DISTRES MANAGEMENT AND PREVENTION STRATEGIES FOR THE NIGERIAN BANKING SYSTEM

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DECLARATION

hereby declare that this thesis has been written by me, and that it is record of my own primary research work. It has not been presented in any previous application for a higher degree. All quotations and sources of information as seen in this thesis are specifically acknowledged by me: as of the given references.



Date

Signature

CERTIFICATION

This thesis titled "Distress Management and Prevention Strategies For the Nigerian Banking System" by *Amina A. Umar* meets the regulations governing the award of the degree of Master of Business Administration (MBA) of the Ahmadu Bello University, Zaria, and is approved for its contribution to knowledge and literary presentation.

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DEDICATION

To Almighty Allah (S.W.T.) for His Guidance and Protection.

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All praises be to ALLAH, the most Gracious, most Merciful.

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ABSTRACT

The financia system is a conglomerate of unions, institutions, markets, instruments and operators that interact within an economy to provide financial services such as resource mobilization and allocation, financial intermediation and facilitation of foreign exchange transaction to enhance international trade among others. The system has over the years, especially during the last decade, undergone a rapid expansion. The oil boom which commenced in 1973 and the economic growth which ensured made banking to thrive and to be lucrative. The economic downturn from early 80's brought strains to the Nigerian economy leading to a depressed economy. This economic predicament coupled with other factors such as mismanagement and inhibitive policy environment where banks were forced to perform developmental roles for which some of them were ill-equipped, controlled interest rates which tended to reduce banks profitability adversely affected the health of many banks.

To avert the collapse of the system following a myriad of problems, various measures were put in place by both regulatory/supervisory authorities and government. However, the effectiveness of the measures depends on improved quality of management in the financial system.

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CHAPTER ONE

INTRODUCTION

Emergence of Distress Bank in Nigeria

The health of Nigerian banks cannot be divorced from their antecedents. When modern banking business commenced in Nigeria by 1892, it was solely a business for foreigners. The Skewness in the ownership structure in favour of foreigners largely contributed to the observed lack of access to bank's credit by indigenous Nigerian entrepreneurs during that period. Nigerian entrepreneurs who came into banking from the late 1920s to early 1950s did so with the principal aim of redressing the situation, and meeting the financial requirements of Nigerian business. Due to problems such as inadequate capital, mismanagement, over trading, lack of regulation and unfair competition from the foreign-owned banks, 21 of the 25 indigenous banks that were established up to 1954 failed. The failures were resolved mainly through self - liquidation. The mass bank failures was bitter hardship for the economy as it brought untold hardship to depositors who lost their money and lost confidence in the ability of Nigerians to manage a banking business.

It was not until government started to regulate banking through the Banking Ordinance of 1952 and the establishment of the Central Bank in 1959, which was followed by the promulgation of the Banking Decree of 1969, that the banking system started to stabilise in the country. The oil boom which commenced in 1973 and the economic growth which ensued made banking to thrive and to be lucrative. The economic downturn, noticeable from mid - 1981, brought strains to the Nigerian economy which soon became depressed. As economic agents were not able to moderate their boom consumption habits in line with the realities of the depressed economy, the financial condition of individuals, firms and government worsened and they were unable to honour their contractual obligation of loan repayment to banks thus impairing banks' port folio quality. This economic predicament, combined

with other factors such as mismanagement adversely affected the health of many banks.

Another problem that affected the financial system was the inhibitive policy environment. Prior to the adoption of a comprehensive economic reform programme under SAP, Nigeria's banking system could be described simply as highly regulated. Some of these regulations had sometimes been counter productive and had contributed to the strains in the system. Banks were subjected to substantial restrictions on their products and activities. These restrictions had, to a reasonable extent, limited some banks' ability to adapt to changing market conditions. The government had generally in the past, made the control over banks an important tool of the country's economic development strategies. These policies were informed by the belief that without such intervention, the banking system might not corporate in, and positively contribute to, the development effort because of the divergence between social and private goals. The inhibitive policies manifested in the form of direct controls and the imposition of interest rate ceilings.

Through the direct credit controls, banks were forced to perform developmental roles for which some of them were ill-equipped. Consequently, their participation led many of them to serious financial problems. The direct credit controls often included the requirement that banks should provide subsidized credit to priority sectors and public enterprises. There were instances of defaults in the repayment of loans and advances to agricultural and small and medium scale enterprises even when they were given below market rates. Compulsory participation of banks in the Rural Banking Programme in the past had also forced some banks to expand faster than their capabilities. This was in addition to the non-viability of one of such branches which some banks dubbed "loss centres".

The control of interest rates tended to reduce banks' profitability and contributed to the poor financial condition of some of them. One of the effects of these regulatory policies was the large number of weak banks, particularly

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the first generation of distressed banks.

Also, the need to sanitise the operations of banks in the market - driven environment prompted the introduction of some measures which adversely affected some of them. Among such policy measures were the prudential Guidelines statement of Accounting Standards for Banks, and the use of stabilisation securities by the CBN to mop up excess liquidity in the system. The adoption of these measures, though sometimes desirable, exposed many weak banks and brought their insolvency to the attention of the regulatory authorities. Some banks which had earlier posted fat profits started to post heavy losses which, in some cases, resulted in the insolvency of the banks. The use of stabilisation securities to mop up excess liquidity also pushed some marginal banks to illiquidity. In extreme cases of illiquidity, there was near panic as some of the banks were unable to meet depositors' demand and consequently, the affected banks embarked upon distressed borrowing, especially in the interbank market, at exorbitant rates.

The distress condition has been traced to a wide range of causes some of which are discussed in chapter three of this study.

OBJECTIVE OF THE STUDY

The research work is primarily aimed at objective identification of the real causes of the current distress in the financial services industry. This will form basis for reassessing the various distress resolution and preventive strategies embarked upon by the banks and regulatory bodies.

Other secondary objectives of the study include:

i. a comprehensive review of developments in the financial services industry in Nigeria particularly during the period 1989 - 1997.
ii. assessing the extent and depth of the distress situation;
iii. professing comprehensive and effective policy package that would ensure a comprehensive resolution of the distress problem in the Nigerian Financial Services Industry.

CHAPTER TWO

RECENT DEVELOPMENT IN THE NIGERIAN FINANCIAL SYSTEM

A financial system is a conglomerate of various institutions, markets, instruments and operators that interact within an economy to provide financial services. Such services may include resource mobilisation and allocation; financial intermediation; and facilitation of foreign exchange transactions to enhance international trade among others. The system has over the years, especially during the last decade, undergone a rapid expansion both in terms of the number of institutions and the scope and variety of financial services offered. Of recent, however, the safety, soundness and stability of the Nigerian financial system have been threatened by wide spread distress, especially in the banking sub-sector. In order to put various issues associated with the distress condition in the Nigerian Financial Sector in proper perspective, a brief review of the structural changes in the sector is considered pertinent in isolating the underlying factors responsible for the deteriorating condition.

2.1 THE STRUCTURE OF THE NIGERIA FINANCIAL SYSTEM

The structure of the Nigerian Financial System has changed significantly, both in size and complexity, from the pre-colonial era through the 1980s and into the 1990s. This is as a result of a combination of factors, including the changing policy environment, technological innovations the interrelationship between the different units or group of units in the system as well as the interplay of market forces and some macroeconomic variables. All these, together with the introduction of the legal and institutional framework for the supervision and regulation of financial institutions, contributed greatly in changing the structure of the Nigerian Financial System.

The Nigerian Financial system comprises the regulatory/supervisory authorities as well as banks and non-bank financial institutions.

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a. ***The Regulatory Authorities***

The regulatory / supervisory authorities are very crucial for the functioning and orderly development of the financial system. Highlights of the role of the various regulatory authorities are provided below:

i. *The Central Bank of Nigeria (CBN)*

The CBN is the apex regulatory authority of the financial system. It was established by the Central Bank of Nigeria Act of 1958 and commenced operations in July, 1959.

The bank was charged, among other things, with the responsibility of promoting monetary stability and a sound financial structure in the country.

Since the commencement of operation of the CBN in 1959, the Nigerian Financial Services industry has recorded remarkable evolution. In carrying out its various responsibilities, the CBN has to ensure that all institutions within the industry operate in accordance with the provision of relevant laws and that their operation are in line with generally accepted practices. With the promulgation of the CBN Decree No. 24, the CBN now has the sole responsibility for the formulation and execution of monetary policy in Nigeria, the power it hitherto shared with the Federal Ministry of Finance. To further strengthen its supervisory capability the Banks and Other Financial Institution Decree No. 25 of 1991 was also promulgated. The CBN directly regulates the activities of the banks, finance companies, and bureaux de change and delegates the supervision of community Banks to National Board for Community Banks as its agency for that purpose.

ii. *The Nigerian Deposit Insurance Corporation (NDIC)*

The NDIC was established by Decree No. 22 of 1988 and commenced operation in March, 1989. The NDIC is an autonomous body which acts as an additional supervisory authority over licensed banks and other deposit - taking financial institutions. NDIC for now insures only commercial and merchant banks and therefore extends its supervisory activities to them. In 1994, the on-site supervisory role of the corporation was expanded to cover the community

banks so as to ensure safe and sound banking system in general and contribute to the development of community banking scheme in Nigeria. The NDIC not only provides financial guarantee to depositors in case of failure but also ensure that banks comply with regulations and practice which foster safety and soundness in the financial market. The NDIC is empowered to apply sanction and corrective measures when lapses are observed in the operation of insured banks. It is also empowered to undertake the liquidation of failed banks when so appointed by the CBN.

