of Law and practice. Vol. 10 No 5 - 1-2 January/April 2006. p59.

3.9 Independence of Central Bank of Nigeria

In Nigeria, the Governor of CBN is under the Minister of finance in matters of banking operations and regulations. The duties and functions of the CBN under BOFIA is subject to the overall supervision of the Minister[196]. This arrangement is a true reflection of the impossibility theory of Coleman is a potential source of delimitation of the power of a central bank

Governor William Coleman,[197] following the view expressed by Friedman states that a central bank cannot be independent in the real sense of the word as such independence would "appear to founder on the impossibility of a sovereign power tying its hands"[198]. Colman's view reflects in legal framework establishing the operation of most Central banks. To promote monetary stability and sound banking system demands as has been discussed above, a disciplined fraud free corporate environment, good and disciplined credit recovery culture and laws. It also requires flexible statutory laws and readiness of the regulatory authorities

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[196] S.1 BOFIA Cap B3 LFN 2004

[197] Coleman W, Is it possible that an Independent Central Bank is Impossible? The case of the Australian Note Issue Board 1920-1924. Journal of Money, Credit and Banking. Vol.33. No3 August 2000.p729.See also Friedman M "Should there be an Independent monetary Authority?"In : The Search of a Monetary Constitution, edited by L. Yeager. Cambridge: Harvard University Press 1960.

[198] Ibid

to facilitate prompt reconstruction of bank capital in case of distress. When a central bank is not independent, it is difficult to achieve these aims. The CBN Governor does not seem to have direct report to the President in matters falling under the BOFIA as is the case under the CBN Act. This should not be the case because the subject of BOFIA covers matters relating to the regulation and operation of banks in the banking system which directly impact on the duty of the Governor to maintain sound financial system in Nigeria under section 2 of the CBN Act. The Governor need full independence to maintain and enforce the provisions of the BOFIA so as to maintain a stable banking system. Lord Loynes stated this emphatically in his report on the establishment of CBN in 1957. He said that the Bank "must be liquid at all times… and as a national institution its management must be above sectional politics"[199]. In the same reports another member Lord Daldry said the monetary technique and weapons in years to come must be based solely upon the good of this country and never upon political expediencies.

[199] See Adaighofua Ojomaikre 'FMF ,CBN, federalism and economic ' The Guardian Vol.25 No 10667 ,Tuesday March 11,2008, p94. Where it was argued that full implementation of the provision relating to cash reserve ratio by CBN against the banks will eliminate fiscal indiscipline by the federal and other tiers of government and will bring macroeconomic stability and growth and ensure the dominance of the private sector in the economy. See 20 years of central banking in Nigeria published by CBN 1979.p43

3.10 Nigerian Deposit Insurance Corporation[200]

The Nigeria Deposit Insurance Corporation was established on the 15th of June 1988 by Decree No 22 of 1988 to protect depositors in the event of bank failure and to promote savings, and banking habits in Nigeria. In other words, the main duties of the NDIC is to insure some class of deposit in deposit money banks in Nigeria and to assist the CBN in caring out its supervisory roles in the banking system. The Corporation was established as a preemptive control measure against anticipated bank failure that would follow the introduction of Structural Adjustment Program (SAP)[201] in 1986. In relation to banking business, SAP deregulated the business of banking in Nigeria by loosening administrative control in issuance of banking licenses. True to the expectation of the government, the liberalization policy caused bank failures as businessmen with little or no banking skill were issued with banking license which enabled them to enter into the banking arena with little or no experience[202]. In the 1950s when free entrance and exit was first practiced in Nigeria banking system ,many banks collapsed and depositor confidence in the banking system was eroded . To prevent a repeat of that experience, Nigerian Government decided to

[200] NDIC or the corporation

[201] The Federal Government of Nigeria introduced structural adjustment program in 1986

[202] See Umoh P N Bank Deposit Insurance in Nigeria, Page Publishers Services ltd Abuja 1997P.47

put the NDIC in place. There was also in existence at the time, thriving deposit insurance scheme in other parts of the world which helped in stabilizing banking system of those countries from distress and shocks. This further acted as an encouraging factor for the idea of establishing a deposit insurance scheme for Nigeria[203].

3.10.1 <u>The Board of the Nigeria Deposit Insurance Corporation</u>

The board of NDIC is made up of a chairman, a managing director and seven other members. The CBN and the Federal Ministry of Finance each

nominated a member to the board[204]. The board has power to manage and superintend the affairs of the corporation.[205] It oversees the administration and formulation of policy for the corporation and can make ,alter or revoke rules and regulations for carrying on the businesses of the corporation under the Act[206]. It may remove from office or/and prosecute any officer or director of a bank for

[203] Opcit P.49. Some of the countries include Czechoslovakia and the United States of America. The former was said to have introduced deposit insurance in its system as far back as 1924.The USA started its own in 1933 (Federal Deposit Insurance Corporation FDIC) which turned out to be the major resource for the establishment and training of the staff of NDIC.

[204] S.2 (2) (a-f) Nigerian Deposit Insurance corporation Act Cap N102 lFN 2004

[205] S.4(a) Nigerian Deposit Insurance corporation Act Cap N102 lFN 2004

[206] S.4(b) (d) Nigerian Deposit Insurance corporation Act Cap N102 lFN 2004

violating the provision of the Act[207] .It can assume the management of a failing bank but must inform the Minister

Of finance of the action that it intends to take as regards the assets and

liabilities of such a bank[208]. It has the power to advise the Minister of Finance on the need to close any bank whose continued operation may jeopardize the interest of depositors[209] . Where a bank has failed, it has the power to appoint claim agents to investigate claims on the insured deposits[210]. It can sell or arrange for the sale of assets of a failed bank and can act as a receiver for a failed bank[211].

3.10.2 <u>Functions of the Nigeria Deposit Insurance Corporation</u>

The corporation functions *inter alia* to engender and prevent

damages to the public confidence in the banking system and to assists the

monetary authorities in the formulation and implementation of banking

policy so as to ensure sound banking practice in Nigeria. The NDIC Act

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[207] S.4(m) Nigerian Deposit Insurance corporation Act Cap N102 lFN 2004
[208] S.4(i) Nigerian Deposit Insurance corporation Act Cap N102 lFN 2004
[209] S.4(g) Nigerian Deposit Insurance corporation Act Cap N102 lFN 2004
[210] S.4(k) Nigerian Deposit Insurance corporation Act Cap N102 lFN 2004
[211] S.4(f) Nigerian Deposit Insurance corporation Act Cap N102 lFN 2004

provides that; "the Corporation shall have responsibility"[212]for insuring deposit liabilities of licensed banks and such other financial institutions operating in Nigeria "so as to engender confidence in the Nigeria banking system.[213] This responsibility on the part of the corporation is the basis of the duty or statutory obligation of the banks to insure their deposit with the Corporation[214]. In times of bank distress, the corporation can take three main actions against an insured bank depending on its assessment of the capital, assets, earnings management and liquidity position of the bank.

It can deny or terminate the status of insurance of such a bank. It can issue such bank with a 'cease and desist order' where the bank is engaged in any dealing or practices the Corporation think is inimical to the interest of the depositors and finally, it can suspend or remove a director or officer of such bank from office.

3.10.3 How NDIC manages Banking distress

When a bank goes into distress, the real task of resolving the crisis is often

[212] S.5 Nigerian Deposit Insurance corporation Act Cap N102 lFN 2004
[213] Deposit by staff of the bank and from public sector organization are not insured by the corporation.
[214] S.5(a) Nigerian Deposit Insurance corporation Act Cap N102 lFN 2004

handled by the National Deposit Insurance Corporation NDIC. The Corporation employs four main steps in the management of bank crisis: The first is to compel the bank to hold action in taking deposits from the public creating loans or liability, and to request a capital reconstruction plan as discussed above from the bank. The objective of this measure is to enable the bank and the supervisory institution to analyze and diagnose the cause of the distress and to agree on how to resolve it. The second step is to attack the problem identified by applying either reconstruction or restructuring technique to the problem. Where reconstruction or restructuring fails resort may be had to receivership and finally the bank may be liquidated.

3.10.4 Bank Restructuring by NDIC

The restructuring activities of the NDIC is aimed at responding to distress and insolvency in the banking industry. It normally commence with a diagnosis of the problem of the bank, identification of the failure resolution mechanism applicable to the problem facing the bank ,determination of the kind of assistance necessary to salvage the bank, and monitoring the implementation of the terms and conditions of such assistance as well as the response of the bank to the measure. Open bank assistance, deposit pay off, bridge bank and purchase and assumption are options available to NDIC in its restructuring activities in a failing bank .

3.10.4 (a) <u>Open Bank Assistance</u>

The corporation normally gives assistance to a failing bank in the interest of the depositors in cases of imminent or actual financial difficulties of a bank, particularly where suspension of payment is threatened.[215] The provision of the Act is not clear as regards the kind of assistance the NDIC can give under this case and the condition that can qualify as financial difficulty for which the corporation's assistance shall be rendered. It can however be inferred from the Act that assistance to depositors comes in where a bank fails, suspends or threatens to suspend payments to depositors or where such an event is imminent. In such a case, payment to depositors by the Corporation to a maximum of N200, 000[216] in event of imminent or actual suspension of payment by an insured bank is provided by the Act[217]. Apart from paying the depositor of the insured sum, the Government may decide to use the Corporation to offer

[215] S.5(b) Nigerian Deposit Insurance corporation Act Cap N102 lFN 2004
[216] See section 26 Nigerian Deposit Insurance corporations Act Cap N102 lFN 2004.This has been increased to N200, 000.
[217] Ss 26,.5(c) Nigerian Deposit Insurance corporation Act Cap N102 lFN 2004

open bank assistance to rescue a failing bank toward recapitalizing it. It can lend to or guarantee a loan or accommodation to the bank to enable the bank continue to operate in it's old name as a going concern. Open bank assistance may lead to indiscipline by banks as it creates the impression that government cannot allow a bank fail in what has been described as "too big to fail syndrome". To maintain good will for banks and to encourage the habit and banking culture in a society, government may be compelled to fund open bank assistance. In Nigeria open bank assistance though not through NDIC was used during the consolidation of banks exercise in 2005 when the CBN extended some debt forbearance to some banks to enable them look attractive to investors[218]. In 2009 CBN made available N620 billion to bail out some distress bank from collapse The implication of the assistance is that in a worst case situation, the CBN would still intervene to rescue a bank or banks where to do otherwise would result to huge loss to the economy. It also goes to show that liquidation is not always the best option for resolution of distress in the banking sector.

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[218] An example of open bank assistance though not coming firm NDIC was when in 2005 the CBN had to offer N75 billion reprieve to eight weak and heavily indebted banks . The move generated wide spread criticism from the public but the CBN explained that investors were no longer interested in those banks because of their huge indebtedness to CBN itself that not to have done that would have amounted to liquidating the bank with the CBN losing everything. See 25billion Naira Capitalization: The Journey so Far and Its likely Implication on Nigeria on http://www .nigeriabusinessinfo.com/25billioncapitalization100705.htm

3.10.4 (b) Deposit pay off

Deposit pay off involves paying the insured deposit to the depositors of the liquidated bank by the deposit insurer like the NDIC . The uninsured deposit is ranked among other debts and paid from the liquidation proceeds after liquidation expenditure has been met. In a modified version of deposit pay off system, the deposit insurer transfers the insured deposit to another bank from where the depositors are encouraged to maintain banking relationship with the new bank. This system is employed to encourage banking habit for depositors some of whom if paid in cash may never have anything to do with a bank again. As practiced so far, in Nigeria deposit pay off has many problems starting from the long time it takes NDIC to verify customers balances in depositors account to the operational and administrative cost and delay in making the payment.

Deposit pay off imposes a lot of financial burden on the deposit insurer and is usually not popular with NDIC because of its poor financial status .

3.10.4 (c) <u>Bridge Bank Option</u>

The third option is the bridge bank option under which government may set up a new bank immediately at the premises of a failed bank to assume theassets and liabilities as well as the obligations of the failed bank. The

new bank retains the license of the old bank. Bridge bank option is less disruptive to the banking system and more favorable to the depositors but does encourage market indiscipline by banks as they know that where the bank fails Government will set up a bridge bank to pay the depositors. It is submitted that bridge bank option should be encouraged as it is less disruptive than other type of restructuring technique open to NDIC. It is in fact the only option that does not lead directly to liquidation. Deposits pay off and transfer of insured deposits always result into liquidation . Bridge bank option saves jobs and deposit from loss and reduces tension and runs on bank and anxiety on depositors. Its economic cost is less than its social cost. It is only required that the insurer should grow and have available skilled and experienced managers and management that can turn around the fortune of the bank with fresh capital in place . The fear often entertained by some deposit insurers against bridge bank option is that the bridge bank may turn not to be viable because of public perception and culture of the staff of the old bank . The fear relates to challenges facing

every bank. Banks that have poor public perception can reengineer its

image and business and will be patronized like any other bank if it can provide excellent customer service and add value to its customers. There is no known case of the use of bridge bank option in Nigeria. It is purchase and assumption that is popular in Nigeria.

3.10.4 (d) Purchase and Assumption Option

This option sometimes utilize some feature of merger transactions. In purchase and assumption, the asset of the failed bank is sold or split and sold to a buyer as "gone concern" after the revocation of the license. The spilt parts may be merged to different bank(s). The buyer may buy the whole of the assets or may pick and choose what to buy of the bank's assets. In the United States of America the buyer is allowed to take over the license of the bank. This should be the case in Nigeria as it will allow for easy sale of such banks because a bank is considered dead once its license is revoked . A bank is worth more alive than dead. Purchase and assumption takes a long time because the negotiation and due diligence exercises involved is time consuming. The major disadvantage however is that it does not encourage market discipline on the bank. It is mostly practiced in Nigeria today because it is a less costly resolution process to NDIC and not because of its comparative benefit to the banking system. In the case of merger compelled by this option, the Act provides that the acquiring bank shall pay insured deposits held by the failed bank[219]. Section 7 of BOFIA[220] which prohibits any kind of restructuring, reorganization, merger and disposal of a bank without the approval of the

governor is inapplicable in purchase and assumption option.