iii. *Federal Ministry of Finance*

The Federal Ministry of Finance (FMF) in addition to its responsibility of overseeing some regulatory agencies, in particular SEC and National Insurance, Supervisory Board (NISB), regulates the People's Bank directly and licenses the bureaux de change in the country.

iv. *The Securities and Exchange Commission (SEC)*

The Securities and Exchange Commission (SEC), which is the apex regulatory authority in the capital market, was established through the Securities and Exchange Commission Decree 1979, later repealed by the new Decree 1988. It is charged with the responsibility for the overall regulation of the capital market.

v. *Federal Mortgage Bank of Nigeria (FMBN)*

The Federal Mortgage Bank of Nigeria (FMBN) was created by Decree No. 7 of 1977 to take over the assets and liabilities of the Nigerian Building Society which had hitherto been performing mortgage administration business since its incorporation in 1956. Following the promulgation of Decree No. 53 of 1989. The FMBN became a regulatory body over primary mortgage institutions. The FMBN is empowered to license an supervise mortgage institution in Nigeria.

vi. *Other Regulatory Institution*

In order to create considerable institutional deepening aimed at reinforcing the supervision of major segments of financial services industry,

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additional regulatory/supervisory institutions were established. These include the National Board for community Bank (NBCB) for registering community banks and monitoring their operation and the National Insurance Supervisory Board (NISB) for regulating and supervising insurance companies and brokers. The development banks are being regulated by their supervisory ministries and the presidency. The Federal Ministry of Industries regulates the Nigerian Industrial Development Bank (NIDB) and the Nigerian Bank for Commerce and Industry (NBCI). The Federal Mortgage Bank of Nigeria(FMBN) in being regulated by the Federal Ministry of works and housing; the Nigerian Export-Import Bank (NEXIM) is under the regulation of the Federal Ministry of Trade; the Federal Ministry of Agriculture looks after the Nigerian Agricultural and Co-operative Bank; and the Urban Development Bank (UDB) is directly under the Presidency.

The existence of several regulatory bodies for various segment of financial services industry dictated the need for the establishment of the Financial Services Regulation Coordinating Committee (FSRCC) to coordinate and harmonise set standards and supervisory efforts of these various apex regulatory bodies. The current membership of the committee comprises: the CBN, NDIC, SEC, FMBN, NSE, NACB, NISB and CAC (Corporate Affairs Commission) with the CBN as the Head of the committee.

b. ***Banking Institution***

The banking institution in Nigeria include commercial and merchant banks, development banks and specialised banks.

i. *Commercial and Merchant Banks.*

Commercial banks are retail banking institutions that accept deposits and make short - term credits available to government, private business enterprises and individuals. The merchant banks, on the other hand, are wholesale banks which are expected to provide medium to long - term finance. Merchant banks unlike commercial banks do not participate in clearing house activities and they do not provide chequing facilities. The

relationship between these banking institutions and other institutions in the financial services industry as well as the banks' functions, limits and modus operandi are spelt out in the Banks and Other Financial Institution (BOFI) Decree no. 25 of 1991. However, with recent amendments to BOFI Decree in 1997, the minimum capital requirement of both commercial and merchant banks has been increased to a uniform level of N500.0 million from the N50.0 million and N40.0 million for commercial and merchant banks respectively.

TABLE 2.1 Number of Banks in Operation in Nigeria for selected years.

Years	Commercial Banks		Merchant Banks		Peoples Bank	Community Banks
	Number	Branches	Number	Branches		
1989	47	1855	34	54	20	
1990	53	1937	48	74	169	1
1991	65	2023	54	84	200	66
1992	66	2275	54	116	228	401
1993	63	2258	54	124	271	611
1994	65	2403	51	144	275	813
1995	64	2368	51	144	275	1132
1996	64	2407	51	147	278	796
1997	64	2330	51	147	278	790

Source : CBN and NDIC annual reports and statements statistical bulletin Vol. Various issues (1990 - 1997)

Since the government commenced active deregulation of the economy in September 1986, the commercial banking sector witnessed rapid growth in terms of number of institutions and product innovation in the market. The number of commercial banks and their branches rose respectively from 47 and 1,855 in 1989 to 64 and 2,330 in 1997. (Fig: 2.1) Two commercial banks were liquidated between 1993 and 1995.

The total assets/liabilities of the commercial banks increased from N458,779.0 million in 1996 to N578,543.5 million in 1997, while deposit liabilities rose to N267,378.3 million in 1997 from N214,360.0 million in 1996. (CBN Annual Report 1997.)

During 1994, three merchant banks (Alpha Merchant Plc, Kapital Merchant Bank Ltd and Financial Merchant Bank Ltd. with five office nationwide were liquidated. By the end of the 1996, there were 51 merchant banks with 147 branches, while their total assets amounted to N118,967.6 million in 1997 as against N89,979.3 million in 1996 and their deposit liabilities of N30,817.3 million in 1997 as compared to N24,413.3 million in 1996. (CBN 1997 Annual Report).

TABLE 2:2 Assets and Deposit of commercial and Merchant Banks for selected years.

Years	TOTAL ASSETS		DEPOSIT LIABILITIES	
	Commercial	Merchant	Commercial	Merchant
1989	65,523.7	22,117.7	27,181.3	3,809.3
1990	82,957.9	28.593.4	38.775.7	5,093.3
1991	117,511.9	37,945.0	52,408.7	7,068.0
1992	181,736.1	50,542.4	76,073.5	11,664.7
1993	226,163.0	53,759.0	110,454.0	19,196.0
1994	295,035.0	62,447.0	142,538.0	20,365.0
1995	385,143.0	79,913.0	178,962.0	17,856.0
1996	458,779.0	89,979.3	214,360.0	24,413.3
1997	578,543.5	118.967.6	267,378.3	30,817.3

Source: CBN Annual Report and Statement of Accounts (1990-1997)

ii. *Development Banks*

Development banks were established to meet the long - term credit needs of particular sectors of the economy. They undertake detailed technical

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and credit appraisals and finance projects through equity participation or long - term loans in the agricultural, industrial, commercial and other sectors of the economy. The activities of these development banks also include the provision of financial and advisory services to indigenous entrepreneurs. They equally act as agents of the government in disbursing funds to the various applicable sectors of the economy.

Currently, such banks include the Nigerian Industrial Development Bank (NIDB), the Nigerian Bank for Commerce and Industry (NBCI), the Nigerian Agricultural and cooperative Bank (NACB), the Federal Mortgage Bank of Nigeria (FMBN) , the Urban Development bank (UDB) and the Nigerian Export - Import Bank (NEXIM).

iii. *Specialised Banks*

Banks in this category are the people's Bank of Nigeria (PBN) and the Community Banks. The PBN came into being in the country in 1989. The bank aims at improving the lot of low income group by providing them facilities outside the regular norms and procedures operating in the conventional banking system.

Community banking concept evolved in 1990. It is a specialised bank whose operation and laws differ from the conventional banks.

c. ***Non Bank Financial Institution***

Finance and investment companies, brokerage firms, insurance companies, mortgage institutions, discount houses, bureaux de change, the Nigeria Social Insurance Trust Fund (NSITF) and the National Economic Reconstruction Fund (NERFUND) are some of the institutions in the category of non-bank financial intermediaries. These institutions perform the role of financial intermediation by mobilising and providing short to long - term funds to the various sectors of the Nigerian economy.

2.2 THE FINANCIAL MARKETS

The main component of the Nigerian Financial markets are the money capital markets. While the money market facilities the process of intermediation between the surplus spending units and the deficit spending units is concerned with long term capital transaction which relates to the issuance and marketing of shares, bond and debentures using the services of brokers, dealers and under-writers. Currently, major participates in the Nigerian money market one the CBN for itself and on behalf of the government and its agencies, NDIC FMF, the discount houses as well as treasury bills, treasury certificates, call money, certificate of deposit (CDS) Bankers Unit Fund (BUF) and commercial papers.

2.3 CURRENT STATE OF FINANCIAL SYSTEM

The impact of the combination of institutional and policy reforms within the broad context of an economy - wide structural adjustment programme was initially positive on the financial services industry. However, this positive impact of the reforms was undermined by the advent of distress which is currently ravaging the industry. The scale of distress in the financial system was generally modest until 1989. Before then, incidences of distress were not rampant and were generally amenable to control by the monetary authorities. Since 1989, the distress in the industry had become generalised, spreading to virtually all the system sub-sectors. In the banking sub sector for instance, financial distress has been on the increase since 1988. The table 2.3 shows the average number of distressed banking institution from 1989 to 1997.

TABLE 2.3 NUMBER OF DISTRESSED BANKING INSTITUTION

Year	No. of Distressed Banks
1988	7
1989	8
1990	9
1991	15
1992	16
1993	28
1994	45
1995	60
1996	52
1997	47

Source: CBN Annual reports (Various Issues) & NDIC Banking Data. (1996-1997)

As indicated by table 2.3, there has been considerable increase in the number of distressed commercial and merchant banks whose restructuring has been the focus of efforts by the supervisory authorities since 1989. For instance, the Table shows that the number of distressed banks increased from seven in 1988 to 28 in 1993 representing an increase of 300 percent. By the end of 1996, the number had increased to 52. Moreover, these distressed banks as at the end of 1995, had ₦70.8b deposit while their total assets stood at ₦95.6b. (NDIC, 1997)

In addition to the distress in the banking sub-sector of the financial services industry, many of the non-bank financial institutions had equally not shown much sign of good performance as the wave of distress had spread to

finance companies, community banks and primary mortgage institutions. By the end of 1993 for instance, about 31 finance companies were classified as distressed while another 118 were in default of matured obligations. Similarly 32 community banks were in distress by the end of 1993. In 1994, the situation had not improved as the incidence in finance companies, primary mortgage institutions and community banks remained substantial. For instance, out of 279 primary mortgage institution operating in 1994, only 116 of them were found to be sound by the Federal Mortgage Bank of Nigeria while 150 others were declared distressed and the rest were operating at various degrees of "ill health". Although relevant data will not readily available, indication were that distress was also significant in insurance companies. (NDIC Quarterly, Sept./Dec. 1996)

The financial system distress has been traced to the prevailing economic recession, socio-political crisis, policy induced shocks, poor and deteriorating asset quality arising from large portfolios of non-performing credits, mismatch of assets and liabilities, over-trading, bad management and insider abuse, among others. The degree of distress in the system portends danger for the stability of the financial services industry with adverse implication for the overall macroeconomy.

To avert the danger of instability, various measures have been taken by the regulatory, supervisory and other relevant authorities. for instance the introduction of an explicit insurance scheme has provided a specialised institution to address the distress and protect depositors. Further more, the CBN over the last few years has revoked the operating licenses of five barrel and in addition to the liquidation of the five banks, it has also revoked the operating licences of 20 finance companies while approval-in-principle for 11 other finance companies were cancelled in 1994.

CHAPTER THREE

REVIEW OF LITERATURE ON CONCEPTS ANALYTICAL FRAMEWORK

In Nigeria, the studies of Jimoh (1993) and Nyong (1994) could be described as having established formal empirical bases for analysing distress in the Nigerian banking system. The studies seek to build upon earlier attempts by developing on analytical framework that in capable of explaining the courses of distress in the Nigerian financial services industry.

Before getting to the main thrust of this analysis, however, it would be necessary to have a good understanding of what distress means and how it is measured.

3.1 DEFINITION OF DISTRESS

Several attempts have been made in the past to define "distress" in the financial services industry. In ordinary parlance, the word "distress" connotes unhealthy situation" or a state of inability or weakness which prevents the achievement of set goals and aspirations (Ologun, 1994). Alashi (1993) associates distress with a cessation of independent operation or continuance without the assistance of relevant authorities such as a deposit insurance institution. Thus, the traditional, quantifiable measures of failure (loss figures represented in standard financial statements) are not very helpful in assessing the degree of severity of distress of such a financial institution. By extension, therefore, such loss figure for the industry will not be of much use in assessing the distress in the industry.

In other to evolve a working equation of distress for financial institution therefore, it may be desirable to synthesize those factors that will make a financial institution unhealthy as well as state some broad set objectives and aspiration of a typical financial institution. Thus a financial institution will be described as unhealthy if it exhibits severe financial, operational and managerial weaknesses (Ologun, 1994). The broad objectives and aspirations

of a typical financial institution, on the other hand, will be to meet its obligations to its customers as and when due as well as to its owners and the economy within which it operates (Ebhodaghe, 1993). From the foregoing, it is possible to describe a distressed financial institution as one with weaknesses which have rendered it difficult for it to meet its obligations to its customers, owners and the rest of the economy as and when due. Thus, distress of a financial intermediary is often technically used to describe two distinct, but closely related states or conditions of the institution, namely, insolvency and illiquidity, CBN/NDIC (1995). While insolvency refers to a condition in which the sum of assets of an institution is less than the sum of its liabilities, a situation which prevents it from honouring its obligations to depositors and other shareholders, illiquidity, on the other hand, describes the problematic cash flow position of a firm. It is important to note here that while a technically insolvent bank could remain sufficiently liquid long after it became insolvent, particularly if it has a large and stable deposit base, a bank could run into liquidity problems arising from a mismatch between the maturity profiles of its assets and liabilities CBN/NDIC (1995). Also illiquidity, as observed by Glassner and Mas (1991), If unassisted by monetary authorities, can turn into insolvency if the institution has to sell its assets at distressed price or pay above market rates on deposits in a desperate scramble for liquidity.

Distress in the financial services industry will therefore occur when a fairly reasonable proportion of financial institutions in the system have liabilities exceeding the market value of their assets which may lead to runs and other portfolio shifts and eventual collapse of some financial firms. This is similar to the description given to distress by the Federal Reserve Bank of San Francisco (1985) where distress in described as a sharp reduction in the value of financial institutions' assets, resulting in apparent or real insolvency of many financial institution accompanied by some runs and possibly the collapse of some institutions.

Based on the extent and depth of the problem, financial system distress can either be of generalised nature or systemic. Generalised distress exits when its occurrence is spreading fast and cuts across all the sub sectors of the industry but its depth, in terms of the ratio of total deposits of distressed institutions to total deposits of the industry; the ratio of total assets of distressed institutions to total assets of the industry; and the ratio of total branches of distressed institutions to total institutional branches of the industry; among others, has not adversely affected the confidence of public in the financial system. The problem may be become systemic and of serious concern to the relevant supervisory/regulatory authorities when its prevalence and contagious effects become endemic and pose some threats to the stability of the entire system, with its attendant negative effects on the nation's payment system, savings mobilisation, financial intermediation process and depositors' confidence (Balino 1991). Under this situation, the ratios of the relevant variables should have risen to a level that public confidence in the system would be completely eroded.

The level at which the system will get before it triggers off runs on the entire system will vary from country to country, depending on the level of awareness in a country, the existence or otherwise of an explicit deposit insurance scheme which normally contains contagious effects, and the level of alertness of the regulatory authorities in swiftly taking corrective actions. In a country where the level of awareness is high, no explicit deposit insurance guarantee is in existence, and where the regulatory authorities are not capable of taking prompt corrective actions, even at lower levels of the ratio of relevant variables, runs on the system could be triggered off. On the other hand, where the level of awareness is low, a functional explicit insurance guarantee exists and the regulatory authorities are capable of taking prompt corrective actions, even a much higher level of ratio of the relevant variables may still not trigger off runs on the system.

3.2 MEASURES OF DISTRESS

The categorization of a financial organisation as a "problem" or "distressed" institution is usually based on the CAMEL rating system (Nyong, 1994; Ebhodaghe, 1993). Under this system, the regulatory/supervisory authorities assess a financial institution's performance in five areas, namely, capital adequacy, asset quality, management competence, earnings strength and self-sustainability in terms of its liquidity position. Based on these parameters, appropriate financial ratios are developed for depicting the condition of the financial institution under consideration.

As observed by Ebhodaghe (1996), a financial institution in distress is usually one where the evaluation depicts poor condition in all or most of the five performance factors as follows:-

a. gross under capitalisation in relation to the level of operation;
b. high level of classified loans and advances;
c. illiquidity reflected in the inability to meet customers cash withdrawals;
d. low earnings resulting from huge operational losses; and
e. weak management as reflected by poor credit quality, inadequate internal controls, high rate of frauds and forgeries, labour turn-over etc.

Using these parameters, an institution's financial condition is assessed against some standard benchmarks like minimum capital adequacy ratio, liquidity ratio, and ratio of non -performing credits to shareholders funds among others, to make statement about the health status if the institution. When these ratios deviate adversely from predetermined critical level by the relevant authorities, the institution is described as exhibiting symptoms of distress. However, the use of such ratio alone may not describe the level of distress. For instance, an institution that has not met the minimum capital adequacy ratio of 8 percent and the liquidity ratio of 30 percent in the case of Nigeria may have manifested some symptoms of distress without providing a good measure of the extent of distress.

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In order to make for this short-coming and derive an effective measure of distress through the establishment of thresholds; attempts have been made at developing a composite measure based on these CAMEL parameters that will enable supervisors determine on a uniform platform, the extent of distress in each of the banks and by extension in the financial system as a whole. Such a composite measure can then be calibrated into a rating grid. with desired categorisation like sound, weak, distressed, terminally distressed, etc.

This composite measure is simply a weighted average of the CAMEL parameters in which the weighted parameters sum to unity (or 100 percent). The weights are made to reflect supervisors' opinion on what to emphasize in bank operations and to this extent, the assigned weights are usually arbitrary. But because there is some reasonable degree of agreement on the critical indicators of good and bad banking practices this arbitrariness is within a narrow range. For example, the proportion of a bank's Total assets that is income generating (i.e. earning assets) is universally accepted as an indicator of the bank's assets quality. But this can be complemented by an indicator of the proportion of deficient credits in the bank's credit portfolio which is a subset of the earning assets. This particular category of earning assets invariably constitutes the single largest chunk. So the measures of asset quality can be combined in a manner that would reflect this complementarity and be appropriately weighted. Once this is borne in mind, the arbitrariness will be narrowed down to reflect predominant peculiarities of each country. These general considerations have informed the weighting of the CAMEL parameters and also explained the variations observed in such weights across countries that use such rating. The monetary authorities in Nigeria have recently embarked on the development of a rating system for banks. This was initiated jointly by the CBN and the NDIC and the draft rating system provides for classifying banks as shown below; given their composite scores.