3.11. Receivership

The major statutory laws for bank resolution namely the BOFIA, NDIC Act

and the CAMA did not define a receiver. The CAMA merely stated in S.650 that a receiver includes a manager. The NDIC Act stated that a receiver means NDIC or such other persons appointed by it to act as a receiver[221] . Section 28 of the same

[219] S.34(b) Nigerian Deposit Insurance corporation Act Cap N102 lFN 2004. See also http://www.ndic-ng.com . Purchase an assumption has been used in concluding the following cases Ecobank Plc acquired the assets of All States Trust Bank. Afribank acquired the assets of Assurance Bank and Lead Bank
[220] LFN 2004
[221] S.46 Nigerian Deposit Insurance corporation Act Cap N102 LFN 2004

Act stipulated the power and the extent of the liability of NDIC as a receiver[222] .A receiver is however defined by the Black's law dictionary as "A person appointed by a court for the purpose of preserving property by a debtor pending an action against him or applying the property in satisfaction of a creditor's claim whenever there is danger that in the absence of such appointment the property will be lost, removed or injured". The definition it has been pointed out is restrictive because debenture holders can appoint receivers or manager even without a pending suit[223]. The receivership aspect of the NDIC function starts only where the license of a bank is revoked by the CBN or where the insured status of an ailing bank is terminated as a result of the bank's inability to meet the demand of its depositors. On the approval of the Minister of Finance NDIC acts as a receiver of such bank and can appoint an agent to assist it in the performance of its duties as a receiver[224]. The CAMA does not seem to contemplate a situation where a receiver in the nature of the NDIC or other corporate body may be appointed as a receiver for the whole of a company by a party other than the debenture holders .Though mention was made in S.388 CAMA of the power of the court

[222] It provides that the corporation is discharged from liability to an insured depositor once the insured sum is paid or transferred to a new bank for the benefit of the insured . Except such a depositor claims his money within 18 months of it the corporation shall be discharged from liability.
[223] See Uwakwe v Odogwu [1989] 5 NWLR Pt 123 ,562at 569.
[224] Ss. 28(1) and 29 NDIC Act CAP N102 LFN 2004.

to appoint official receiver for debenture holders and "other creditor " of the company being wound up , it is clear that the interest of bank depositors would be better protected under NDIC as such than within the contemplation of "other creditor "as used in the section. The duty of the receiver under CAMA is subject to right of prior encumbrance, to take possession of and to protect the property, receive the rent and profit and discharge all out-goings and realize the security for the benefit of those on whose behalf he is appointed[225]. That of the NDIC under the NDIC Act is not clear[226]. In practice once a bank is closed without adequate provision made for the payment of its depositors, NDIC normally would advertise and request depositors to forward their claims and proof for payment subject to the Corporation right of subrogation against the failed bank[227].

NDIC as the receiver realizes the assets, enforces the individual liabilities of the shareholders and directors of the failed bank before winding up the affairs of the bank[228] . It is after recovery of the sum paid to insure depositor as subrogation and after meeting all the expenses of liquidation and realization of the assets of

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[225] S.393 CAMA Cap C20 Vol.3 LFN 2004. The section provides that except a receiver is appointed a receiver as well as a manager he shall not have power to carry on any business or undertaking of the company.
[226] S.28(1) NDIC Act with short title "Corporation as a receiver and power to appoint agent" provides that the Corporation shall subject to the approval of the minister act as a receiver of a failed bank and appoint an agent to assist it in performance of these duties . The duties were not stated.
[227] S.27 Nigerian Deposit Insurance corporation Act Cap N102 LFN 2004
[228] S.25 Nigerian Deposit Insurance corporation Act Cap N102 LFN 2004

the bank that uninsured depositors and other creditors are ranked and paid out of the balance of the net amount realized from the asset of the bank[229].

Compared to the official receiver under the CAMA, the receivership function of NDIC is different from the function of the official receiver under the CAMA. In the CAMA only a person appointed as a receiver and manager has the power to carry on the business of the company but the power to carry on the business of a bank by NDIC is exercised when it takes over the control of a failing bank under S.36 of BOFIA. Under such condition it can carry on the business of the bank in the name and on behalf of the bank until such a time as in the opinion of CBN it is no longer necessary for the Corporation to remain in control of the business of the bank.

3.12 The Securities and Exchange Commission (SEC)

The Securities and Exchange Commission (SEC or the Commission) is a regulatory agency charged with the responsibilities of surveillance over securities market and the review, approval and regulation of mergers, acquisitions and all forms of

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[229] S. S.25 (3) Nigerian Deposit Insurance corporation Act Cap N102 LFN 2004 and subsequently by S.314 (1) of ISA 2007.

business combination in Nigeria. It was established with retrospective effect from April1 1978, by Decree No 71 of 1979[230] in response to the recommendation of a financial system review Committee. After the establishment of Lagos Stock Exchange in 1960, a Capital Issue Committee was established in 1962 under the CBN to examine and appraise requests from companies seeking funds from the Stock Exchange. The committee operated until March 1973 when it was replaced by Capital Issue Commission. The commission was established due to increased economic activities generated by the promulgation of Nigeria Enterprises Promotion Decree 1972. In 1979 SEC Decree was promulgated with retrospective effect to regulate and develop capital market in Nigeria. The enabling Decree has undergone some amendment[231] occasioned by the need to promote a virile and efficient capital market for Nigeria. In 1999 it was amended to Investment and Securities Act[232]. The Commission regulate financial market activities , creates public awareness of securities investment industry in Nigeria , protect inventors and participants in the capital market and controls financial crime so as to build public confidence in Nigeria capital market.

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[230] Repealed by Decree NO 29 of 1988 Cap 71 LFN 1990.
[231] The Decree No 79 of 1979 was reenacted in 1998 as SEC Decree No 29 of 1988 and amended in 1999 as Investments and Securities Act.
[232] Act No 45 of 1999.

3.12.1 The Composition, Function and Powers of SEC

The Commission has a board of 11 members headed by a Chairman[233]. It has a Director General as its Chief Executive[234], two Commissioners who are full time staff and five part time members[235]. The CBN and the Federal Ministry of Finance are represented on the board by a member each.

As the apex regulatory body for the Nigerian Capital market the Commission promotes and register self-regulatory organizations in the capital market, trade associations, investments and securities[236]. It has a duty to register and regulate Security Exchanges, Capital Trade Points[237], Derivatives Exchanges, Commodity Exchanges and other Investment Exchanges[238]. It also registers securities to be offered for subscription or sale to the public. SEC prepares guidelines and disseminates information necessary for the establishment of Securities Exchanges and Capital Trade Points. It registers and regulates corporate and individual capital market operators, the workings of venture capital funds and collective

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[233] Appointed by the president on the recommendation of the Minister of Finance.

[234] S.10(10) Investments and Securities Act Cap 124 LFN 2004. He is responsible for the day to day administration and control of the employees of the Commission.

[235] See section 2 (1)-(3)

[236] S.8(a)

[237] Section 264 Securities and Investment Act Pt XVI Cap 124 Revised LFN 2004 defined Capital Trade Points as an exchange registered by the commission pursuant to the Act which constitutes, maintains or provides market place, facilitates s for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the function commonly performed by a Stock Exchange.·

[238] See Section 20 (1) Investments and Securities Act Cap 124 LFN 2004 which states that no Securities Exchange or Capital Trade point shall commence operation unless it is registered with the commission

investments schemes and the issue of pubic offers. It facilitates securities trading in the Nigerian capital market and sees to the protection of investors and maintenance of fair and orderly market by prohibiting trading in some securities in public interest. It facilitates the linking of all markets in securities and makes information available to brokers, dealers and investors. SEC registers and regulates central depository companies , clearing and settlement companies, custodians of securities, credit rating agencies and other agencies and intermediaries. It reviews, approves and regulates mergers, acquisitions and other forms of business combinations in Nigeria. In summary, SEC provides avenue that facilitates exchanges in the capital and commodity market.

3.12.2 <u>Investment and Securities Tribunal (IST)</u>

Investment and securities Tribunal (IST) was established to exercise jurisdiction, powers and authority under the Investment and Securities Act[239] . The tribunal consists of a chairman and 9 persons called “Capital Market Assessors”. It operates from a secretariat administered by a secretary appointed by the Minister of Finance. [240]. But the secretary reports to the Capital Market

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[239] See Section 224 SEC Act Cap 124 LFN 2004.
[240] See Section 225 SEC Act Cap 124 LFN 2004

Assessors[241] . It is provided in the Act that a person to be appointed as a Capital Market Assessor must be knowledgeable in laws, regulations, norms and operations of the capital market. The tribunal has exclusive[242] power to adjudicate on disputes, and controversies arising from the rules and regulation made under the Act[243] . In particular, it adjudicates on matters relating to the interpretation of laws and regulations to which the SEC Act applies and on disputes between parties in the capital market. The origin of this adjudicatory power can be traced to 1973 when the Central Bank of Nigeria established the Capital Issue Commission (CIC) to regulate the activities of all participants in the Capital Market .Appeal from the CIC lies to the Federal Commissioner of Finance. It was followed by the Securities and Exchange Commission Act of 1979, which was repealed by the Securities and Exchange Commission Act of 1998. The 1988 Act vested the Federal High Court with jurisdiction over offences arising from capital market transactions and created the Administrative Hearing Committee to resolve all disputes arising from transaction in the capital market. Appeal lies from the Commission to the Federal High Court. In 1999 the Investment and Securities Act was promulgated under which the Investment and Securities Tribunal(IST)

[241] See Section 231 SEC Act Cap 124 LFN 2004
[242] S.224(2) conferred exclusive jurisdiction on the tribunal on matter enumerated under the A ct and not even an injunction can be granted by any civil court on issues that fall under the jurisdiction of the tribunal.
[243] See Section 234 SEC Act Cap 124 LFN 2004

was created as a tribunal with powers to adjudicate on disputes and controversies from the Act and regulations made therein[244] thus leaving the Securities and Exchange Commission (SEC) with just administrative powers to adjudicate on complaints arising from transactions in the capital market through the Administrative Proceeding Committee (APC). Appeal lies from the (APC) to the IST though parties can appeal directly the IST.

The IST is mandated to conduct its proceedings in such a manner as to avoid undue delay and is expected to dispose of any matter before it within three months from the date of commencement of the action. Proceedings of the tribunal are deemed to be judicial proceeding and the tribunal is deemed to be a civil court for all purpose[245]. For the purpose of discharging its functions, the tribunal has powers to summon and enforce attendance of any person and to examine any person on oath; require the discovery and production of documents; receive evidence on affidavit and call for the examination of witnesses or documents[246]. The tribunal has power to review its decisions and to decide matters before it exparte . It can do anything which in its opinion is incidental or ancillary to its functions under the Act. A person appearing before the tribunal

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[244] See Section 234 ISA Cap 124 LFN 2004
[245] See Section 237(3) ISA Cap 124 LFN 2004
[246] Section 237(2) ISA Cap 124 LFN 2004

has a right to legal representation by a legal practitioner or in the case of a company by its officer. Chartered Accountant, Stock brokers and even financial advisers all have right of audience before the tribunal. Appeal to the tribunal can be made in writing and an award or judgment of the tribunal is enforced as if it is a judgment of the Federal High Court. Appeal against the judgment of the court on point of law lies to the Court of Appeal. The view has been expressed that the power of Investment and Securities Tribunal to adjudicate on matter relating to ISA is not to the exclusion of other courts. That the federal High Court remains the appropriate court to review and sanction merger schemes and that in the face of S.251 of the Constitution of the Federal Republic of Nigeria which confers exclusive jurisdiction on the Federal High Court in respect of matter of Federal enactments relating to commercial and industrial monopolies[247] . Notwithstanding the above observation, the Investment and Securities Tribunal has decided many case relating to the regulation of activities of participants in Nigerian Capital market. Two decisions have contributed in building transparency and strengthening the integrity of the market.

[247] Olatujoye A. Bank Consolidation in Nigeria Legal Challenges: In Regulators' Perspective Proceedings of the 2006 National Seminar on Banking & Allied Matters for Judges organized by the Chartered Institute of Bankers of Nigeria in Collaboration with the National Judicial Institute at Ritz Hotel Abuja on 4th December 2006. Page 31.

AG Olisaemeka v Securities and Exchange Commission[248]was an action that sought the order of the Investment and Securities Tribunal to set aside the decision of the APC for breach of fair hearing provision of the 1999 Constitution and to restore all the right and privileges of the appellant in the capital market. Appellant was a staff of Apex Securities Ltd. Sometimes in November 2002 the company was invited for questioning by the police in respect of investigation of large scale fraud involving UAC Plc shares after which i*n July 2003 SEC wrote to the company suspending the appellant from the trading floor of NSE. On July 26th* Apex Securities Ltd *was invited to the Administrative Proceedings Committee of SEC. Appellant was told by the Managing Director of* Apex Securities Ltd to *represent the company*. During the meeting appellant was queried on personal matters and the alleged falsification of the signature of the Managing Director of the Company in the UAC share scam. He was found guilty of complicity to perpetuate fraud in the capital market, banned from operating in the capital market and was handed over to the Economic and Financial Crime Commission (EFCC) for investigation and prosecution. On appeal ,the tribunal set aside the suspension and subsequent ban of the Appellant from the capital Market on the ground that the SEC letter suspending the Appellant was not issued in

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[248] (2007) 2Nigerian Investment and Securities Law reports p. 177

accordance with S.29(7) of the Investment and Securities Act. That overwhelming evidence show that the Appellant was not invited to the main APC meeting where the decision to suspend him was taken. That the tribunal violated the rule of *audi alteram partem* In **CSCS & Others Ltd V Bonkolas Investments ltd & Others** [249], Applicants sought to be indemnified by the Respondents for losses suffered for clearing some shares whose genuineness the Respondent guaranteed and undertook to indemnify the Appellants against all liabilities for its transfer. The facts of the case are that sometimes in1992, it was discovered that some stock broking firms cleared and sold some share certificates of Nestle PLC which was fraudulently introduced into the Appellant depository. On investigation it was discovered that the shares were sold through the Respondent and that the collusion of the staff of the Appellant account for the success of the fraud. The APC found that the negligence of the Appellant principal officers in exercising due care and in supervising their staff facilitated the introduction of the share certificates into the Appellants depository system. The Appellants and Union Bank Registrars were found to be primarily liable to jointly restore the affected investors to their original position before the scam in the Nestle shares. They were found negligent for failing to re-verify dematerialize certificate sent to it by

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[249] (2007)2Nigerian Investment and Securities Law reports p. 95

CSCS in accordance with market practices as a result of which they are liable to compensate those who lost their investment in the scam.

3.12.3 Securities and Exchanges Commission ,Investment and Securities Tribunal and Capital Reconstruction

The level of development of a Stock Exchange in a free-enterprise's economy reflects the state of the economy in general, its fundamental strength or weakness and its growth potentials[250]. This explains why capital markets and Stock Exchanges all over the world are highly regulated with the primary focus on investors' protection. For instance, all securities offered to the public must be registered with SEC. Similarly, the secondary arm of the market is regulated by both the Securities and Exchanges Commission and the Nigeria Stock Exchange. The later is a self regulatory entity. Companies' securities, for instance, may only trade on the exchange after the company has met rigorous requirements of the Exchange, known as listing requirements. This measure ensures that participants in the Stock Exchange comply with the ethics and rules of the Exchange. The secondary market is where instruments subscribed for in the Primary market are

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[250] Onosode Opcit page 251

traded. The existence of the secondary market or Stock Exchange facilitates activities in the Primary market. It affords those who have invested in the Primary market opportunity to relinquish their holdings when necessary. It provides liquidity and encouragement for subscriptions in the primary market. The markets are closely linked to the banking system such that any negative activity in one affects the other

The SEC and the IST have played vital role in promoting economic development the capital market. For capital reconstruction in bank to serve as viable alternative to liquidation in the banking system an enabling environment must be created where banks can tap resources or fund their capital. The capital market provides an avenue where the surplus units of the economy interact and lend to the deficit unit of the economy. The surplus units are those investing what the deficit unit's needs to fund their capital. The consideration for the exchange of such funds includes dividend, interests, and options. The security of these forms of consideration must be assured and its continuity reliably guaranteed for an investors to participate in the market and for banks to be able to recapitalize from the market. Security of investment in the capital market is vital for the financial system in general and the banking system in particular. The IST and SEC are therefore playing vital role in fostering the growth and development of the capital market. .The ruling in **CSCS & Others Ltd V Bonkolas Investments ltd & Others** discussed above is commendable. Transaction involving dealing in shares and other securities should be conducted in full compliance with the rules of the market[251] including rules and regulation made by SEC and those made by other organizations authorized by SEC by virtue of its enabling powers. SEC must take all necessary measures to curb cases of misappropriation of client's money by some market operators, non remittance or late remittance of issue proceed by issuing houses and non registration of share or stock brokers[252] .Delay in sending share certificate or return monies to subscribers and the problem of unclaimed dividends should be solved if the market is to serve its purpose [253] . Sharp and fraudulent manipulation of prices and other activities by some market participants like stock brokers, registrars and other operators in the capital market should be curtailed. Cases of price and market manipulation and insider's abuse are on the increase and has contributed to the sudden clash of the market[254]. Unfortunately the sanction provided against these irregularities

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[251] See Summit Finance Co Ltd V Iron Baba & Sons Ltd(2003) N17 NWLR Pt 808 at 89.
[252] See [2004]NISLR.PP6-18
[253] SEC recently set up a committee headed by Mr. Bayo Olugbemi to review some of these problems including the possibility of using courier companies to dispatch share certificates and the redesign of application form to include home address of subscribers. See Gbenga Agbana SEC inaugurates Committee on registrars, IT and infrastructure. The Guardian,Vol. 5 No 10,648, Thursday February 21 2008.p.20.
[254] See Okereke- Onyiuke faults SEC's probe of Six Firms The Guardian,Vol. 5 No 10,648, Thursday February 21 2008.p.19. The firms being investigated are African Petroleum Plc, Afro oil Plc, First Aluminum Plc Capital Oil Plc and IPWA Plc.

appears not to be sufficient deterrent to some participants[255]. This calls for stringent enforcement of rules regulating the market. SEC must drill down the market structure to eradicate the problems of unauthorized or fraudulent sale of share by stock brokers, illegal transfer of shares by operators, non remittance of proceeds of shares sold by stock brokers, non purchase or undue delay in purchase of shares on behalf of the investors by stock brokers. This primarily is the duty of the Nigerian Stock Exchange as a self regulating entity but SEC must have to stamp its feet in ensuring that these duties are carried out diligently. Investor's confidence is highly essential for effective functioning of a Stock Exchange and the capital market.

[255] Section 87 of SEC Act provides that contravention of Ss. 81-85 which deals with false trading and market rigging activities is punishable with a fine of not less than N500,000 or/and a term of imprisonment ranging from one to three years.

CHAPTER FOUR

REGULATION AND CONTROL OF BANKS IN NIGERIA

4.0 Introduction

The legal and institutional mechanisms for capital maintenance in Nigerian banks were discussed in the last chapter. It was noted in the chapter that during the banking crisis of the early 1990s some banks were liquidated by the NDIC due to bad loans, poor management and poor corporate culture practices. This chapter is set to consider how merger and acquisition can be used as a strategic survival device by a bank in time of crisis. It starts by reviewing the impact of regulations in the banks as well as the interrelationship of liquidity and distress management; capital and money market as well as how crisis in one of the system can affect the other. The last consolidation program of the Central Bank of Nigeria is discussed and appraised with emphasis on how mergers, acquisitions take-overs and other business combination methods can be used to resolve future crisis in the banking system. The introduction of mergers and other kinds of business combination came with the challenges of protecting the contracting parties from legal problems that had scuttled mergers and acquisition in some companies. Consequently, emphasis was laid on the importance of diligence in business combination. Mergers create permanent or lasting changes in corporate entities that drive an economic system more than contractual agreements. In some cases, like the banking system, it reduces the numbers of operating units in the system while in others it integrates the operating components in a more close relationship that may result in squeeze out or foreclosing competition from the industry. Hence, there is the need for a virile antitrust enforcer, a role now played by Securities and Exchange Commission in addition to regulating securities and exchanges in the economy. This chapter therefore considers possible factors that should be the concern of the Securities and Exchange Commission in approving or declining request for mergers and take-over under the Investments and Securities Act (ISA)[256]as it affects the banking industry in particular. This is because in the final analysis the power to approve mergers and acquisition in banks seems to lie with the Securities and Exchange Commission in view of the provision of the (ISA) which stated that every business combination including those consummated by virtue of authority conferred by any Federal Government owned Agency under any statutory provision must be reviewed and approved by the Securities and Exchange Commission[257]

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[256] Investment and Securities Act 2007
[257] S.118(4) Investments and Securities Act 2007.

4.1 Liquidity and distress management

Liquidity refers to the ability of a bank to meet its financial obligation to customers on demand. This obligation could come from customers' demand for withdrawal of their deposits or request for loan facility from the bank[258]. A bank can fund its liquidity from internal sources like loan repayments, the sale of marketable securities, receipt of equity fund or from external sources like savings and deposit mobilized from depositors, borrowing from the CBN or the interbank market. The amount of loan asset it can create is a function of the liquidity under its control. Consequently, when banks lose money, they source for more funds to match the proportion of their loan assets that is no longer covered by deposit as a result of their loss. In ordinarily time, the money market provides this fund but during systematic liquidity crisis, the money market sources will dry up as banks hoard fund instead of lending to each other. As soon as the money market is dried up and banks stop lending to each other, credit crisis will set in because short term fund suppliers will be running on the banks for their funds. The run normally start from the whole sale fund owners who constitutes major source of liquidity in the market. At that point even commercial papers will dry up and borrower will be starved of funds. The situation will become worse if it compel

[258] Wariboko N supra. p.53.

the banks to recall their loan assets from the economy. The time lag between when a depositor or major depositors may call for their deposit from a bank during crisis and the time within which a bank can call in a loan made from the deposit from its debtors makes banks vulnerable to sudden collapse. The gap may force a bank to shrink its balance sheet faster than it can manage and accounts for the inability of some banks to survive liquidity crisis without government intervention.

The lag arises from the fact that the banker is neither in control of loan he granted to his customer nor the movement of deposit placed in his bank. To the depositor the banker is a debtor. He receives the money from depositors without providing security. The confidence of the depositor on him that he will be paid is based on the integrity and honour of the banker. The banker in turn may lend the depositors moneys to borrowers with or without collaterals. Unlike the borrower, the banker is bound to make payment on demand by the customer, of the amount not exceeding the customer's credit balance[259].This he must do whether or not the loans he made with depositors funds has been repaid. The implication of this banker customer relationship is that deposits may be subject

[259]See Goldface-Irokalibe I J , Law of Banking in Nigeria, Malthouse Press limited Lagos 2007.p.40-47.See also Folley v Hill 918480 2 H.L Cas 28;9ER 1002 ,Joachison v Swiss Bank Corporation 1921 10 KB110 and Yusuf v Cooperative Bank (1994)9 SCNJ67

to sudden withdrawal without notice on slight adverse press report or rumors of crisis. The effect of loss of deposit by a bank and the illiquidity it can cause can be heightened by the fear of the depositors regarding uncertainty as to the scale of risks or loans the bank and the banker's ability or capacity to collect it. Banks with high leverage and high reliance on short term or whole sale fund rather than retail deposits are at more risk during liquidity crisis.

4.1.1 Liquidity Management

Liquidity management in the banking system is carried out essentially by the monetary authority with the Governor of the CBN. Individual banks conduct their liquidity management through the treasury department and the Asset and Liability committee set up for that purpose. The objective of liquidity management is to guide against a bank or banking system running into illiquid or insolvency problem. A bank is considered illiquid where its current account with CBN is overdrawn and not covered by the next working day consecutively for five days in one month or where such a banks suffers adverse clearing settlement for five consecutive days without adequate cover to the extent that recourse had to be made to its clearing collateral. Another sign of illiquidity is where a bank is a net taker of fund in the interbank market of up to 25% of its total deposit.

In managing liquidity in the banking system, the CBN relies on the use of cash reserve ratios and the open market operation as well as interest or discount rate adjustment. The CBN prescribes the minimum liquidity ratio from time to time in line with its monetary policy directives . Enforcements of various ratio requirements stipulated by the CBN is a veritable instrument of controlling liquidity in the banking system but some banks can evade this control through the use of off balance sheet financing technique which has the potential to expose the system beyond the contemplation of depositors , the shareholders and the regulatory authorities. The rationale for financial deregulation is based on the assumption that free markets produce a superior outcome or returns to capital. It is assumed that unencumbered capital can be propelled by an invisible hand to flow to an area of most productive use. This will boost economic growth and improve economic wealth of the nation. It is assumed that introduction of financial innovation that spread financial risk more widely like debt securitization and derivatives products would reduce the cost of capital, allow more people access to credit and make the financial and economic system more resilient to shocks. Under the assumption, Government intervention or rescue of distress financial institution is discouraged on the premises that where the management of banks take appropriate decision the invisible hand in the free enterprises system is expected to automatically adjust any inefficiency in the system so that taxpayer's money would not be used to reward bad decision taken by the managements that result in a bank distress crisis[260]. Today, a different premise has become popular. It is clear that financial markets are inherently unstable because it passes through cycles. It is also clear that uncontrolled financial deregulation encourage speculative activities in the banking system which in turn leads to insider's abuse. Bail out or government intervention is increasingly being applied in core capitalist economy to purchase the assets of distressed banks and so free them to lend more to the economy to avoid total collapse of the system. Hyman Minsky a 20th century American economist had argued that stable financial system was an illusion, that economic stability encouraged ever greater and ambitious debt structure[261] but the idea did not command acceptance until the recent global financial crisis . Successful distress management depends largely on the ability of a country to grow its real economy or GDP against shock as well as the ability of the managers of the banking system to maintain a balance growth between the level of credits in the financial system and real output in the economy so that the financial system does not grow at a faster rate than the GDP.

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[260] Iffer Emmanuel, US House Approves $700billion Bailout Bill, Leadership Weekend No 139 Saturday October 4, 2008 pg. 1

[261] "Rescueing the banks we have a plan". The Economist October 11 2008 p.10. From a report of the comprehensive strategy adopted by the British Government to bail out their banks caughtt in the web of the global financial crisis.

If for instance the banking system creates loan asset beyond the country's GDP, the government may lack the capacity to salvage it in event of crisis in which case either the banking system's capital or the GDP will be wiped out. It should be ensured that the economy supporting a banking system has real productive base to ensure that a crisis in one will not erode the other. Unfortunately, this has not been the case in Nigeria and has led to another round of crisis in the banking system which the CBN is currently managing. The banks were not controlled from excessive risk taking. A sudden capital flight by foreign investors occasioned by the global economic meltdown led to the near collapse of the capital market. The banking system was badly affected because it financed margin loan in the market. The she share was both primary and secondary source of the loan repayment so when it suffered drastic reduction in value, the banks suffered great loss. This break down in legal and regulatory control system resulted in some banks failure to adequately quantify and spread the risk inherent in their loan portfolio. The legal requirement for minimum capital ratio which controls growth of banks in line with loan asset quality was not observed. In fact loans were growing faster than capital, retained profit and reserves which were supposed to absorb loan lacked transparency, independence, consistency in rule enforcement and that in many cases they are uninformed of the losses or support the banks prudent operations. This is a repeat of what happened during the banking crisis experienced in sub-Saharan African countries from 1985to 1995. Roland Dumont had noted that in that crisis, the regulators and supervisors worked in an environment that lacked transparency, independence and consistency in rule enforcement and that in many cases the regulators and supervisors are uninformed of financial condition of the banks and so unable to detect financial and managerial weaknesses in them[262]. The present crisis followed a special examination of all the banks in the country on four main pillars capital adequacy, liquidity, solvency and governance which led to the removal from office of many managing directors and executive directors of the banks for frauds and corporate governance issue. The government has also injected over N400 billion to rescue the banks. [263]

4.1.3 Lender of last resort in Distress Management

Lender of last resort strategy is one major technique employed to inject liquidity and restore confidence in a failing banking system. The very need for lender of last resort in a banking system is often an indication of the extent of problem

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[262] Roland Daumont ,etal Banking in Sub-saharan Africa:What Went Wrong? IMF working Papre WP/04/55 p.24. The paper noted that insiders lending was a major problem in Nigerian banks. That about 65% of the total loan of four banks liquidated in 1995 were insiders loan and basically all irretrievable.