TABLE 3.1 CLASSIFICATION OF BANKS BASED ON THE PROPOSED RATING SYSTEM

CLASS	COMPOSITE SCORE (%)	RATING
A	86 - 100	Very Sound
B	71 - 85	Sound
C	56 - 70	Satisfactory
D	41 - 55	Marginal
E	0 - 40	Unsound

Source:- NDIC quarterly Vol. 6 No. 3/4

The above table (3.1) shows the range of composite scores for each rating, and if a threshold is agreed upon, it could enable the authorities determine those banks that are distressed and whether marginally or terminally. Details of the weights and the financial ratio used for assessing each CAMEL factors are shown in table 3.2.

TABLE 3.2 PROPOSED FACTOR / COMPONENT WEIGHTS

	FACTOR	COMPONENT		COMPONENT WEIGHT (%)	TOTAL Weight (%)
1	Capital	(a)	Capital to Risk-weighted Assets Rations	15	
		(b)	Adjusted capital ratios	5	
		(c)	Capital Growth Rate	5	25
2	Asset Quality	(a)	*Non-Performing* Risk Assets to Total Risk Assets	15	
		(b)	Reserve for losses to Non-Performing Risk Assets	5	
		(c.)	Non-Performing Risk Assets to Capital and Reserves	5	25
3	Manage-ment	(a)	*CAEL / 85*	5	
		(b)	Compliance with laws and Regulations	10	15
4	Earning	(a)	Profit Before Tax to Total Assets	5	
		(b)	Total Expenses to Total Income	5	
		(c)	*Net Interest Income to Total* Earning Assets	5	
		(d)	Interest Expenses to Total Earning Assets	5	20
5	Liquidity	(a)	Liquidity ratio	10	
		(b)	Net loans and Advances to *Total Deposits*	5	*15*
TOTAL					**100**

The scoring under management factor is based on its effects on other factors; hence, for the first parameter under this factor, "CAEL/85", the score is the sum of the weighted scores in other factors divided by 85 and represented by a weight of 5. The other parameter, "Compliance with laws and Regulations", is given a weight of 10. The reasoning for this approach to scoring management factor is that management quality is reflected in the other factors and that other quantitative indications of management performance would fit into one or more of the other CAMEL factors.

There has also been a commendable private initiative at developing a bank rating system in Nigeria by Augusto and Co. It essentially follows the same general consideration, using a group of financial ratios to measure bank performance in respect of certain factors, weighing these to sum up to 100 percent and using the composite score to rate the banks. The state objectives of this private initiative include assisting bank counter-parties and significant depositors to assess the risk involved in doing business with these banks. The rating grid classifies banks as shown in Table 3.3.

TABLE 3.3. BANK CLASSIFICATION BASED ON AUGUSTO'S RATING SYSTEM

CLASS	COMPOSITE SCORE (Percent)	RATING
I	at least 80	Superior Risk
II	70 - 79	Good Risk
III	60 - 69	Acceptable Risk
IV	50- 59	Deteriorating/Weak Risk
V	less than 50	Very weak Risk
VI	-	Unclassified

Source:- Augusto & Co. (1994)

The unclassified risk class is in respect of those banks which timely and or adequate information could not be obtained for meaningful analysis and rating. The factors and their assigned weights in the Augusto model are presented in Table 3.4 below. It should be noted that for merchant and commercial banks, different factor weights were assigned to "Capital Adequacy" and "Market Share".

TABLE 3.4 FACTOR AND ASSIGNED WEIGHTS

	Commercial Banks	Merchant Banks
Capital Adequacy	10	15
Track Record	10	10
Profitability Asset Quality	25	25
Liquidity and Liability Generation	15	15
Market Share	10	5

Source : Augusto & Co. (1994)

The important points of departure in these to initiatives are in respect of:

(i) the factors and their component ratio/weights; and

(ii) the treatment of the management factor.

As discussed earlier, there is a consensus on the critical factors to consider and also to a reasonable extent, on the relevant financial ratios. But the factor weighting and the subsequent component weighting have wide disparities. The basis for assessing and probably improving on these initiatives are as follows:

(i) how comprehensive these factors are in capturing good banking practice;

(ii) the complementarity and analysis of qualitative variables under the management factor; and

(iii) the complementarity of the components in adequately assessing the factors.

The Augusto model uses the following factors, namely: Capital Adequacy, Track Record, Asset Quality Liquidity, Market Share and Management and staff Quality. The Regulatory Authority Rating Model (RARM) uses the familiar CAMEL factors which in the main coincide with the factors used by the former (based on the component ratios used), except for market share. The inclusion of market share deserves some comments. Market share of individual bank is more useful in macro analysis of the market structure. It is believed that this factor will at best reveal the resilience of individual bank and the extent to which a bank can "take the market for a ride" (CBN/NDIC (1995). For instance, the Nigerian banking public at present rightly or wrongly believes that the big and older banks are safer. Thus, for the Nigerian environment "market share" may be a critical factor.

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3.3 EXTENT AND IMPLICATION OF DISTRESS

3.3.1 EXTENT OF DISTRESS

The distress phenomenon in the Nigerian Banking Industry is of recent origin. The manifestation became discernible with some policy shocks starting in 1988 with the CBN directive to banks that Naira backing for foreign exchange application be lodged with the CBN . This was followed in 1989 by another directive requiring public sector deposits to be transferred to the CBN. These two directives exposed the precarious liquidity positions of some banks and the distress they had subterraneously haboured. What was then thought to be a temporary liquidity problem for a few banks soon caught up with a lot more banks. This development spurred the supervisory authorities to more vigorously examine the safety and soundness of the banks by assessing their extent and depth of distress. With the implementation of prudential standards, the number of distressed banks that stood at 9 in 1990 rose to 16 in 1992. As at December 1994, there were 45 distressed banks compared with 38 in December 1993. The number peaked at an alarming 60 as at the end of 1995 out of which 51 were not only insolvent but terminally distressed (P.N. Umoh, 1997).

Table 3.5 depicts a six year trend of the deterioration in the banking industry. It indicates both the magnitude of distress as implied by the number of distressed banks and the depth by the extent of required recapitalization and proportion of non-performing credits.

The ratio of classified loans and leases to total loans and leases of these distressed banks fluctuated over the period and ranged between 43 per cent in 1992 and 76.5 percent in 1996. Measured against the maximum prudential ratio of 20 percent for classified loans and leases to total loans and leases being adopted in the country, the capital base of these banks had been completely eroded by provision for non-performing assets. This mainly explained the reason why the fresh capital required for the volume of operations of the distressed banks to enable them to operate in a safe and

sound manner had sky-rocketed from ₦1.1 billion in 1989 to ₦39.9 billion at the end of third quarter 1996.

TABLE 3.5 LEVEL OF DISTRESS IN THE NIGERIAN BANKING SYSTEM.

Parameters	1989	1990	1991	1992	1993	1994	1995	1996*
No of Bank	81	107	119	120	120	116	115	115
No. Of Distressed Banks	7	9	15	16	38	45	60	52
Total Loans and Leases of Distressed banks (₦' billions)	4.3	6.4	5.4	15.7	29.1	39.4	66.5	53.9
Non-Performing Loans and Leases of distressed banks (₦' Billion)	2.9	4.7	4.1	6.8	18.4	26.2	44.5	40.6
Ratio of Non-Performing Loans and Leases to Total Loans and Leases of Distressed banks (%)	67.1	72.8	76.5	43.0	63.1	67.0	67.0	75.4
Parameters	1989	1990	1991	1992	1993	1994	1995	1996*
Additional capital Required by Distressed Banks (₦ Billions)	1.1	2.0	2.4	5.5	13.6	23.4	38.0	39.9
NDIC Deposit Insurance Fund (₦' Billions)	0.4	0.7	1.2	1.9	2.8	4.2	6.0	7.88

* Figure as at September 1996.
Source : P. N. Umoh Bank Deposit Insurance in Nigeria (1997).

3.3.2 IMPLICATIONS OF DISTRESS ON THE ECONOMY

The intermediating role of banks and their relevance both in the transmission of monetary policies and in the payment system underscore their importance as well as the problem that bank distress at the prevailing dimension in our economy could precipitate. Arising from their intermediation, banks generate financial resources and put these at the disposal of deficit economic growth in the form of increased employment of otherwise idle resources and this in turn leads to increased output. Therefore, an industry-wide insolvency of banks, such as the one being experienced in Nigeria should be expected to retard the economy's rate of capital formation, reduce its level of employment and output and ultimately, the pace of economic growth.

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In the course of mobilising financial surpluses, banks issue claims (securities) on themselves to the fund owners. Such securities become less attractive in the event of wide spread insolvency thereby increasing the holder's risk exposure and also making them lose confidence in the banking system. This clearly paralyses the development of a good banking culture. But more importantly, this development will cause the bank's cost of intermediation to rise as banks will need to pay higher returns to attract and retain deposits. Coupled with this is the fact that there will also be great and pervasive uncertainty such that the perceived real returns on financial assets will be lowered. Other indirect cost will also go up as in the case of more frequent intervention by the regulatory authorities. In the worse circumstance in which the banks become terminally distressed, depositors fund is lost unless there is an explicit / implicit provision for protecting depositors.

Another serious danger posed by widespread distress among banks is the threat to the development of an efficient payment mechanism. Settlement of transactions will become predominantly cash-based with its associated risks. Also, the effectiveness of monetary policies will be reduced in direct proportion to the extent of loss of confidence in the banking system as reflected in the instability that will characterise the demand for money and the proportion of money in circulation that will be outside the banking system as banks no longer serve as safe as safe depositories.