Ade Ogidan, Intrigues, fear hit banks amid crisis ,The Gurdian Vol.27 No 11,228 Wednesday ,September 23,2007.pg1 See also Ade Okeaya-Inneh, legal aspect of current regulatory exercise of CBN, The Gurdian Vol.27 No 11,26 2 Tuesday ,October 27,2007.pg115 facing the system and whether the government apart from lending to the banks to salvage them from collapse will have to engage in confidence building campaign to stabilize the economy. Lender of last resort and confidence building go together in distress management and capital reconstruction strategies. Government has an important role to play in each case, which in summary is to free the banks and financial system from bad loans or collapse by buying them. Apart from solving immediate distress problem, lender of last resort program serves as corrective device for past fiscal and monetary policy defaults in an economy however, its success relies critically on the state of the economy and the efficiency of the monetary and fiscal instruments adopted. Capital injection to bail out a failing bank system can only succeed where the confidence in the system has not been eroded and the capability of the managers of the crisis is not in doubt. The manager could be a private sector buyer, the CBN or NDIC. Whichever institution the government decides to use in this function must be capable of paying more than the fire –sale price of the failing banks or institution. Government should be able to negotiate a crisis salvaging price if its agency is to be the buyer and such price must be higher than the intrinsic value of the bank so that the taxpayer will not lose money. This may be difficult in times of systematic crisis. Except government has sufficient funds to go round the entire distressed banks it may have to sell some salvaged assets of the banks to be able to rescue more banks[264]. However it is done, the present global crisis and the measures taken so far by core capitalist economies to salvage their economy and banking system from collapse have shown that banks are too important to be allowed to fail because the impact of bank failure on the society is beyond the capital and depositors funds often lost in the crisis[265].

4.2 Banking sector consolidation and restructuring

Capital reconstruction is a part of corporate restructuring the objective of which in normal circumstance is to maximize the wealth of the entity through structural changes. The main objective of consolidation and restructuring in the bank is to restore the banking system capacity to create or maximize wealth and to withstand macro economic shock. It is a strategy pursued by bank to be bigger,

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[264] See The Economist Ibid, p 47 .

[265] Argentina is presently facing billions of dollars claims from 43 private investors at the World Banks Centre for Settlement of International Disputes. Their claims arose from her 2001-2002 economic collapse and her remedial reaction to it which destroyed the economic base for many of the investments attracted to the country in the first place by government privatization and public-private partnership program. See Michael Robinson "Argentina Debt "The Economist October 11th-17th 2008.p2 . The truth is that some of the policy program forced by the World Bank and IMF on developing countries does more harm than good to their economy. The structural Adjustment program in Nigeria in 1986 is an IMF program that led to the collapse of many banks in the country. Based on the principle of laissez faire banks were allowed to fail with depositors fund contrary to big intervention package the West is dolling to save its banks today. The European Union has gone to the extent of guaranteeing interbank lendings. Britain is responding to her banks request for emergency funding by investing for preference share participation 12 billion in RSB,10 billion in HBOS 7billion in Lloyds TSB and 3 billion in Barclays

efficient, better capitalized[266]. Consolidations are naturally driven by market forces and business motive. In the case of Nigerian banking system, consolidation has been accelerated by regulatory intervention that changed the entry barriers, capital requirements and operational fundamentals in the system[267]. Mergers and acquisition is the main technique used by the CBN in restructuring the system. The consolidation program executed in 2005 by the CBN injected fresh capital into the banking industry and reduced the problem of weak capitalization of the operating units in the banking system. This was possible because the CBN collaborated with other institutions to fast track the legal, regulatory requirement and other process that enabled rapid conclusion of the consolidation program which would not have been possible in a normal mergers and acquisitions process. The emerging problem of the banking system has shown that consolidation has not been able to achieve some of its objective. The banking system is still with insufficient capacity to support deep financial market in the economy. The banks without the support of the CBN lacks capacity to serve as

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[266] Obafunmilyo A, Challenges & Opportunities in the Consolidating Nigerian Banking Sector.. A paper deliverd at the seminar on Merger and Acquisitions at the Lagos Lagoon Restaurant, Ozumba Mbadiwe Street, Victoria Island Lagos on 28th -29th September 2004. P6

[267] Apart from regulatory intervention, the closure of five banks that failed in the 1994 and 26 that failed in 1997/8 did significantly reduced the number of operating bank without affecting the deposit spread in the banking industry because after the closure the threes old generation bank: First Bank Of Nigeria (FBN) , the United Bank for Africa(UBA) and the Union Bank of Nigeria (UBN) retained more than a quarter of the total deposit of banks in the country .Of the 99 banks in the system in 2003, 12 of them controlled over 32% ,32% and 44% of the total deposit, total assets and total share capital respectively of the banking industry

custodian of financial assets of large institution and cannot support the local institutions with funds for development as a result it cannot really integrate the economy into the global financial system.

The program exposed the banks to international business opportunities some of them expanded their credit creation activities. However the credits were not channeled to the real sector of the economy but towards financing margin loan in speculative activities at the capital market. These credits especially the consumer financed credits ended up creating jobs in China and the western countries of the world where the consumers goods are mainly produced. The small scale industries that needed the credit did not get it because the banks were afraid to lend to them due to lack of enabling infrastructures that would guarantee productivity and security of credit advanced to them.

The consolidation program reduced the number of banks in the economy. Reduction in the number of operating banks is expected to have enhanced the task of the regulatory authorities in checking regulatory abuses and operating malpractices. But the post consolidation crisis in the industry has exposed the shortfalls of the weak regulatory system. The CBN has to inject over N620 billion to bail out some of the banks it found to be in grave situation after it conducted a special examination to test the strength of the banks in liquidity capital adequacy and corporate governance in August 2009. The banks are said to be suffering from poor corporate governance culture, poor risk management, and poor loan quality as well as unethical practices by some directors of the banks[268].

4.3 Mergers and Acquisition

The Investment and Securities Act[269] defined a merger as "amalgamation of the undertakings or any part of the undertakings or interest of two or more companies or the undertakings or part of the undertakings of one or more bodies corporate"[270] . This can be achieved as stated by the Act through purchase or lease of shares or assets or amalgamation or combination of the companies. A merger can therefore be said to be the combination of two or more separate companies (acquirer *and a target) into* a single firm. The single firm may be bearing a new identity or the identity of one of the old firms. An acquisition takes place where a company (an acquirer) takes over the controlling shareholding interest of another (target) thereby making the target company a subsidiary of

[268] Adeyemi Adepetun , Reform: CBN in Pursuit of Corporate governance The Guardian Vol.27 No 11277 .,Wednesday November 11 2009.p.23.
[269] Cap 124 LFN 2004 as amended
[270] S.117 (1) ISA 2007.

the acquirer[271]. Mergers in Nigeria has been common to big companies as seen in the regulatory compelled mergers during the last banking sector consolidation[272]. Mergers and acquisitions are useful reorganization tool to management in business restructuring and repositioning. It enables the combination of organizations resources and opportunities more effectively and helps in fostering economies of scale, brand acquisition, diversification, increase in market shares and opportunities. The need to extend this benefit to the small and medium scale sector of business in the economy seems to have prompted the inclusion of a threshold for categories of merger under the Investment and Securities Act[273].

4.3.1 <u>Mergers as a Consolidation tool in banks</u>

For successful mergers and acquisitions to occur, there are important merger steps that must be systematically followed. The first step is to plan the overall

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[271] Jonathan A D Long, "Mechanics of Mergers & Acquisitions" A paper delivered at the workshop on Mergers & Acquisitions: How not to go wrong. At Lagoon Restaurant, Ozumba Mbadiwe street, Victoria Island, Lagos on 28th and 29th September 2004. P.2

[272] Before the CBN consolidation in 2006,Union Bank of Nigerian acquired 75% of Citi Trust bank Ltd in 1995. The bank was renamed Union Merchant Bank Ltd. Intercontinental Bank Plc acquired 70% of Meriden Equity Bank of Nigeria in 1996.Thesame year, Guaranty Trust Bank ltd acquired 100% equity shares of Magnum Trust Bank ltd. The National Insurance Corporation of Nigeria in 1997 acquired 100% of Nigerian Arab Bank which was renamed Assurance Bank ltd. In 1998, Stanbic Merchant Bank ltd had 48.9% of its share acquired by the SBIC Africa Holding Ltd of South Africa. The standard Trust Bank Plc in 2003 acquired 51% equity holdings of continental Trust Bank.

[273] See section120 (1) which provides for the use of turnover or assets as a measure of threshold for categorizing merger either as small , intermediate and large merger. The turnover threshold is ranges from N0.5b for small merger to N5bfor large merger respectively.

corporate strategy so that the merger or acquisition fits into the overall framework of the company. The acquirer must identify the essential characteristic that will fit into its plan or corporate strategy. Those characteristics should then be developed into screening criteria by specifying quantitative and qualitative factors with which a preliminary screening of target banks is to be conducted.

The second step starts with detailed investigation of the prospective target(s) that emerged from the first stage. The investigation provides the basic information for evaluation, deal structuring and negotiation. This stage involves full purchase investigation and audit. Investigation with detailed valuation studies provides the necessary details for structuring specific deals. If there is serious interest and a consensus, the parties proceed to the level of deal structuring often referred to as the pre-contract negotiation stage. It is during the deal structuring stage that a memorandum of understating or letter of intent is exchanged.

Contractual negotiation comes in after the MOU is signed. At this stage, specifics on object of purchase or merger such as purchase prices and contractual modalities, time of transfer, warranties and guarantees are determined and concluded. Determination of legal, economic , tax and financing method that will be of utmost advantage to the scheme is made at this stage after which the acquisition or merger agreement is drafted to enable the parties give pre-merger notice . This and formal application to SEC and CBN stating the agreement, terms and condition. Thereafter, court ordered meeting will then be held to sanction the scheme. The last of the merger steps is the implementation of the merger or acquisition deal. It normally begins with transfer of the asset when the necessary registration and notification has been concluded. It is followed by the practical integration of the merging corporate cultures.[274]

4.3.3 Documentation in Merger and Acquisition Deals

It is vital in merger and acquisition in banks that legal issues and necessary documentation be understood by all the parties to minimize misunderstanding and forestall future litigation and acrimonies that can affect the bank negatively. Business combination transactions generate a lot of documents such as Memorandum of Understanding (MOU) or letter of intent, exclusivity and confidentiality agreements, disclosure letters, accountant reports and working

[274] Werry Clare , M&A -Protecting the Purchaser ,in AIJA Law Library ed by Philip Martinius Kluwer Law International ,The Hague ,The Netherland 2005 pp 489 -513

papers of the auditor of the seller as well as the title documents for the assets of the transferee company. In friendly acquisition the selling bank not only prepare a memorandum on the company but may sometimes provide a data room or an office accommodation where the buyer can visit and sight some of these documents.

In mergers and acquisition deals, the memorandum of understanding (MOU) is a vital document because it sets out explicitly, the terms of agreement between the parties. MOU is sometimes referred to as letter of intent. Its major weakness is its lack of legal force as it is not legally binding on the parties. Apart from the MOU, the parties may execute an exclusivity agreement. The purpose of this agreement is to prevent the seller from seeking or negotiating with another buyer for a given period within or after the negotiation by the parties. To protect the target company from loss of business or trade secret to the buyer, a confidentiality agreement may be executed to impose duty of confidentiality on the buyer. There is also the asset or share purchase agreement executed to capture warranties by the seller and sometimes a letter of disclosure is often made by the seller which contains any qualification of warranties given in the sale agreement. The disclosure letter is normally divided into two parts. The first part deals with matters of public notice to which the buyer has access and so can investigate while the other part deals with matters relating to specific issues. The former is called general disclosure while the later is called specific disclosure. Letter of disclosure may enable the buyer to claim for breach of contract if a warranted fact turns out to be untrue regardless of whether or not he relied on the fact in question. Tax deed is another document that may be executed by the seller. The purpose of tax deed is to ensure that the purchaser is protected from tax liability of the old entity.

4.3. 3 Transfer of title in Merger and Acquisition

Transfer of title is important in business combinations. Title passes in share deals for instance when the name of the buyer is entered in the register of members of the company. The process starts with the execution of the share transfer forms in the case of shares or the transfer of the asset involved in the case of asset deals. In mergers title is transferred after the stock transfer form has been dully stamped filled by the appropriate authorities. Necessary notices, approval and registration must also be complied with. This may take weeks to conclude as a result, the buyer needs to get legal protection to cover his interest during this period. He can seek for indemnity executed by the appropriate registered holder of the share or better get the seller to execute power of attorney in his favor which he can use in the interim in relation to all the shares between the time he purchased the shares and the time title is transferred. In addition he must confirm that the shares purchased are free from encumbrances like lien, equitable charges and other third party rights. The seller should be made to covenant that the sale is free of adverse change to the financial and other conditions of the shares, business, assets, properties and prospects of the company. This will protect the company from adverse pending litigation or investigation.

4.3. 4 Legal Risk and Due Diligence in Merger Acquisition and Take-overs

In merger, acquisition or take-over, once a target is identified, a buyer has to decide to go either for the shares or the asset of the target. Asset purchase has little risk once perfect title is transferred. Share purchase has the implication that both the assets and employee of the target will be transferred to the purchaser. Asset purchase is common in purchase and Assumption (P&A) a method usually employed by Nigerian Deposit Insurance Corporation to disposes assets of some failed bank. Asset sales enable a purchasing bank to pick the desired assets or deposit liabilities of the failed bank.

Share purchases or acquisition can be advantageous to a viable bank because it can enable a viable bank to convert the losses of the failed bank to tax advantage thereby reducing stamp duty tax burden. The buyer should confirm that the shares purchased are free from encumbrances like lien, equitable charges, right of preemption and other third party rights. Seller would ordinarily prefer to transfer shares and limit their liabilities to the extent of ongoing indemnities and warranties and buyer would prefer to buy the assets or shares of the companies free of liabilities hence the need for proper exercise of due diligence by the parties. Due diligence allows a buyer to determine the level of protection he needs so as to take necessary measures either to negotiate price reduction , get the seller warranty or pull out of the deal. It involves determining the value (hidden or otherwise considered), quality, types, reliability of the assets and the liabilities. The consequences, nature and extent of the contingent part of the liabilities must be thoroughly understood as such it demands high level of judgment, care, and prudence which are expected to be exercised by a buyer to evaluate a business proposition. It is a critical stage in mergers and acquisitions process aimed at enabling the acquirer identify, confirm and evaluate the effect which material fact, figure and values provided by the seller will have on the acquirers business. Due diligence must be exercised by the buyer to highlight key trends and characteristics, hidden competitive threats and liabilities in the target company as *caveat emptor* reign supreme in mergers and acquisitions . It requires professional expertise and due attention to detail, mental dexterity and coordinated skill to protect the buyer from the risk of overpayment and hidden liabilities. Adequate information is essential for the parties to take informed decisions in merger and acquisition transaction to enable them determine and know the risk facing them as well as what to do to mitigate it [275].

Due diligence is a critical success factor in mergers involving failing banks as the banks involved may be worth more or less than their balance sheet value. Proper evaluations need be made of the inherent intrinsic and intangible values like trust, brand efficiency before the acquisition or merger. In conducting due diligence exercise, the buyer relies mostly on his lawyer and other experts. The buyer's lawyer would normally submit to the seller questionnaire requesting information on issues such as the Memorandum and Article of Association of the company, patent and intellectual property rights, among others. Notwithstanding the answer given by the seller on the questionnaire, the parties must clearly

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[275] Jonathan opcit p. 13

understand the position of the off balance sheet engagement or transactions such as tax liabilities and advantage of the scheme. Reasonable forecast should be made of the reliability of the customer base, cash flow of the bank and the capacity or reliability of the customer base to support the cash flow, performance of the bank and their balance sheet strength?[276]

4.4 Applicable Statutes in Mergers, Acquisitions and Takeovers

The principal legislation regulating mergers and acquisitions in Nigeria is the Investment and Securities Act[277] . It is provided in the 1999 Act that other existing law relating to mergers and acquisitions "are to be read with such modifications as to bring them into conformity" with the provision of ISA[278]. Some of the laws that impact on mergers and acquisitions in Nigeria include the CAMA[279], the BOFIA[280] , Company Income Tax Act, and the Federal Inland Revenue Service

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276 Ogiemwonyi Victor, Industry Peculiarities in Mergers and Acquisitions (Reference to Banks). Being paper presented during SEC/AIHN Seminar on Mergers and Acquisitions at the Lagoon Restaurant, Ozumba Mbadiwe street , Victoria Island, Lagos on 28th and 29th September 2004. Pp 7-11.

277 . See Cap 124 LFN 2007 Section 261(2) provides that any law that is inconsistent with the provision of the ISA shall be void and the Act shall prevail over that other law to the extent of the other laws inconsistency. The Act is complemented by rules and regulation made by SEC. The rules prescribe the disclosure requirements, procedures and scope for the conduct of mergers and acquisitions, anti restraint on competition and monopoly.

278 S.261 (1) ISA 1999 Cap 124 LFN 2004.The ISA 1999 was repealed in June 2007 by S.314 ISA 2007. S118(1) of the 2007 ISA provides that notwithstanding anything to the contrary contained in any other enactment, every merger , acquisition or business combination between or among companies shall be subject to prior review and approval of the commission.

279 Cap 124 LFN 2007.Under which incorporation of companies is regulated as it relate to filing of notices , alterations to the Article and memorandum of Association , registration of corporate names must be conducted with the Corporate Affairs Commission.

280 Cap LFN 2007 Bank merger must be approved by CBN in accordance with Section 7 of BOFIA discussed earlier so SEC will require a letter of no objection from CBN to process an application for merger.

Act[281]. In general, the major institutions a bank must relate with in mergers and acquisitions are the Securities and Exchange Commission (SEC), the Nigerian Stock Exchange and the Administrative proceeding Commission {APC) of the NSE[282]. The roles of these institutions in mergers and acquisitions are prescribed by the Investments and Securities Act (ISA)[283]. Under the Act, mergers, acquisitions and takeovers in banks are regulated with a view to controlling the operators in the industry from constituting monopolies in the provision of financial services in the economy.

4.4 .1 Mergers and Acquisitions through the Companies and Allied Maters Act (CAMA)

The Companies and Allied Matters Act 1990 as amended provides for a scheme of arrangement by which a company can during members voluntary winding up, sell or transfer their property to another company in consideration of shares in transferee Company. Such arrangement is one of the methods of consummating merger. The method was not commonly used in effecting mergers because it is

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[281] Cap 60 LFN 2004 which provides that tax due and payable under the Company Income Tax and the Capital Gains Tax Act must be settled before the merger can be consummated.

[282] The ISA has extensive provision for registration, monitoring, investigation and enforcement procedure in Mergers and Acqusition.

[283] Prohibiting restrictive business practices which prevent ,restrict or distort competition or constitute the abuse of a dominant position of market power in Nigeria is the objective of the Federal Draft Competition Bill. See S.3 of the draft bill, See also Chigbue, An Overview of the Federal Competition Bill: Which Model: Being paper presented at the Nigerian Bar Association Annual General Conference held in Port Harcourt August 26th to September 1 2006.p.168

cumbersome when compared with merger procedure under the Investment and Securities Act . The procedure under the CAMA requires that members through special resolution would resolve to voluntarily wind up their company and authorize a liquidator to sell or transfer the undertaking in part or in full to another company or transferee in consideration or part consideration of fully paid shares, debenture, polices, cash or other interest in the transferee company.

Such consideration is normally distributed in accordance with the right of the members in liquidation. A sale or transfer of share in pursuant of the resolution binds the company and any member who fails to signify his intention to dissent from the resolution within 30 days of passing the resolution[284]. A member who wishes to dissent from the resolution is however allowed to petition the liquidator and signify his dissent within 30 days of life of the resolution. On receipt of the petition, the liquidator will either stay action on implementing the resolution or buy off the dissenting member's share at a price to be determined by SEC[285].

Alternatively, an aggrieved member or creditor can petition the court against the resolution to wind up a company under S.538 (1) of CAMA by pleading that the

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[284] S. 538(3) CAMA Cap C20 Vol.3 LFN 2004

[285] In the case of public companies but see S.538 (2) (b) and (4) (a) (b) CAMA Cap C20 Vol.3 LFN 2004 as it relates to private company with alien participation.

resolution so passed is oppressive or unfairly prejudicial to him or to the members as a whole. The sale or distribution of interest or shares to the transferee in such a case can only be invalidated by the court[286]. It is doubtful whether the proviso in S.538(2) (a) (b) can avail an aggrieved member any utility in view of the fortuitous nature of the condition attached to its operation which is that a prejudicial order must have been made against the scheme by the court within one year of passing the resolution. It seems that a creditor stands a stronger ground of benefiting from the proviso of S.538 (2)(a)(b) than a member because S.538(5) protects the creditor against any variation or abrogation of his right in the company during the period [287]. This is not the case with a member of the company because section 538(3) CAMA appears to foreclose the right of a member who fails to signify his dissent as provided therein within the period.

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[286] See S.310-312 CAMA Cap C20 Vol.3 LFN 2004 on the relief of unfairly prejudicial and oppressive conduct and ground upon which such application may be made as well as the kind of order a court can make in the instance. See S.538 (2)(a) (b) CAMA Cap C20 Vol.3 LFN 2004 for the proviso to the special resolution scheme of arrangement and compromise .

[287] A creditors right can however be compromised under S.539 of CAMA Cap C20 Vol.3 LFN 2004 if a majority representing not less than 75% of the class of creditor aggress to and SEC approve such a compromise . But see Okonkwo Opcit . pg 60 where it was suggested that a merger can be effected under this section using scheme of arrangement and compromise as provided therein. This is doubtful as the section appears to focus on how to resolve differences that may arise in relation to the interest of creditors where such interest cannot be accommodated under members voluntary winding up condition in S.538 CAMA Cap C20 Vol.3 LFN 2004. To assert that merger can be effected using scheme of arrangement and compromise under S.539 CAMA amounts to asserting that creditors having difficulty in enforcing their rights against a company would necessarily prefer to exchange their interest for equity participation in the company which is not likely to be the case for creditors of ailing companies. The compromise will also be difficult to promote in cases of ailing bank except as a species of reconstruction.
See the common law case of Senath v Valley Gold ltd [1893] 1 Ch 447,449 where compromise was defined as an agreement which terminate a dispute between parties as to their right of one or more of them or modify the undoubted right of one or more of them which is difficult to enforce.

Another difficulty that may be encountered in using this method is in the administration of the power the section conferred on SEC to determine the price payable to a dissenting shareholder in respect of his shares[288]. The use of SEC to value share provides ground for delay from aggrieved members who may eventually turn to court to challenge such determination. This may be the reason the value of such shares in take-over cases under the new Investment and Securities Act 2007 are determined by the court rather than by the SEC[289]. Knowing that the court may not have the technical competence to carry out the valuation, the section provides that the court has discretion to appoint one or more than one independent valuer to assist the court in fixing a fair value for the shares.

Reconstruction can be effected under a scheme of arrangement between the company and its creditors or members in Section 539 of CAMA. The court may in a summary application of a company, its creditors, members or the liquidator[290], order a meeting of the creditors, members or class thereof for the purpose of

[288] S.538(4) CAMA Cap C20 Vol.3 LFN 2004. The provision stated that in respect of private companies without alien the price is to be determined by agreement.
[289] S.146 (3)(b) and 147 of ISA 2007
[290] See S.450 CAMA Cap C20 Vol.3 LFN 2004 generally on the requirement for applying the scheme to debenture holders and the information that must be circulated to members and creditors by the directors in respect of the scheme.

considering a scheme of arrangement or compromise [291]. If not less than 75% majority of the members or creditors approve the scheme, arrangement or compromise, it will be sent to the court which will in turn refer it to SEC to investigate and report back on the fairness of the scheme [292]. If the court is satisfied as to the determination by SEC on the fairness of the report, the court will approve it by an order which becomes binding on the creditors, members or contributories as the case may be. The order will have effect when registered with the Corporate Affairs Commission and when it is reflected in the Article and Memorandum of Association of the company.

Mergers under this section, like other sections in CAMA are prone to suffer avoidable delays due to requirement of several interfaces between SEC and the court in the process of determining the fairness of the scheme as well as the fact that the court lacks the power of making any facilitating order in pursuance of the scheme. Mergers will therefore be cumbersome, expensive and time consuming under the CAMA procedure.

With the introduction of the Investment and Securities Act in 1999, there were reservations as to whether the scheme of arrangement provided under CAMA

[291] S.540(10(a) CAMA Cap C20 Vol.3 LFN 2004. The directors are expected to send with the notice of the meeting, a letter explaining the effect of the scheme or arrangement and any material interest of the director and how the scheme will affect them differently from the way it affect others.

[292] S.539(1) (2) CAMA Cap C20 Vol.3 LFN 2004

could really be utilized to consummate merger due to the fact that the word merger was not used in any part of the sections and the sections did not provide for compulsory acquisition of dissenting shareholders shares. The confusion appears to have been cleared by the new ISA as two provisions of the ISA 2007 has brought reconstruction schemes under CAMA 1990 in contemplation of merger under Investments and Securities Act 2007. The first provision is that which defined merger as any amalgamation of the undertakings or any part of the undertakings or interest of two or more companies or the undertakings or part of the undertakings of one or more companies and one or more bodies corporate[293]. The second is the provision which stated that merger contemplated under the Act may be achieved in any manner, including through purchase or lease of the shares, interest or assets of the other company in question or amalgamation or other combination with the other company in question[294]. Since the subject matter of the above provisions are the same as those covered under the relevant provisions of CAMA 1990 which is dealing with arrangement and compromise schemes under sections 537-540 and since the provision of section 118 of the Investment and Securities Act 2007 provides that "Notwithstanding anything to the contrary contained in any other enactment, every merger, acquisition or

[293] S.119(1) ISA 2007
[294] S. .119(2) ISA 2007

business combination between or among companies shall be subject to the prior review and approval of the Commission"[295]. It can be argued then that business combination can still be effected under CAMA1990 as amended not withstanding its cumbersome procedure.

4.4 .2 <u>Mergers and Acquisitions through the Investment and Securities Act</u>

In the Investment and securities Act , merger is defined as "any amalgamation of the undertakings or any part of the undertakings or interest of two or more companies or the undertakings or part of the undertakings of one or more companies and one or more bodies corporate"[296]. A merger contemplated under the Act may be achieved in any manner, including through purchase or lease of the shares, interest or assets of the other company in question or amalgamation or other combination with the other company in question. The Act used market share, asset and turnover threshold to classify mergers into small, intermediate and large merger[297]. A small merger" means a merger or proposed merger with a value at or below the lower thresholds. An intermediate merger" means a merger or proposed merger with a value between the lower and upper thresholds .A large merger" means a merger or proposed merger with a value at or above the

[295] S.118(1) ISA 2007
[296] S.119 ISA 2007
[297] S120(1)(2) ISA 2007

upper threshold. The lower turnover threshold is ₦500, 000,000, while the upper turnover threshold is ₦5, 000, 000,000. Based on this categorization judicial and regulatory notification required in a particular class of merger is determined. For instance, it is only in large and medium merger that SEC needs to be notified for its approval before consummation[298]. Based on the categorization also, judicial sanction is dispensed with in small and intermediate mergers. Judicial interface in merger is restricted to large mergers only[299]. As a result of restriction of judicial interface to large merger the court can only sanction a merger on reference to it by SEC, when SEC has considered a merger and has given its 'in principle approval' . In principle approval is assumed where SEC directs the merging companies to make an application to the court for an order directing separate meetings of shareholders of the merging companies for the purpose of getting their approval to the proposed merger. In-principle approval procedure and reduction in judicial interface in mergers has effectively reduced the time within which SEC must convey its approval of a merger to 20 days in small or intermediate merger and 40 days for large mergers[300].

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[298] S.122(1) 123 ISA 2007.

[299] The era of getting preliminary order of court to hold the general meeting of the company where mergers are considered before getting back to court for it to sanction the scheme has be done away by the new ISA .

[300] The 1999 ISA now repealed by S. 314 of the 2007 ISA had provided under S.100 that where any scheme proposed for compromise, arrangement, reconstruction or the mergers of any two or more company(s) involves the transfer of the asset or undertaking of the companies to a

The court has power to make facilitating orders in furtherance of merger schemes. Under S122 (6) ISA 2007 as was the case in S.100 of ISA 1999, the court can during or subsequent to sanctioning merger scheme make provision for an order transferring the property, undertaking or liabilities of the target company to a transferee[301] It can make provision for allotting of interest or shares in the transferee[302]. An order for the transfer of property or liabilities under the section becomes by virtue of the order binding on the companies and the property becomes in effect that of the transferee company. A commentator rightly observed that the facilitating order where made, eliminate the expenses and delay associated with transfer and conveyance in merger and acquisition transactions[303].