In Nigeria today, it is puzzling that inspite of the global trend towards credit - based economies and the growth of this culture in most emerging markets, most economic transactions in our economy are carried out on a cash-and-carry basis. This phenomenon accounts for the huge pool of fund in the informal sector, estimated to be as much as about 50% of total money supply (Ebhodaghe, 1996). A good proportion of this represents idle fund that could have been effectively utilised in the productive sector if the banking system in stable, safe and sound. The cash-based nature of our economy not only chokes the development of the financial services industry by hampering

efficient resource allocation and financial intermediation, but it also encourages distortion in money supply and macro - economic management.

Also, there will be financial cost to be incurred by the economy in order to resolve the distress problem. This invariably, is borne by tax payers at large. The implications would even be more severe for a depressed economy that is already on the path of declining growth. For example, the present financial condition of the hard core distressed banks are tending towards irreversible distress situation. The cost of recapitalising the distressed banks amounts to ₦39.9 billion while that of liquidation is up to ₦18 billion (P.N. Umoh and Ebhodaghe, 1997). Given that these funds have alternative uses which will have their multiplier effects on the economy, the loss to the economy as a result of this magnitude of bank failure is better imagined than quantified.

3.4. CAUSES OF DISTRESS.

A number of factors account for the distress in our banking industry. They include adverse economic condition, capital inadequacy, inept management et cetera. These factors are examined below.

3.4.1 ADVERSE ECONOMIC CONDITION AND INCIDENCE OF NON-PERFORMING ASSETS

Over the years, the Nigerian banking System has been under severe stress as a result of the large amount of non - performing loans (classified loans or bad and doubtful debts).The problem of bad and doubtful debts in the country was exacerbated partly by the global recession of the early 1980s which particularly adversely affected our oil sector and the subsequent economic downturn in the country. The adverse economic condition has been characterised by high inflation depreciating and unstable value of the Naira, large fiscal deficits, heavy external debt overhang, high unemployment, and slow growth.

This situation, no doubt, resulted in many borrowers being unable to service their loans thereby making many banks to come under severe stress. This problem has since been compounded by the attitude of some borrowers who are unwilling to repay even when they are known to have the means to settle their debts. Such borrowers sought refuge under the hitherto inadequate legal framework and cumbersome loan recovery processes which made it difficult for the lending bank to foreclose on collaterals.

A fall in the value of the Naira also shot up the cost of production and lowered the capacity utilisation in the country. Of course, this reduced the ability of some business borrowers to repay their bank loans and advances.

These problems greatly impaired the quality of banks' assets as classified loans and advances became unbearable and turned out to be a huge burden on many banks. The financial intermediation of many of these banks had equally been seriously impaired thus jeopardizing their existence as they could neither make profit and grow nor contribute to economic development of the country.

3.4.2 CAPITAL INADEQUACY

An important function of capital in a bank is to serve as a means of absorbing losses. Capital provides a cushion to withstand abnormal losses not covered by current earnings, enabling banks to regain equilibrium and to re-establish a normal earning pattern. In addition, it has been established that a bank with a higher capital has a potential for higher profitability.

Unfortunately, a good number of the country's banks are still grossly undercapitalised. This situation could be partly attributed to the fact that many of the banks especially the state government - owned banks, were established with grossly inadequate capital. This situation largely informed the decision of the regulatory authorities to raise the minimum equity share capital of commercial and merchant banks from ₦50 million and ₦40 million respectively to a uniform level of ₦500 million in 1997.

2.4.3 MANAGEMENT PROBLEMS

It is universally acknowledge that quality of management makes an important difference between sound and unsound banks. Poor management is therefore seen as the most important cause of banks' financial distress. One very significant and characteristic of mismanagement is the negative attitude and behaviour of bank managers which is difficult to reverse through external policies and measures.

Four common types of mismanagement are identified in banks; namely technical mismanagement, cosmetic mismanagement, desperate management and fraud (P. N. Umoh 1997). They are all prevalent in the Nigerian banking system and have undermined the health of many of our banks.

Technical mismanagement involves inadequate policy guidelines, lack of standard practices, prevalence of over-extension, poor lending, mismatching of assets and liabilities, weak and ineffective internal control system, poor or total lack of strategic planning. All these have manifested themselves in the management of Nigerian banks. This is partly evidenced from the instability in the tenure of directors and key management staff of some banks. Also these directors indulge mainly in insider abuse, empire building, arbitrage opportunities and rent - seeking activities, and quarrels on access to privileges and perquisites of office rather than charting profitable and growth oriented plans for their banks. In addition, the proliferation of banks has over - stretched the executive capacity to the extent that the quality of technical manpower has become very low in the industry.

Cosmetic mismanagement, usually a derivative of technical mismanagement, consists of hiding past and current losses to buy time and stay afloat, looking, hoping and waiting for miracles. This include systematic roll-over, recognition and capitalization of accrued interest income on delinquent facilities, keeping dividends constant on spurious earning, fictitious collateralization, etc, particularly before the introduction of the prudential guidelines.

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Despe ate management is a situation where bankers see themselves in danger to leclare, among others, capital reduction, operational loss, and no dividends The main unwholesome practice in desperate management by Nigerian bar kers include speculation particularly by the distressed banks which used o pay above market interest rates for deposits and charging higher intere t rates to borrowers.

Fraud s part of the delinquent features that turn good bank managers into bad one s. Where there are too many of them, the affected bank might have lost its capital several times over before it is discovered. This is precisely the case in our banking system which has been riddled with fraudulent managemen . The amount lost through fraud has been alarming and on the increase in he recent past. Some of the banks' management even violate regulations and falsify returns to the authorities just to cover up the level of frauds in the r banks.

3.4.4 EFFECT OF DEREGULATION.

The deregulation of the economy brought about increased competition and innovat on in the financial market. The increasing competition and innovation have equally brought about visible traces of strain into the banking system. In a competitive environment, allocative and operational efficiency requires that nefficient and marginal firms be crowded out and allowed to go under. In acc ordance with the principle of market mechanism, there must be free entry an l free exit. Some banks, notably the government-owned banks, that had previously been protected from competition do not have the management expertise to survive in an increasingly complex, volatile and competitive market which has resulted from the deregulation of the industry. In a way, the efore, it is a paradox that while competition enhances the menu of bank pro ducts available to customers, such competition has indirectly caused the insolvency and failure of some banks in Nigeria.

3 4.5 OWNERSHIP STRUCTURE AND POLITICAL INTERFERENCE

Owners' direct intervention in the internal operations of the banks, most especially in government-controlled banks, has contributed to distress in some of them. In the private banks, the prevalence of boardroom quarrels and insider abuse are precarious cankerworms causing distress in many of them. In the five liquidated banks namely, Kapital, Financial, Alpha merchant banks, Republic bank and United Commercial banks, the main cause of their failure had ben insider abuse and financial malpractice by their owners.

Besides, most of the government owned banks are often treated as political banks. Some of these banks are characterized by inept management whose tenures of office are occasionally very unstable. In most cases, as the owner governments change frequently so also do the Boards and key management staff of the banks. One result is inconsistent policies due to the fact that what one board did, the succeeding one (for political reasons) would overturn with reckless abandon.

CHAPTER FOUR

DATA PRESENTATION AND ANALYSIS

The last few years have been both traumatic and revolutionary for the Nigerian Banking Industry. Accustomed to steady profits and little or no problem since 1959 when the Central bank of Nigeria (CBN) was established, the industry has, in recent times (1991 - 1995) produced the largest number of technically insolvent and undercapitalised banks. (NDIC Quarterly returns sept/Dec. 1996). Currently, the magnitude of distress in the nation's banking industry has reached an unprecedented level thereby making it an issue of concern to the government, the regulatory authorities, the bankers and the general public.

It is important to note that the banking system was already in distress by the time the NDIC was established. By then, about seven banks were known to be technically insolvent. The government at that time, did not embark upon a cleansing exercise that would have removed from the system the distressed institutions because it feared that such an action would lead to loss of public confidence and flight of foreign capital moreso when there was no deposit insurance institution to expeditiously manage such bank closures. The NDIC was, nevertheless, required to insure all banks. That means that the corporation has been involved in managing distressed banks even before it could settle down and muster enough resources for this important task.

4.1 CONCEPTUAL ISSUES IN DISTRESS MANAGEMENT.

Management of distress implies restructuring which, according to Andrew Sheng (1990), essentially involves the apportionment of losses arising from the failure of a set of existing contracts and the renegotiation of a fresh set of contracts - a new institutional set-up. According to him, a bank engages in financial intermediation through two basic sets of contracts. The first is civil contract between the depositor and the bank (in which the bank borrows funds from the depositor and warrants to pay the nominal value of the deposit

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plus interest at due date); and another contract between the borrower and the bank on a loan in which the bank deploys depositors' funds. The second set is a social contract between the state the banks, the depositors and the borrowers. It is through the social contract that the citizens expect that the state will protect individual property rights by enforcing the civil contract through regulatory agencies, in the same way, as an impartial judiciary does. In Nigeria, as it is in many countries, these property rights have not been effective and so the Nigeria Deposit Insurance Corporation (NDIC) was established to protect the rights of depositors if, and when, the civil contract breaks down.

The management of distress or restructuring is therefore embarked upon by the regulatory authorities to restore public confidence in the banking system, preserve the sanctity of the social contract, and provide an opportunity to build a banking system that can better provide the efficient services necessary to enhance the development of the economy. The management of distress also includes measures such as improvement of bank accounting standards, portfolio audits and diagnostic studies of ailing banks, greater bank financial disclosures, reform of banking laws and regulations, and upgrading of bank supervisory capacity especially in off-site surveillance and on - site examination.