In the exercise of its power of facilitating order under the Act, the court, can order for the liquidation without winding up of any of the transferor companies[304] and

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transferee, the court on a summary application of one of the companies may order a separate meeting of the members of the companies to be held for the purpose of considering the scheme[300]. If the meetings approve the scheme by members holding not less than 75% of the value of the shares, the scheme will be presented to SEC for consideration and approval. Thereafter it is sent back to the court for sanction of the merger.

[301] The order in S. 122(6) ISA 2007 is subject to the proviso in S. 122(7) ISA that the whole of the asset of the transferor company must be transferred to the transferee.
[302] 122 (6) (b) ISA
[303] Okonkwo Opcit p.13
[304] 122(6) (d) ISA

can direct that provision be made for any person who dissents from the merger[305]. The court also has power to make incidental, consequential and supplemental orders on matters as may be necessary to ensure that the scheme is fully carried out[306]. In any case the facilitating order for liquidation of the company can only be made if the court is satisfied that adequate provision has been made by way of compensation or otherwise with respect to the interest of the employees of the company to be dissolved[307]. The section afford the employee opportunities to assert their right against the scheme or the transferee as it defines liabilities to include rights , powers and duties of every description notwithstanding that such rights powers and duties are of a personal character which could not generally be assigned or performed vicariously[308]. The section renders inapplicable, the common law rule in **Doncaster v Amalgamated Collieries** which ratio is that transfer of property does not include transfer of contract of personal services[309]. Contract of employment can now pass as liabilities to the transferee. Apart from these, employee right in merger cases has further been strengthened by S.123(1)(2) of ISA 2007 which mandated the primary acquiring company and the primary target company to provide a copy of the notice contemplated in the

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[305] 122(6) (e) ISA
[306] S. 122(6) (f) ISA
[307] 122(7) (a) ISA
[308] 122(10)(a) (b) ISA
[309] (1940) A.C 1014.

merger to any registered trade union that represents a substantial number of its employees or the employees concerned or representatives of the employees concerned, if there are no such registered trade unions.

4.4.3 Regulatory authorization and control of anti-competitive practices in merger and take-over under the Investment and Securities Act (ISA) 2007

Apart from its normal duty of ensuring that shareholders are fairly treated in mergers, acquisitions and take-over deal, the Investments and Securities Act 2007 enlarged the powers of the Securities and Exchange Commission in business combinations and strengthened its control of competition in the economy .This is evidenced from the way mergers, take-over and other business combinations is controlled in the Act.

There are two points at which SEC controls takeover-bids under the new Investment and Securities Act. The first is at the stage an applicant is required to obtain from SEC, the authority to proceed with takeover bid under S. 134 (1) of ISA. The second is at the point at which the applicant is required to convince SEC to approve a copy of the proposed takeover-bid for registration and for circulation to shareholders under section 135(1) of the Act. At this stage the applicant must show that he properly obtains authority to proceed with the bid under S.134 of ISA. The Commission is empowered to refuse registration to a takeover-bid that fails to comply with the above requirements.

SEC uses the power of granting authority to proceed to ensure that a target company for a takeover is not a private company, that the bid is not aimed at fewer than twenty shareholders of the target company and would not result to some share being purchased by the applicant by way of separate agreement outside the takeover-bid.

It is important to understand the control stages in takeover bid under SS. 134-136 ISA and in mergers under S.121 of the Act by examining what the Commission can do or not do under the various stages. In the case of merger, the Act provides that SEC shall not approve any merger that is likely to substantially prevent or lessen competition in the market unless such merger is likely to result in a technological efficiency or other pro-competitive gain which will be greater than, and off-set, the effects of any prevention or lessening of competition that may result or is likely to result from the merger, and would not likely be obtained if the merger is prevented[310]. In takeover-bid, section 135(6) of the Act states that for the purpose of deciding whether or not to grant an authority to proceed with a take-over bid to an applicant, SEC shall have regard only to the likely effect the take-over bid if successful will have on Nigerian economy and on any policy of the Federal Government with respect to manpower and development[311].

The second stage in control of takeover is the point at which empowers the Commission to refuse registration to any proposed bid that fail to comply with the requirement seems to be targeted at remedying any loophole that may be exploited by an applicant to directly or indirectly take control of a company through hidden identity or indirect ownership. It is also meant to ensure that no single investor acquires control of companies that may enable it exercise influence or control detrimental to Nigerian economy or any policy of the Federal Government with respect to manpower and development as prohibited under S.135 ISA. Therefore the objective of the requirement of authority to proceed under S.135 is to stop at the initial stage any takeover –bid that would have negative effect on Nigerian economy. That may explain why the section did not unlike the preceding section provide an aggrieved applicant an opportunity to protest against SEC's refusal to allow him proceed with a takeover-bid. However

[310] S.121 ISA 2007
[311] Section 135(6) (a)(b) ISA Cap 124 LFN 2004.

under the section the commission is required to have requested from applicant further information to enable it make decision on whether or not to grant the applicant the authority to proceed with the bid. An aggrieved applicant under S136 (2) Investment and Securities Act can however challenge the decision of the Commission by compelling the Commission to refer the fact of its refusal to register the bid to the court under section 136(3) of Investment and Securities Act [312]. The court may, after hearing such a reference order the Commission to register the bid.

From the above analysis, it can be asserted that SEC controls takeover bid with a view to preventing an applicant from using take-over bid to turn itself to a monopoly by acquiring the control of existing company in an industry or market segment. The control in mergers and acquisitions is aimed at preventing the same result through mergers but unlike the mergers provisions, the takeover objective is not expressly stated for proper guidance to the applicants[313].

This can be seen from the fact that while section 121 Investment and Securities Act 2007 set out in detail, factors that should guide the Commission in determining whether or not to approve a merger proposal, section 134 Investment and Securities Act 2007 dealing with take-over made a generic

[312] See generally Section 10 6(1)-(4) ISA Cap 124 LFN 2004.
[313] SS 121(2) and 134(c) of ISA 2007

provision requiring that the commission shall satisfy itself that such takeover if successful will not have adverse effect on the economy of Nigeria and on any policy of the Federal Government with respect to manpower and development.

It is submitted that a liberal interpretation should be given to section 135(6) of Investment and Securities Act 2007 which when literally interpreted, tends to suggest that the Commission when deciding whether to register a take-over bid or not shall consider the effect a successful bid would have on Nigeria economy with respect to Federal government manpower development policy. A take – over bid which creates employment in the short run for instance may end up creating monopoly control in the long run which if not controlled at early stage of development may be detrimental to the economy in the long run. Section 136 (I) of Investment and Securities Act 2007 attempted to address this loophole by providing that registration of a takeover- bid shall be condition precedent to dispatching the bid to target company's shareholders but it failed to further provide factors that should guide the Commission in carrying out this determination. The section needs to be more explicit to eliminate uncertainties and subjectivities in its interpretation. Applicants under the section need to be guided on factors and business practices that SEC may consider in deciding whether a proposal may have negative effect on government economic policies and employment. Relative to the merger provisions , such factors have been listed to include the actual and potential level of competition in the market, the dynamic characteristics of the market, extent of vertical integration in the market , the probability of collusion, and the need to avoid or reduce business failure in a particular industrial sector among others.

4.4 Defending a Merger or Take-over proposal in Court or before the Commission

Where reference or determination is required of the court or the SEC in the course of a bank capital reconstruction that result in business combination proposal, protection of public interest should be an overriding factor. An applicant that wants to make a successful case for such a merger, take-over or other forms of business combination under such proposal must be able to discharge the onus of proof that the combination if successful will not have negative effect on the economy of Nigeria which is the spirit of the law in the relevant sections of the Investment and Securities Act. In particular, he must show that approval of such plan will not hamper the capacity of SEC to control the banks from acts or business practices that are anti-competition. The Act did not mention business practices that are anti-competition but in relation to banks such practices may consist of act or series of acts such as abuse of dominant positions achieved, limitation of availability of banking services or technical development to the prejudice of consumers, preventing, restricting or distorting competition in the system by fixing prices, applying dissimilar condition to equivalent transactions with different customers. Such acts may also involve manipulating condition of competition in the banking system as to place other banks in a competitive disadvantage. When determining whether or not to allow a merger on the ground that it is likely to substantially prevent or lessen competition the strength of competition in the relevant market, the level and trends of concentration, history of collusion, in the market, the dynamic characteristics of the market, including growth, innovation, and product differentiation are relevant factor to be taken into account[314].

4.4.4 <u>Bank failure as a Justification for Mergers , Acquisitions or Take-over</u>

The commission is empowered by *section 121(2)(g)*ISA 2007 to approve an otherwise anticompetitive merger where it appears to it that there are some pro-

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[314] S.121(2) ISA 2007

competitive benefit that will be of public interest from the merger. One of such benefits is where the business or part of the business of a party to the merger or proposed merger has failed or is likely to fail and so may be saved from failure as a result of the merger. The use of merger as a tool for averting business failure in banks can be justified on both the public interest ground and on the ground that it has a strategic objective of protecting that particular industrial sector and employment as envisaged under section 121(2) of the Act. These provisions of the Act can be utilized in carrying out capital reconstruction of banks during crisis in the banking sector. This is because where parties or a party to merger are banks in distress the likelihood of the union constituting a monopoly in the short run is remote and so mergers, acquisition or take- over should be utilized to save such banks from imminent failure and loss of its assets from the banking system . In the United States, the courts had held that bank failure was not a compelling justification for approving merger with likely restraint to competition. In US vs. Fleet/Norstar Inc [315] , the court refused to allow a transaction on the defense of failing bank because a less anti competitive purchaser was still available even though the preferred purchasers offered less price than the Norstar. It is likely that the case will be decided differently today given the consequences of the

[315] No 91 -0221-p (D. Me. July 5 1991) Steven opcit p.201

failure of Lehman Brothers in the United State. It was estimated that $700 billion would have bailed out. American government left it to collapse but ended up having over 700 collapsed banks and spending over $16 trillion in managing the systematic crisis that followed[316]. It is likely that if sized with similar case of US vs. Fleet/Norstar Inc and given the American experience, Nigerian courts will follow the American precedent. In fact regulatory authorities will act in support of such merger given the fact that NDIC has adopted similar measure in the form of open bank assistance as a resolution technique under which it acquired and sold some banks that had liquidity problems during the 1989 bank distress[317]. The arrangement led to the merger of National Bank of Nigeria limited with Wema Bank Plc, the Nigerian Universal Bank(NUB) ltd with FINBankPlc , the Nationwide Merchant Bank ltd which changed its name to platinum Bank Ltd merged with Habib Nig Bank Ltd to form the present BankPhb , the New Nigerian Bank Ltd which joined with other banks to form the present Unity bank and the ACB International Bank Ltd which joined with other banks to form the present Spring Bank Plc. It is easier for such capital reconstructions and sale of banks to pass as a merger given the recognition accorded to such sale by the definition of merger

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[316] Ben Uzor, NDIC at 20: An overview of a financial gatekeeper. The Guardian Monday November 2 2009.p15

[317] Adeyemi Adepetun ,Reform: CBN in Pursuit of Corporate governance The Guardian Vol.27 No 11277 .,Wednesday November 11 2009.p.23.

under Section 119 of the Investment and Securities Act 2007. It will also be easier to bring such reconstruction under the public interest perceptive of the Act.

The interest of the depositors, the public interest and the general good of the economy should be the overriding factor in considering whether the bank should be allowed to merge and subsequently be controlled by SEC and CBN to reduce its potential power of restraining competition[318]. Except where a bank merger or take-over will lead to financial instability in the new entity, the banking system or where the interest of the depositors will be prejudiced or inconvenienced, it makes economic sense to allow a merger or takeover of a bank that is unable to meet its financial obligation or is unable to reorganize than allowing it to collapse or injecting tax payers' money to rescue it. The Commission can in subsequent time order the break- up of the bank into separate entities in such a way that its operations do not cause or continue to cause substantial restraint of competition in banking system.

4.4.5 Deposits as a measure of strength of competition

In relation to banks, a bank total deposit capacity is one way of measuring its market share or strength as it indicates its capacity to provide banking services

[318] Bernstein J A, Merger and Acquisition The legal Hurdles Banks faces in choosing to Consolidate. The banking Law Journal Vol. 109 No 4 May-June 1992 p.205

which when aligned with good branch network can put a bank in a competitive advantage over others in the economy. Therefore where a merger or takeover proposal if allowed will lead to substantial accumulation of deposit of the banking system in one bank, the onus lies on the merging banks to convince SEC why such deposit should not be considered against it in determining the possibilities of the merging entities constituting substantial monopoly in the banking sector. In such situation, such banks may argue that merging banks often suffer loss of deposit after merger consummation as customers tend to move accounts after merger. It may be pleaded that in terms of deposit the merging banks lack the capacity to influence the market and as such will not have post merger monopolistic power or influence to constitute monopoly in the market. It can be asserted that the banks generally offer close substitute product or services in deposit mobilization. That other banks can reposition their product to afford close substitute with that of the merging banks or that other banks in the industry though not offering the same products have comparative advantage to offer it at a cheaper price than the merging banks. It can also be shown on the ground of public interest test that the merger or acquisition will result in cost reduction for the banks and can lessen the incentive of such banks to agree with other banks in the industry to limit output and increase price or charges for its services.

In Nigeria, bank charges are governed by banker's tariff approved by the CBN with the recommendation of the bankers committee. The implication is that banks will not be able to sustain high price for long without attracting the attention of the CBN or quick and substantial entry to the market by competitors. If there are enough institutions to enter the market and the entrants have trained staff with adequate skills, branch network and technology to participate in the market, the price of bank product will in the long run return to the premerger level. But proof may however be required from the applicant of timelessness, likelihood and sufficiency of such entry.

4.4.6 <u>Justification on Technological Efficiency and Other Pro-Competitive Gain</u>

Efficiency that may be pleaded as criteria to support a merger has to do with technological efficiency. For efficiency to be sustained as an argument in favor of merger or take- over bid, a high standard of proof will be required of the amount and quantum of efficiency to justify its approval. It has to be shown that such technological innovation that will come from the merger can only be gained if the merger is allowed. Technological efficiency will be difficult to prove in bank merger proposal. It may be easier to establish in the oil, agricultural, telecommunications and other related sectors of the economy than in the banking sector. Efficiency as it is known in bank relates more to human art of management than technology. It is closely related to cost reduction. Where it is to be basis for justification for merger, the plan to be adopted to reap the benefit of the said efficiency must be systematically pleaded and proved. A plan to close unprofitable branch especially rural branches may increase efficiency but may not be allowed by where it limits capacity and output in the banking system and the banking culture in the rural populace.

The need to provide employment and other labour related issues may compel SEC to allow an otherwise anti competitive merger under this ground. Infact, SEC is enjoined by S.135(6) of Investment and Securities Act 2007 to have regard to the likely effect a business combination ,if successful ,would have on Nigerian economy and on any policy of the Federal Government with respect to manpower and development. In this respect SEC have to be mindful of the effect a merger method may have on the labour force of the merging entities. For instance transfers of undertaking by selling of the shares normally imply that the employees of the target company are to be transferred to the new company. This is because contract of employment now passes as liabilities to the transferee. This may not be the case where only the assets of the target company is transferred, sold or leased to the transferee. Therefore, disengagement of labour connected with transfer of this kind of interest are likely to be protested by labour union. The buyer therefore must have strong economic or organizational reason to convince SEC and union leaders because to approve such merger. Where interest is being transferred through shares, the seller should be made to warrant the discharge of the liabilities due to the workers before the combination is concluded because accrued staff benefit is often transferred to the buyer. Inability of one of the parties to account for huge deduction made from but unremitted on behalf of former employees seems to be one of the reasons for non actualization of the acquisition proposal between Diamond Bank (DBN) Plc and the failed African International Bank (AIB) in 2007. It is one of the requirements for bank merger that the proposal sent to CBN for approval must contain the arrangement the acquirer has for the staff that are to be disengaged as a result of the merger. Disengagements can be challenged for being unfair which may result in litigation, damages and delay to the merger.

4.4.7 Rights of Minority shareholders in Merger and Take-over under the Investment and Securities Act 2007

The objective of SEC in controlling take-over bid appears to be to ensure fair, equal treatment and availability of information to all shareholders to enable them exit a company where a single person acquires control of controlling interest in the company . This ensures that all shareholders of the same class in an offeree company are treated similarly by an offeror and that during the course of an offer or when an offer is in contemplation, neither an offeror nor the offeree company nor any of the representatives and advisers of the offeror or offeree is furnished with information not made available to all shareholders.[319] Because availability of information is vital to shareholders in taking decision regarding their investment in the company, the commission will refuse registration to a bid that fail to comply with this requirement.

Apart from ensuring that all shareholders are fairly, equitably and similarly treated in merger or take-over deals, the Act introduced an innovation to protect the minority shareholders in the form of mandatory take-over bid under S.131 of Investment and Securities Act 2007 . The section provides that an offeree contemplating an acquisition that may trigger off mandatory bid must make a general offer to all other shareholders and must ensure that he can implement such offer. It stated thus:

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[319] S.131(2-3) ISA

Where any a person:

(a) acquires shares, whether by a series of transactions over a period of time or not, which (taken together with shares held or acquired by persons acting in concert with him) carry 30 per cent or more (or any lower or higher threshold as may be prescribed by the Commission from time to time) of the voting rights of a company; or

(b) together with persons acting in concert with him, holds not less than 30% but not more than 50 per cent (or a lower or higher threshold as may be prescribed by the Commission from time to time) of the voting rights and such person or any person acting in concert with him, acquires additional shares which increase his percentage of the voting rights, ***such person shall make a take-over offer to the holder of any class of equity share capital in which such person or any person acting in concert with him holds shares.***

The implication of this provision is that on acquiring 30% share of a company an offeror is bound to make a mandatory take -over bid to the rest of the shareholders in the company or to the class of shareholders in issue. The mandatory take-over bid imposed by S.131 of Investment and Securities Act 2007 may be justified in two ways first, as cost of corporate control that should be borne by a shareholder that acquires substantial voting powers beyond the 30% threshold and secondly as a fair exit route to shareholders who had been motivated to invest in a company because of the management of that company[320]. Mandatory take-over seems to impose a burden on investors who interested in just increasing their shareholding in the offeree company and not in taking over the control of the company.

It is submitted that the mandatory take-over bid of S.131 of ISA will hinder the use of takeovers in achieving business combination in Nigeria. Instead of imposing a mandatory bid on all offeror within the 30% threshold of shareholding, the provision should be amended in consonance with the spirit of take-over provisions of the Act which is to protect the minority shareholders and to prevent the negative effect that could result from the monopolistic tendencies such a takeover may have on the economy. In mergers, minority interest is taken care of by the Act. This is because the provision of the avails a dissenting shareholder the right to compel acquisition of his shares where in pursuance of a mergers scheme nine-tenths in value of the shares in his company or of any class of those shares is transferred to another company[321]. Also in takeover, it is mandatory of an applicant in a takeover-bid to ensure that adequate arrangement is in place to

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[320] Idigbe A and Dimgba N, Appraisal of mandatory takeover offer under Investment and Securities Act 2007.p2 http:// www.nigerianlawguru.com. Visited September 20 2009.

[321] S.130 ISA 2007

make fund available for payment of any cash consideration resulting from the takeover-bid[322].

The right of a minority shareholder is further protected by his power to compel acquisition of his shares where in pursuance of a mergers scheme nine-tenths in value of the shares in his company or of any class of those shares is transferred to another company[323]. This he can do where 90% of the shareholders have accepted the takeover-bid and the offeror have not given the dissenting shareholder(s) notice of his intention to acquire their shares[324].

Again the minority shareholder can determine the method of payment for his share from the offeror. He may elect to transfer the shares on the terms of the bid or demand to be paid on fair value of the shares especially where payment is being enforced through the court[325]. Furthermore ,once a dissenting shareholder applies to the court for the purpose of determining the fair value of his shares under this provision, all the dissenting shareholder who elected to demand for the fair value for their shares will be joined as parties to the case[326] This provision has the advantage of settling once and all problems arising between

[322] . S.110 ISA
[323] S.130 ISA 2007
[324] S.I46(2) ISA2007. The offeror must pay for the shares within 20 days of his sending notice of his intention to acquire the dissenting shareholders shares.
[325] S. 117(3)(b) ISA
[326] S. 117(2)(3) ISA

the dissenting shareholders and the offeors as regards the determination of the fair value of the shares since it provided that on application for determination of the fair value of the shares, the court shall fix a fair value for the shares of all dissenting offeree who elected for determination of the fair value of their shares. The court may employ the services of a valuer to enable it determine the value of such shares[327].

Another important protection for a dissenting shareholder and other minority interest against takeover bids is the power of the court to make facilitating orders under the Act. To facilitate the completion of takeover bid the order of the court made with a view to determination of the fair value of shares of dissenting offeree operates against the offeror in favor of each dissenting offeree[328]. The court can make a specific or general order it think fit to facilitate the bid. It can fix the consideration to be held in trust for the dissenting offeree by the offeree company or determine the interest to be paid on the consideration from the date the dissenting shareholder surrender his certificate to the offeree company[329] and by whom the consideration shall be held. Once made, the order operates to divest the offeree company of the money or other consideration and vest it on

[327] S. 118(6)(7) ISA
[328] S. 118(8) ISA
[329] S118(8) ISA

the person named in the order or the trust. The offeree company is bound to issue the offeror a certificate once it is satisfied that the consideration has vested on the dissenting offeree[330].

4.4 .8 Post Consolidation Crisis and the future of Merger and Acquisition in Bank Consolidation

Banking system consolidation transactions through merger whether accomplished by hostile acquisition or friendly negotiation or regulatory fiat is going to continue in Nigeria. Banks that run into distress due to bad loan, poor management or economic downturn will be the target of acquisition by strong banks that are eager to capture market share or reduce their cost and overhead through economies of scale. The first post consolidation merger was between IBTC and chartered Bank. Consolidation therefore will continue to be employed to help unhealthy bank survive. Government in fact will continue to encourage takeover or mergers where it will reduce incidence of failure and rescue burden on it. This is despite the regulatory hurdle purposely designed in the merger and acquisition process to protect the industry from monopoly. Notwithstanding

[330] S119(2) ISA 2007

overlapping statutory and regulatory framework governing business combination banks will continue to use mergers and acquisitions even across the border to acquire regional markets. The regulatory hurdles have come to be accepted as a necessity to prevent the repercussions of bank failure which has wider effect than ordinary corporate bankruptcies.

CHAPTER FIVE

SUMMARY,FINDINGS, RECOMMENDATION AND CONCLUSION

5.0 SUMMARY

The foundation of free market system is built on capital or assets that initiate surplus production and increase productivity[331].Deposit with banks and the banking system is an important medium by which such capital is accumulated and multiplied. Banks use the deposit to create credit which is the lifeline of the economy. In the free market system regulation is antithetical because early political economists propagate that free legal intervention or any intervention for that matter is unwelcome in the free market process[332]. That market should be deregulated and be free to produce superior outcome. Unencumbered capital would flow to its most productive use, thereby boosting economic growth and improving welfare. Innovation will spread risk more widely and reduce the cost of capital, allow more people access to credit and make the system more resilient to shocks or distress. Applied to bank, it follows that government intervention or rescue of distress banks should be discouraged on the premises that taxpayer's

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[331] Herrnando D S opcit .29

[332] See Brenan J and Buchman J, The Power to Tax: Analytical Foundation of a Fiscal Constitution, Cambridge University Prtess Cambridge 1980. Quoted from The Law: An Engine for Trade . Being a lecture delivered by Lord Irvine of Lairg to the British Academy on Wednesday 22 November 2000 published in The modern Law Review Vol. 64 N0 3 May 2001 p.341.

money should not be used to reward inefficiency of few bank managers[333]. Stakeholders in the banking system are expected to bear their respective losses consequent upon their action or inaction in preventing a bank from going under. The cost to the depositor is the loss of uninsured portion of his deposit.

Nigeria, bought this idea fully in 1986 when it introduced the Structural Adjustment Program (SAP) an economic program sponsored by the International Monetary Fund (IMF) under which Nigeria liberalized its economy and deregulated its banking system. Following the principles it liquidated 41 banks in her economy between 1994 and 2005. Fourteen more were liquidated after its banking sector consolidation program in 2006. Banks that failed even before the commencement of the consolidation program remain closed for long with depositors fund trapped in them.

Today, a different premise has become popular which is: that financial market in a free enterprise system is prone to distress and is inherently unstable as it passes through cycle; that government should bailout, intervene or save distress in banks which experience distress as the economy passes the cycle and government should buy the asset of those banks so as to free them to lend more to the

[333] Iffer Emmanuel, US House Approves $700billion Bailout Bill, Leadership Weekend No 139 Saturday October 4, 2008 pg.

economy instead of liquidating them. This development brings out three key factors necessary for capital reconstruction in banks namely the principle of obligation, protection and balanced responsibility. It is the responsibility of government to maintain a sound financial system. The responsibility dovetails to ensuring that the capital of the banks in the banking system is protected from any kind of erosion. If the bank capital is protected the bank depositors would have been protected from bank distress. Where in the discharge of this responsibility bank capital or depositors fund is lost the government is obliged to promptly restore the depositor at no worse position than he was before the crisis.

To balance this responsibility, the Government must put regulatory institution in place primarily to control banks from mismanaging customer’s fund and to take reasonable course of action to save those banks instead of relying on economic principles and ideology of free market to liquidate bank. Government should take higher stake in failing banks. Tighter control and supervision, higher state control and regulation should be applied once a bank’s capital fall below the threshold. Bank liquidation is painful, expensive and wasteful to the society. Therefore banks should be liquidated as a last resort where capital reconstruction effort has failed or have no prospect of success. In Nigeria, the government uses two major institutions to reconstruct the bank capital namely the CBN and the NDIC. The new investment and securities Act has created a major role for the SEC in the process through mergers and acquisition.

The CBN Governor in the discharge of his duty to maintain sound financial system in Nigeria under Section 2 of CBN Act has direct report to the President but he does not have such power in matters covered under BOFIA like the issuance and revocation of banking licenses. The issuance and revocation of banking license is subject to the prior approval of the Minister of Finance[334]. The provision of Section 1 of BOFIA requires that he reports to the Minister of Finance in that respect. This should not be the case because the power and process of revoking banking license is one matter that touches indirectly on the duty of the Governor to maintain sound financial system in Nigeria. There is need to streamline the process involved in the exercise of this power to avoid the process being subjected to political manipulation. Even if the Governor must have the approval of the Minister of finance before a banking license is issued, the Governor and the regulatory authorities should have full authority to enforce exit of non compliant entities from the banking system by revoking their licenses. The requirement for approval by the Minister of Finance provides room for political interference which derails the purpose of using revocation of license as a

[334] S.1 (3) BOFIA Cap B3 LFN 20043

regulatory tool. The Governor needs full independence to maintain and enforce the provisions of the BOFIA that can affect the stability of the financial banking system[335]. The roles of SEC and CBN in capital reconstruction of banks need some harmonization as more of business combination technique is utilized to resolve crisis in the banking sector. To minimize delay and financial loss to depositors and to ensure that the bank gets back to business promptly after crisis, less reliance should be placed on the free market principle that a bank like any other business entity should be allowed to collapse or liquidated where it cannot survive on its own. If mergers, acquisition and business combination should be used to safeguard failing banks instead of liquidating them, more interaction among the regulatory agencies is necessary for fast-tracking the process of mergers and other business combination. Overview of legal requirements relating to bank mergers and acquisitions shows that under Section 7 of BOFIA the consent of the Governor of CBN is required for any transfer of shares or business of a bank in Nigeria. The CBN concern seems to be on the effect such merger or transfer will have on the depositors and stability in the banking system. Under S.121 (1) and 134 (1) of ISA approval of SEC is required for any kind of business combination or

[335] See Adaighofua Ojomaikre 'FMF,CBN, federalism and economic ' The Guardian Vol.25 No 10667 ,Tuesday March 11,2008, p94. Where it was argued that full implementation of the provision relating to cash reserve ratio by CBN against the banks will eliminate fiscal indiscipline by the federal and other tiers of government and brings macroeconomic stability and growth and ensure the dominance of the private sector in the economy. See 20 years of central banking in Nigeria published by CBN 1979.p43

merger between two companies. The ISA Act requires that the SEC be satisfied that the proposed acquisition, merger or take-over will not constitute monopoly power or trade restraint in the economy before its approval is granted to the merger. It is noted that SEC,s approval does not dispense other regulators approval that the bank is required to obtain by the CBN in S.7 of BOFIA. Thus SEC and CBN share similar concern in a matter that can be resolved under one law. The objective of S.121 of ISA as applied by SEC and S.7 of BOFIA as applied by the CBN are the same, yet there is no statutory requirement that the agencies should notify one another on receipt of application for business combination by an applicant in respect of such issue. Approval procedure should therefore be merged in one body preferably the CBN. This is important because ISA in S.118 (4) provides that mergers consummated pursuant to the authority given by a Federal government owned Agency under any statutory provision vesting such power on the Agency shall be subjected to prior review of SEC while S.7 of BOFIA provide that no transfer or merger of a bank shall be effected without the approval of the CBN. There will be conflict where one of the body like CBN approve a business combination in bank which is not allowed by the SEC. There is need to clearly harmonize the role and objective of the two regulators in this regard and to have the related legislation in a single law. For instance, once a bank's capital fall below regulatory standard, the CBN under section 13 (3) of BOFIA is obliged to extract a capital reconstruction plan from such bank. Most often the solution to the problem leads the banks to taking steps that would involve a transfer, arrangement or scheme controlled under S.7 of BOFIA 2007 by the CBN. To harmonize the approval process under section 7of BOFIA and the objective of SEC under S.119 of ISA, it is submitted that Section 7 of BOFIA should be amended to specify the essential things that must be contained in plan for capital reconstruction or reconstitution for it to secure CBN's approval. A critical analysis of S.121 of ISA 2007 for instance will show that the section prohibits any scheme or arrangement which is likely to cause a substantial restraint in competition or likely to create a monopoly in an industry[336], but that cannot be said of the provisions of S. 7 of BOFIA 2007. Section 7 of BOFIA should be amended to make its objectives clear. The amendment should prohibit any arrangement or plan that is capable of affecting negatively the funds of the depositor or likely to cause instability or distress in the banking system and should be made to have overriding effect on other legislation that covers the same ground. This will reduce the time and cost involve in using business combination to rescue a failing bank under our law.