Generally, the resolution of the problems of distressed banks involves either rehabilitation or liquidation through the use of appropriate option. Bank restructuring or management of banking distress is an umbrella concept that covers bank rehabilitation as well as liquidation. A distressed bank is said to be rehabilitated if it is revived or brought back to life. In order to rehabilitate an ailing bank, it has to be given a special and intensive care that restores it to its former state of viability. In the case of bank liquidation, the distressed bank is closed.

Failure resolution options are therefore the strategies adopted to effectively manage a distressed bank for the purpose or rehabilitating or

liquidating it in an orderly and efficient manner so as to prevent the distress from affecting others and to sustain public confidence in the system by ensuring that depositors are protected and the stability of the system is not compromised.

4.2 DISTRESS MANAGEMENT

Distress management in the Nigerian banking industry is jointly handled by the CBN and the NDIC. If there is a significant deterioration in the condition of a bank, it is officially declared to be distressed and placed under close supervision. Such a bank will normally be required to submit additional returns to the CBN/NDIC, so that the implementation of the various corrective measures imposed on it can be monitored. Over the years, the CBN and the NDIC have undertaken a number of such distress management measures to handle the problems of distressed banks. The measures taken include, the following, among others:

4.2.1 Moral Suasion

As a first step in distress management, the CBN and the NDIC hold regular discussions and consultations with the owners and management of the affected banks with a view to making them embrace healthy practices that would enhance their performance, as well as, take prompt and decisive actions to revitalise their banks. Although this approach has helped in making the owners and management of most problem banks to focus greater attention on certain areas of operational problems, not much has been achieved in addressing the fundamental problems of under-capitalisation and debt recovery.

4.2.2 Imposition of Holding Actions

Banks that are identified to be distressed, after a special examination, are placed under close supervision and restriction through the imposition of

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Holding Action. The aims of the Holding Actions are to allow the troubled banks to undertake self-restructuring measures as a first line of self-salvaging action and to arrest further deterioration in their financial condition. This approach is anchored on the belief that given determined management and boards, the declining fortunes of the problem banks could be reversed.

To date Holding Actions have been imposed on about Fifty-two (52) distressed banks. Holding Actions imposed on distressed banks require them to do the following:

i. to stop further advertisement for deposits without prior consent of the CBN
ii. not to grant further loans and advances until the regulatory authorities are satisfied with the bank's liquidity position;
iii. to take necessary steps to ensure adequate internal control measures to safeguard its books, records and assets;
iv. to inject further capital funds;
v. to engage in aggressive debt recovery drive;
vi. to take steps to perfect all collateral securities pledged for loans and advances (and keep in protective custody);
vii. to segregate all dormant accounts within a specified time limit;
viii. not to embark on new capital projects without clearance from the CBN;
ix. to reconcile all longstanding items within a given deadline;
x. not to dispose of any fixed assets of the bank without prior consent of the CBN; and
xi. to embark upon possible rationalization of staff if considered necessary to enhance efficiency and restore viability.

In addition, each distressed bank on which the Holding Actions have been imposed, is required to furnish CBN and the NDIC within 30 days of being served the Holding Actions, details of its strategic plan for the revitalization and effective management of the bank. Such a turn-around plan is expected to be credible and to include proposals for debt recovery,

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rationalization of costs and staff, injection of additional capital, training, et cetera.

Furthermore, each distress bank is expected to render to the CBN and the NDIC the following return monthly, using the format provided:

i. Debt recovery;
ii. New lendings
iii. Statement of non-performing and renegotiated loans and advances;
iv. Maturity profiles of assets and liabilities;
v. Cash flow variance analysis;
vi. Profit and loss accounts;
vii. Interest income; and
viii. Non - interest income.

Finally, each bank on which the Holding Actions are imposed is expected to notify its staff of the measures and ensure that adequate steps are taken to comply with them. Officials of the CBN/NDIC monitor compliance form time to time. The effects of these Holding Actions on the distressed status of the affected banks would normally suggest the next set of supervisory measures to adopt.

The experience of the regulatory authorities has shown that these Holding Actions have not materially reversed the distressed status of most of the banks because the heavy accumulated losses make the recapitalization requirement to be beyond the means of the shareholders. An evaluation of the Holding Actions has also revealed that while owner State Governments do not have the capacity and resources to turn around their ailing institutions, private shareholders do not appear to be committed to the survival of their banks. In addition, the debt recovery efforts have not been successful because the chronic debtors are mainly insiders to the affected banks who are usually unwilling to repay their debts, or who had not provided adequately perfected collateral which could be foreclosed.

4.2.3 Financial Assistance

NDIC in collaboration with the CBN extended Accommodation facilities to help ten banks out of their liquidity problem in 1989. This measure recorded some success as confidence was restored within a reasonable time.

In the past years, the corporation (NDIC) has received and appraise application for liquidity support from some banks. Though a few of these applications were approved, it was later found that the problems of the banks transcended illiquidity to include insolvency, and hence could not be adequately resolved by mere provision of illiquidity support. The regulatory authorities, therefore, decided to directly intervene by taking over the chronically distressed banks.

4.2.4 Supervisory Intervention

One major distress management measure that has been adopted by the regulatory/ supervisory authorities is prompt supervisory intervention. The limited success of this measure has however, suggested that regulatory/ supervisory authorities must find a more effective approach to manage distress in the Nigerian banking system. The authorities have thus initiated and taken stronger supervisory actions which are hereby discussed;

a. *Change of Management*

Following the protracted shareholders' crisis in Fidelity Union Merchant Bank Limited in 1992 the CBN/NDIC removed the bank's board and appointed an Interim Management Board that managed it for one year. The bank was handed over to its shareholders after resolving their differences. Similarly, an Interim Management Board was constituted for Alpha Merchant Bank Plc on receipt of protests from some shareholders that the bank was being mismanaged through careful manipulation of some board members and management staff and after confirming that the protests had merit. The presence of the CBN/NDIC in the management of the bank further revealed a lot of insiders abuse and financial malpractices which eventually culminated

in the revocation of its licence and its liquidation.

b. ***Assumption of Control and Management***

Early in 1992, the CBN took over the control and delegated the management of the distressed National Bank of Nigeria (NBN) to the NDIC pursuant to the provisions of sections 34 and 36 of BOFI Decree. The decision to take over the NBN was informed by a number of factors including the fact that the bank's operations had virtually been suspended and the capital deficiency had grown beyond the financial capacity of the shareholders. Furthermore, the regulatory authorities believed that the action would send a strong signal to the owners of other distressed banks should they fail to take appropriate corrective action to turn them around.

On its part, the NDIC appointed an 11-man Task Force to examine the bank's books and to evaluate its financial condition. From the report submitted by the Task Force, NDIC made far-reaching recommendations to the Federal Government for the resolution of the problems of the bank. Unfortunately, government took much longer time than anticipated to decide on the distress status of the NBN. It was finally agreed that the bank should be acquired for a nominal fee for the purpose of its restructuring and subsequent sale to the public. As required by law, the CBN had to obtain the approval of the President to invoke the provisions of sections 36 of BOFI Decree for the acquisition of the bank. It is instructive to note that it took the CBN about 18 months to obtain court order for the acquisition of the NBN after numerous adjournments. It would appear that the provisions of the BOFI Decree requiring court order for the acquisition of banks has allowed the owners of such banks to challenge the action of the regulatory / supervisory authorities. Subsequently, an Interim Management Board (IMB) was appointed to turn around the bank.

The regulatory authorities has since discovered that the case by case approach adopted in handling the distressed NBN was inadequate due to many reason. The selection of the banks, one at a time, for restructuring

would prolong the exercise while the financial condition of other distressed banks not yet taken over would continue to deteriorate. This necessitated the reassessment of the framework for the handling of problem banks in Nigeria. The reassessment was further informed by the following factors:

i. the continued existence of the distressed banks would constitute a threat to the NDIC's Deposit Insurance Fund because of the continued deterioration of the banks' financial condition, and

ii. the selection of which bank to restructure next would be viewed as arbitrary and subjective by interested parties.

Against this background, a framework that entailed simultaneous takeover of all the first generation insolvent banks (global restructuring) was adopted. Following the approval of the President on May 21, 1993 the CBN in the exercise of the powers vested in it, assumed the control of the affairs of five distressed State Government-owned banks and handed their control and management to NDIC, thus bringing the number to six. The banks are African Continental Bank Plc, New Nigeria Bank Plc, Pan African Bank Ltd, Mercantile Bank Plc, and Co-operative and Commence Bank Plc. The responsibilities of the NDIC as a managing agent included superintending over the affairs of the banks as well as proposing a failure resolution option consistent with the circumstances of each bank. The corporation, in turn, appointed an Interim Management Board (IMB) for each bank to assist it in working out appropriate restructuring plans. The key terms of reference of the IMBs were as follows:

i. to superintend over the affairs of the banks;

ii. to evaluate the condition of the banks, with the assistance of external auditors appointed by the Corporation and recommend appropriate failure resolution strategy;

iii. to undertake extensive rationalization of operations of the banks so as to reduce operational losses;

iv. to implement, generally, the Holding Actions imposed on the banks by

the CBN and the NDIC; and

v. to assist in the banks' debt recovery efforts.

After an exhaustive evaluation of the turn around plans submitted by the IMBs, the CBN/NDIC reached a conclusion that the plans would not reverse the distressed conditions of the banks without spending a huge amount of tax payers money. As the Federal Government was not willing to bail out any bank with tax payers money, it requested that the banks should be sold to willing and credible buyers within six months after which those that are not sold should be liquidated. The CBN/ NDIC has since dissolved the IMBs and constituted a Transitional Supervisory Board (TSB) to midwife the sale and/or liquidation of the six banks.

The CBN had since acquired, through the Federal High Court, all the first 6 banks under its control and management at a nominal fee. It should be observed here that while the legal process in acquiring the NBN was unnecessarily prolonged, probably being the first of its kind, the acquisition of the five other banks had been done with relative ease and without any legal constraint. The acquisition of these banks was to facilitate their sale or liquidation by the authorities.

c. ***Comprehensive Supervisory Intervention***

While considerable efforts had been made towards addressing distress in the banking system, the supervisory measures adopted had not stopped the crisis. As at the time the six banks were taken over there were fewer than twenty distressed banks in the industry under the close supervision of the CBN/NDIC . Since then, the number of distress banks had risen to about sixty (60) in 1995 as earlier indicated. It therefore became necessary to consider a more comprehensive approach that would simultaneously address all the terminally distressed banks in the system.

Consequently, the Federal Government approved the taking over of additional seventeen (17) distressed banks for the purpose of restructuring them. This consisted of 8 commercial and 9 merchant banks. The commercial

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banks were: Amicable Bank of Nigeria Ltd, Credit Bank Nigeria Ltd, First African Trust Bank Ltd, Lobi Bank of Nigeria Ltd, Nigeria Universal Bank Ltd, North - South Bank Nigeria Plc, Premier Commercial Bank Plc, and Progress bank of Nigeria Plc. The nine Merchant banks were: Abacus Merchant Bank Ltd, Century Merchant bank Ltd, Great Merchant Bank Ltd, Group Merchant Bank Ltd, Ivory Merchant Bank Ltd, Merchant Bank of Africa Ltd, Nationwide Merchant Bank Ltd, Prime Merchant Bank Ltd, and Victory Merchant Bank Ltd. All the banks were taken over by the CBN on 15th September, 1995. The boards of directors of these banks were dissolved and in their place management boards were constituted as conservators. The shareholders of these banks were given another opportunity to recapitalise their banks to the satisfaction of the CBN/NDIC within one month failing which the management boards would package the banks for sale, merger or liquidation depending on which option would help to restore public confidence and would be most cost effective. In addition, the management boards which were to report to the NDIC were charged with the responsibility of among others, implementing the Holding Actions earlier imposed on the banks, identifying the bad debtors for the purpose of recovery and identifying those involved in financial malpractices with a view to prosecuting them in accordance with the provisions of Decree No. 18 of 1994 for the purpose of recovery of debts owed to the banks, and conserving the banks assets.

d. ***Suspension of Banking Licence***

In February 1994, the CBN suspended the licences of two commercial banks - Republic Bank Limited and Broad Bank (Nigeria) Limited - following the discovery of serious malpractices perpetrated by the management of these banks in the inter-bank clearing system. While the suspension of Broad Bank was subsequently lifted, the Republic Bank could not meet the condition for the restoration of its operating licence.

e. ***Liquidation of Distressed Banks***

Having exhausted all possible means of resolving the distressed condition of some banks, the CBN/NDIC decided to invoke the provisions of BOFI Decree and revoked the operating licences of five (5) banks with the approval of the Head of State. The licences of Kapital Merchant Bank, Financial Merchant bank, Alpha Merchant Bank and United Commercial Bank were revoked in 1994 and that of Republic Bank was revoked in 1995.

Consistent with the provisions of the BOFI and NDIC Decrees, the CBN appointed the NDIC as the liquidator of the 5 banks. The liquidation of the banks was unique as it was the first time since banking business became formally regulated in Nigeria that distressed banks were being liquidated. Secondly, the liquidation of failed banks was consistent with the posture of deregulation that allowed for free entry and free exit of banks - a major departure from the previous policy of propping inefficient and mismanaged banks. Lastly, liquidation of technically insolvent banks would promote market discipline by sending strong signals that shareholders of banks stand to lose their investments should they run their bank aground.

4.3 PREVENTION STRATEGIES

Prevention of distress in the banking industry is the responsibility of various parties namely, bank directors, shareholders, bank management, supervisory authorities, bank employees, and government. However, the following specific measures can be taken in order to prevent/minimise distress in the banking sector.

a. ***Harmonization of Efforts Among Various Regulatory/Supervisory Bodies in the Finance Sector***

There is need for greater co-operation among the various regulatory authorities to enhance the exchange of information and make supervision and regulation less burdensome and more effective. The present effort in this

regard, through the setting up of the Financial Services Regulation Co-ordination Committee (FSRCC), is a step in the right direction. To make the deliberations and decisions of the FSRCC more effective, legal backing should be given to its existence. Such legal backing would also make it mandatory for all member institutions including the Federal Ministry of Finance to be represented.

b. ***Tackling the Critical Problem of Poor Management***

One of the most critical factors that has contributed to the poor health of many banks, is the poor quality of management. The ineptitude of management translated into a number of related problems such as poor asset quality, poor credit administration, fraudulent practices, insider abuse and ineffective machinery for debt recovery.

In order to effectively address this problem, the regulation/supervisory authorities should ensure that the policy on the possession of proper and adequate academic professional qualification, technical know-how, relevant experience and credible track record as prerequisite in constituting the management team for banks, is rigorously enforced. In addition, the assessment of the quality of management as a performance indicator during examinations should continue and recommendations contained in the examination reports on specific changes in management structure should attract more rigorous monitoring.

Furthermore, the importance of a workable and effective internal control system covering all aspects of a bank's operations and strict implementation of the laid down procedures need to be emphasized. With an efficient and effective internal control system, the incidence of insider abuse, fraud, poor asset quality, poor and credit administration and ineffective machinery for debt recovery would be reduced.

c. *Reducing Bank Examination Cycle*

In the last five years, the frequency of bank examinations by the CBN and the NDIC increased considerably. However, efforts must be made to further reduce the on-site examination cycle to once every year. To achieve this, it is necessary to speed up the computerization of information gathering, analysis and report generation. This effort should be complemented with a functional early warning system, (that clearly defines intervention thresholds and needed corrective action) developed by the regulatory authorities.

d. *Examination of Financial Supermarkets*

Currently, the supervisory activities of the regulatory authorities are concentrated on commercial and merchant banks, while their affiliated financial companies operate largely outside the scope of supervisory authorities. This has provided ample avenue for circumventing official regulation. This situation needs to be redressed in line with the Basle Convention. Banks and other financial institutions should report in detail on all companies in which they have significant interests. Field Examinations should now be extended to cover these other institutions. To make this possible, the legal framework should be expanded while the co-operation of the immediate regulatory authorities responsible for monitoring these other institutions should be sought through the aegis of the FSRCC.

e. *Overhauling the Existing Legal Framework*

The effectiveness of the regulatory and supervisory authorities is dependent on the existence of an effective and efficient legal framework with clearly defined responsibilities for the various regulatory/supervisory bodies. Inspite of the significant improvement in the legal framework following the promulgation of the CBN Decree and the Bank and Other Financial Institutions Decree (BOFID), in 1991, there is urgent need to review the legal framework to make for greater efficiency.

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In this regard, BOFID should be amended to give the CBN the power to deal decisively with ailing banks and related problems without recourse to the political authorities. In addition, the NDIC Decree (1988) should be amended to enable it take greater responsibility for the resolution of distress in banks with respect to restructuring, mergers, purchase and assumption as well as liquidation.

f. ***Encouraging Self-Regulation by Various Groups Within the Financial System***

With the phenomenal growth in the number and type of financial institutions, it is expedient to encourage self-regulation as a way of reducing the pressure on the supervisors. In this regard, operators within each banking sub-sector should be encouraged to form associations with laid down rules and procedures for their operations backed by appropriate sanctions for non-compliance.

g. ***Strengthening Accounting and Audit Reporting Systems and Standards***

The regulatory/supervisory authorities had in the recent past expressed concern at the level of accounting and auditing reporting systems, especially in respect of proper recording and reporting of accounting related transactions. Consequently, it is proposed that a consultative system should be established to enable the regulators/supervisors and the external auditors of banks hold regular consultative meetings to discuss issues of common interest touching on accounting/audit reports, such as transparency, greater standard of disclosure of financial information with a view to enhancing greater cooperation between both parties.

h. ***Establishing a Loan Recovery Agency***

In order to complement the Failed Banks (Recovery of Debts) and Financial Malpractices in Banks Decree, No. 18 of 1994, there is the need to establish a Loan Recovery Agency with sufficient legal powers to facilitate loan recovery. The agency will articulate its loan recovery strategy and implement/monitor recovery process. Such Agency would also have the responsibility for taking over non-performing assets and the corresponding liabilities of liquidated banks for final determination on behalf of the NDIC, for an agreed commission.

i. ***Macro-economic Policy Stability***

Absence of a stable macroeconomic policy regime and uncoordinated policies have contributed to bank distress over the years. Government must forestall this situation by ensuring consistent and stable macro-economic policies that would encourage overall economic growth and development. Government must also ensure budget discipline, fiscal transparency and accountability. Government at all levels should map out strategies for the repayable of large debts owed to banks and contractors.

j. ***Promoting political Stability***

There is no doubt that a stable political environment would enhance general economic development and by extension prevent bank distress. Aside from providing a conducive environment for foreign investment, a stable political environment would encourage domestic investment upon which economic growth is based.