[336] See Investment and Securities Act Cap 124 LFN 2004.

The NDIC is an important regulatory body responsible for capital reconstruction process in the banking system. The Corporation primarily is the insurer of a category of depositors fund in the banking system. Presently, it is financially ill-equipped to face the challenges of today's banking system. The Corporation needs to be strengthened financially to enable it play its role in this process and to reduce its resort to liquidation of banks as a crisis resolution option. It should be empowered to intervene swiftly and to take over banks once such banks

capital adequacy fails below the required standard. It should not wait until such a bank becomes a failing bank before it intervenes. This is necessary for the mean time because it is doubtful if the corporation as presently constituted can withstand a major crisis in the banking system. Therefore, once a bank's weighted risk capital falls below 8 percent it should prompt the CBN to step in their capital reconstruction measures and get the shareholders to either recapitalized the bank, or it will be acquired by a stronger bank. In the alternative, the Government should recapitalize the bank and take control of it. Closely related to deposit insurance function of NDIC is government exercise of its power as a lender of last resort. This tool enables government to control systematic distress in a banking system.

Apart from solving immediate distress problem, lender of last resort program serves as corrective device for government previous fiscal and monetary policy defaults but its success relies critically on the state of the economy and the efficiency of the monetary and fiscal instruments adopted. It entails injecting of capital to bail out a failing bank system. It succeed mostly where the confidence in the system has not been eroded and the capability of the managers of the crisis is not in doubt. The manager could be a private sector buyer, the CBN or NDIC. Whichever institution the government decides to use in this function must be capable of paying more than the fire –sale price of the failing banks otherwise the depositors will resort to runs and the bankers will cease supply of credits to the economy.

5.1 Findings

It can now be asserted from the process of this research that:

1. In the absence of active supervision, statutory capital requirement for banking business afford inadequate protection to depositor in Nigeria banking system. This is borne out of the dynamic nature of capital requirement in banking business. Notwithstanding that the CBN raised the minimum capital requirement for banking business from N2 billion to N25 billion in 2005 during its consolidation

program, some bank's capital was eroded and substantial depositors fund was lost barely 4 years after the program.

2. The risk of a run or related problem is inherent in banking business but is exacerbated in a system where there is lack of confidence on the ability and skill of the regulatory authority to resolve banking crisis outside liquidation of banks. In banking sector insolvency resolution in Nigeria, little is known on how to restore and grow the capacity of the economic entity concerned without terminating its life. Therefore, overwhelmed by inadequate funding and this lack of innovations, the regulatory authorities are prone to resort to liquidation instead of capital reconstruction as resolution mechanism during bank crisis not withstanding its negative consequences to the economy and the society.

3. The fact that liquidation unlike others crisis resolution technique denies all depositors prompts access to their fund during its process is the major cause of lack of confidence in the banking system.

4. The provision of S.118 of the Investment and Securities Act 2007 which require the approval of SEC for mergers and acquisition approved by Government Agency

(including the CBN) is a legislative oversight that can hinder the efficiency of the CBN in reconstruction of bank capital during crisis under S. 7 of BOFIA and the exercise of its powers to maintain financial sector stability under S.2 of CBN Act.

5.2 <u>Recommendation</u>

In view of the above findings the research recommends that:

1. In the resolution of banking sector crisis, the regulatory authorities should use liquidation as last resort and other regulatory authorities like the NDIC should show sufficient step taken in rehabilitating a bank in crisis before it can be liquidated
2. Capital reconstruction of banks as a crisis resolution technique should be seen to go beyond changing the ownership structure of bank to include measures that can remove the burden of debt, attract fresh capital for such bank and restore confidence in the banking system.
3. The roles of regulatory institutions in mergers and acquisitions should be harmonized and the number of regulatory interface in the process should

be minimized to encourage the use of market driven mergers as against regulatory induced merger in reconstruction of banks capital.

4. The provisions of section 7 of BOFIA should be amended to have overriding effect on other legislation that covered the same ground like the provisions of the Investment and S.118 of Securities Act (ISA) so as to reduce the time and cost that may be required in rescuing a failing bank and to enhance the independence of the CBN.
5. Notwithstanding that a merger or other business combinations may lead to monopoly or restrain of competition in the future, it preferable and should be used instead of liquidation of bank during crisis. This is because monopoly power which the SEC would normally seek to prevent can be controlled or even broken by the exercise of the power conferred on SEC under S.128 of ISA 2007. Bank failure and liquidation are irreversible events that need cautionary haste and prompt control by CBN if its consequences and collateral damage to the economy is to be prevented.

5.3 CONCLUSION

The CBN, NDIC and the SEC are statutory bodies exercising administrative and quasi-judicial function relating to financial and economic affairs of the nation. By the nature of their function they are responsible for depositors' protection and financial system stability. The CBN and the NDIC are directly involved in the supervision and control of the banks. The SEC exercises control on the banks by virtue of the facts that the bank shares are listed in Nigerian Stock Exchange (NSE). The listing procedure to a large extent is tailored to promote sound corporate governance practices and to reduce the risk of bank or corporate failures. The problem of insiders trading, margin lending and role of stock broker in the recent banking crisis has cast doubt on the efficacy of the oversight function of SEC in this respect. The other aspect of its control in banks is through its power of regulation of competition and business combination particularly mergers, acquisitions and take-over. Its duty of ensuring fairness in treatment of shareholder through such deal is vital for prevention and resolution of bank failures in the country.

The NDIC is supposed to play its major role as a "risk minimizer" by monitoring banks to ensure their soundness and stability. It has however functioned more as a pay box with focus on bank liquidation and depositors reimbursement. It closed

21 banks during the 1989 bank crisis and 13 others that failed to meet the N25 billion consolidation requirements in 2006. It is noteworthy that most of the banks that NDIC managed as failing banks during the 1989 bank distress which were later sold to other banks under different resolution methods are still having , liquidity, corporate governance or capital inadequacy problems. The banks include present Wema Bank Plc, some of the banks that make up Finbank Plc, the Nationwide Merchant Bank ltd which changed its name to platinum Bank Ltd to form the present Bankphb, the New Nigerian Bank Ltd which joined with other banks to form the present Unity bank and the ACB International Bank Ltd which joined with other banks to form the present Spring Bank Plc among others[337].

NDIC has achieved moderate success in use of purchase and assumption method to prevent loss of deposit in 12 of the 13 banks it closed in 2006 as result of the consolidation exercise. The fact that banking services continued in the premises used by the banks and that access is availed some of their depositors to their fund after the failure of the bank has helped in encouraging banking culture in the system. Under the arrangement, Eco bank Plc assumed the private sector deposit of the defunct All state Trust bank and Hallmark Bank. The UBA PLc assumed the deposit of the defunct City Express bank and African Express Bank Ltd as well as

[337] Adeyemi Adepetun ,Reform: CBN in Pursuit of Corporate governance The Guardian Vol.27 No 11277 .,Wednesday November 11 2009.p.23.

that of the Gulf Bank Ltd. Afribank Plc assumed Assurance Bank Ltd and Lead bank Plc, while Zenith Bank assumed Eagle bank Ltd. The success attained by the Corporation in the use of purchase and assumption to salvage some depositors fund and assets of these banks from total loss can be attributed to the fact that it has no obligation to make prompt payment. The corporation also favors the method because its power in deposit pay off is limited by financial incapacity. For instance it has a total deposit insurance fund of N175.6 billion in December 2008 against N8.7 trillion of total insured bank deposit for the same period[338].The implication is that in event of failure of CBN to prevent systematic distress and liquidation in the banking system, NDIC will be incapable of resolving such failure without disruption to the payment system. Purchase and assumption will not be able to protect the banking system in such situation because the sudden and extra ordinary rush that normally ensue as depositors run for their fund will not afford the purchaser of the failing banks assets the time to verify asset and deposits to be assumed.

In most of the distress cases which CBN intervene in Nigeria the objective has always been to resolve the problem that arises where a bank has insufficient asset to match its liabilities. The BOFIA empowers the CBN to revoke the license and to

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338 Ben Uzor,NDIC at 20: An overview of a financial gatekeeper. The Guardian Monday November 2 2009.p15

liquidate a bank that fall into such situation[339]. It also empowers it to specify and enforce the minimum ratio of fund that must be maintained by banks free of loss[340]. Where a bank is unable to comply with the ratio as a result of loss the CBN is empowered to extract business plan of how the capital will be reconstituted from the bank within a given period failing which it can get the bank out rightly liquidated. In most cases because of the amount of money required to reconstitute such capital, combination or outright sale of the business of the bank may be necessary in which case the investors and the bank must necessarily follow the procedure stipulated by S.119 ISA 2007 and S.7 BOFIA. To ascertain the reason a bank's asset fall below it liabilities the CBN may conduct a special examination in such bank under S.33(1) of BOFIA 2007. Where such examination proves that the bank is insolvent, the CBN may treat such bank technically as a failing bank under S.35 (1) of BOFIA. A failing bank is considered to be in a grave situation which normally prompts the CBN to take steps to rescue it by ordering in writing the removal of the directors and appointing any person to manage the bank[341]. Such examination recently led to the dismissal of nine Managing Directors and some executive directors of some bank by the CBN. The common trend in this and other crisis discussed has been the failure of the bank to

[339] S.12(d) BOFIA 2007
[340] S.13(1) BOFIA 2007
[341] S.31(2)(d)(i)(ii) BOFIA 2007

maintain its assets above its liabilities. This in effect implies that no matter how much banks are stringently regulated, they are prone to runs because they are known to be highly geared. Statutory capital requirement and regulation are therefore put in place to boost confidence as well as a way of protection against the risk inherent in banks business and to prevent the banks from over lending. Lending is a banker's major business. Inherent in the business of lending is the risk that not all loans are collectable as a result not all depositors will be paid in event of insolvency of the banker. Since what the banker lends is not his capital but depositors fund, it becomes necessary that bank loans must be backed to some extent by a banker's capital. The regulator must monitor the banker to ensure that the rule is observed otherwise the banker trading with inadequate capital would after eroding his own capital waste his depositors' fund. Banks should be compelled to have capital that is permanent, of high quality and readily available to absorb losses. In addition it should have in place adequate plans to grow its capital at required ratio to its loan portfolio. Observation of capital adequacy and lending principle does not immune a bank or banking system from distress inherent in financial system because financial indiscipline in one bank or banking system can infect other banks or banking system. Therefore a country must be able to fashion out capital reconstruction mechanisms capable of preventing its bank or banking system from collapse. Market discipline or self regulatory measures often flaunted by proponent of free market and economic deregulation cannot be relied on wholly to achieve stability in a banking system. Resolution process, by which the asset of the bank may have to be sold off separately like Purchase and Assumption used by NDIC in recent time though better than outright liquidation is not the best option because it ended up dismembering the banks business before the bank eventually slipped away to piecemeal liquidation. It is therefore necessary to employ some elements of private contracting and a mixture of incentives that will reduce the delay and hardship to the depositors under the purchase and assumption process [342]. Mergers, acquisition and take-over offer better advantage and should be utilized to save banks from liquidations . Therefore capital reconstruction through business combination should be actively encouraged, provided that such combination shall not lead to present or future financial instability in the entity or the banking system. It should also be encouraged as a failure resolution mechanism where the cance of failure in the combined entity is not greater than the possibility of failure in either one or both of the combining entity standing alone. Public benefit and interst

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[342] Armour J and Deakin S. Norms in Private Insolvency: 'London Approach' to the Resolution of Financial Distress. Kluwer Law International. The Hague 2003. P.242

should be the overriding factor in distress resolution in banks especially where the invisible hand of the free market may lead to unreasonable course.

The banking sector Consolidation program implemented in 2005 by the CBN has shown the advantages that can be derived from mergers and acquisition. This was possible because the CBN collaborated with other institutions to fast track the legal and regulatory process that enabled rapid conclusion of the consolidation program which would not have been easy in a normal process driven by Nigeria's mergers and acquisition process. However, the post consolidation crisis has exposed major challenge that relating poor corporate governance culture and the weak regulatory framework under which the banks operated.

To continue to utilize the advantage of business combinations in capital reconstruction of banks harmonization and strengthening of the powers of some of the institutions that play vital roles in the process is recommended.

Notwithstanding that a merger may lead to monopoly or substantial restraint in the banking system, it should be a starting point when considering a viable alternative to liquidating a bank[343].

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[343] Bernstein J A, Merger and Acquisition The legal Hurdles Banks faces in choosing to Consolidate. The banking Law Journal Vol. 109 No 4 May-June 1992 p.205

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