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CHAPTER FIVE

APPRAISAL OF CURRENT FAILURE RESOLUTION OPTIONS.

The failure resolution options employed by the regulatory authorities aimed at ensuring the safety and soundness of the banking industry were however, not very effective. These resolutions included Holding Actions, assumption of management and control as well as outright liquidation among others. For instance, prior to the revocation of licences of the five (5) liquidated banks, sometimes in 1994 and 1995, they were subjected to various Holding Actions by the regulatory/supervisory authorities which unfortunately failed to improve the financial position of the banks. The failure of the adopted resolution options has remained a major concern to the regulatory/supervisory authorities.

5.1 POLICY AND OPERATIONAL CONSIDERATION IN THE DESIGN OF FAILURE RESOLUTION FRAMEWORK.

In a competitive setting, the failure of an individual bank should not be of great concern for as long as the rest can be insulated from the ripple effects of the failed bank. It is therefore the manner in which such failing institutions are handled as they approach and eventually reach the point of liquidation that has important implications for the stability of the entire system, and the ability of the deposit insurer to remain viable. Generally, to be efficient, reliable and credible, a failure resolution framework must take into cognisance certain policy and operational issues.

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5.1.1 Policy Consideration

The choice of a specific re-structuring option will usually be guided by certain desirable policy considerations and objectives which, in the long run, are expected to enhance confidence and stability of the financial system. The first policy objective therefore relates to the need for such framework to be able to maintain public confidence and stability. This implies, among other

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things, the need to avoid failure resolution methods that could heighten instability in the system in the course of failure resolution.

A second objective would be the need to encourage market discipline against risk-taking. This is particularly so since different resolution options have different probable loss implications for different claimants. Thirdly, the resolution framework should be cost effective. The 'cost test' should at least be reasonably satisfied. Lastly, the framework should be as equitable and consistent as possible. This should be made transparent to all parties as perception of inequitable distribution of gains and losses, based on imperfect information can sabotage any restructuring effort.

Secondary policy objectives in failure resolution have been identified to include the need to minimise disruption to the communities where the insolvent banks are located, as well as minimise government ownership, financing and managing financial institutions and assets.

5.1.2 Operation Consideration

a. *Diagnostics*

Typically, when banking problems begin to surface, the regulatory/ supervisory authorities fear to face up the issues because of the high budgetary costs involved, the sensitive political issues and the bureaucratic wishful thinking that the problem would go away, Sheng (1991). In many instances, the authorities refrain from the reform of the law and accounting standards and even engage in regulatory forbearance, thereby allowing the financial conditions of such problem banks to get worse. However, experience has shown that bank problems do not just go away, but rather concerted efforts of both the participants and the regulators as well as the support of other concerned parties, viz: employees, depositors, creditors, etc are necessary in resolving the problems over time.

The first consideration to guide a good failure resolution framework is the need for setting objective standards of measurement in terms of

identification of failing banks. Secondly, there is also need for proper and improved verification of results of bank operations through upgrading bank supervisory capacity especially in off-site surveillance and on-site inspection. Thirdly, the issue of banks' asset valuation needs to be handled with care. Consideration should be given to valuation based on current cash flow and revenue, on current economic conditions and on borrowers' viability rather than collateral.

b. ***Rule Reforms***

Bank restructuring occurs when it is apparent that a bank or a set of banks is failing or has failed. Such a failure is manifested in the form of a break-down of existing financial intermediation contracts. The externalities of contracts relating to deposit taking and general financial intermediation can be so large that the enforcement of contracts by the state and the establishment of efficient dispute resolution mechanisms are important public goods in any developing / developed financial system. Hence, a good operational consideration should ensure adequate prudential re-regulation, redrafting of banking laws, enforcement powers, clear bank entry requirements, ownership concentration and clearer bank exit rules. In other words, any desirable restructuring option should improve the rules of the game and at the same time, ensure enforcement.

Improving the rules of the game generally implies improving competition and bank intermediation efficiency, leveling the playing field, preventing monopolistic and oligopolistic practices and determining more clearly and more equitably the gains and losses of banking. The legal framework should prompt regulators to act in a timely fashion by assigning them responsibilities and giving them strong legal backing and protection against pressures from political or other special interest groups. It should specify the policies and procedures to be pursued under a range of possible scenarios.

c. ***Loss Sharing***

Conventional western thinking assumes that losses should be borne in broad descending order as follows:-

i. Borrowers

ii. Shareholders

iii. Fellow banker/ banks

iv. Other creditors/employees

v. Government

vi. Depositors

Even though experiences so far, especially in developing economics, are not so discernible as above, it needs be emphasised that this order of loss sharing needs to be followed for any meaningful option to work effectively and be socially optimal.

Essentially, factors such as unwilling to pay, outright fraud and the use of political clout, amongst other factors, by borrowers often mitigate against repayment of loans and advances. However, under whatever framework, it is necessary for the regulatory authorities to endure full repayment (principal with (out) interest). Secondly, shareholders should be made to bear the brunt of losses since they are in the first instance, responsible for the bank's affairs. Again, experience has shown that this is not easily practicable.

The issue of forcing fellow bankers to absorb losses of failed banks is an open one: depending on whether government wants to encourage greater bank concentration or not. In a situation where government wants more concentration in the industry, established banks should be induced to absorb ailing smaller banks.

In considering the position of employees as regards loss sharing, factors such as the largeness and power of the labour unions in the industry and the position of labour laws should be taken unto recognition. Experience has shown that in countries where government owned banks fail, labour union lobby against closing and hence such banks are kept open at public

expenses. It thus becomes a protracted problem trying to lay off these workers and this could continually worsen the distressed situation. Whatever the status of a bank under distress, staff retrenchment is inevitable, but the labour laws as regards equitable retrenchment benefits must be taken into consideration under the cost of restructuring.

The protection of depositors is the primary assignment of regulators worldwide, and this is especially so in an economy with an explicit deposit insurance scheme. The assumption is that depositors must be protected to encourage savings and maintain confidence in the banking system. Within any particular failure resolution framework and in an environment with or without explicit deposit insurance scheme, it is necessary to note that no restructuring option would succeed unless depositors' position is fairly /fully protected. The attendant consequences of lack of protection could be very grave for the whole economy. In the absence of deposit insurance scheme, experience in the south East Asian countries showed that the deposit-equity conversion of banks achieved two objectives of recapitalisation as well as guarantee some payments to the depositors in the future provided that the managements of such banks are in good hands and an efficient domestic capital market exists.

How much the public should share constitutes the last consideration under the loss-sharing policy. Should the public share of the losses be absorbed by the treasury or the central bank? The answer to this question can be critical in the design of the failure resolution framework. A traditional central bank with only non-interest bearing monetary liabilities, high capital and reserves represented mainly by foreign assets should have little problems in absorbing the bank failure losses. On the other, a central bank with high interest-bearing liabilities and net foreign exchange liabilities do not have the capacity to absorb bank failure losses. Such central banks would monetize such losses through the growth of their monetary liabilities, generating inflationary pressure that, in effect, distributes the losses to the holders of

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currency and central bank liabilities.

Experience suggests that where central banks do not have the capital and reserves to absorb banking failure losses, the loesses should be absorbed by the treasury. The treasury may finance bank finance losses through six options: raising additional taxes, cutting expenditures, introducing domestic long-term borrowing, introducing external borrowing, using the inflation tax or selling its real or financial assets. All involve passing on the burden of bank failure losses ultimately to either the tax payer or the holder of public debt. Every option has its own implications.

d. ***Restructuring Mechanisms***

Restructuring techniques vary according to the economic condition of the country and the resources available for restructuring. In spite of this though, the treatment of certain critical operational issues is very important for all varieties of restructuring techniques.

First, the treatment of bad assets is one thorny issue in the consideration of restructuring mechanisms. Several options are open for consideration. Bad assets could be retained in the books of banks and a lifeboat assistance comprising long-term loans/equity provided by the regulatory authorities. Thirdly, such bad assets could be centralised in an independent government agency. However, a much important determinant of any adopted option would depend on the legal environment and the existing institutional arrangement. For instance, the adoption of a centralised independent government agency would much depend on the legal issues of whether the new asset managers have full power of disposal of assets and whether the bank managers can be trusted to dispose of such assets at fair market price.

A common restructuring mechanism is the idea of a deposit insurance scheme which is often described as a vehicle for rehabilitation and liquidation. In the absence of deposit insurance scheme, it is important, for effectiveness,

to have an independent and objective institution, with the flexibility to recruit professionals to do the job, working closely with the central bank.

Thirdly, there is the need for a complete change in bank management for failing banks. Leaving old management to look after assets of such banks can lead to ever greater losses. Experiences has also shown that retaining staff with suspect integrity had resulted in continuing weakness in control over asset quality. Fourthly, for efficiency and cost consideration, if private sector purchasers cannot be found for a failed bank, in general, liquidations are cheaper than keeping insolvent banks open.

Finally, mechanisms for resolving bank failure constitute only one part of well-coordinated strategy for the financial sector and will not succeed unless structural adjustments are made in other government financial policies, including the banking sector competition and confiscatory reserve requirements or other forms of explicit or implicit taxation.

5.2 OVERVIEW OF THE CURRENT FAILURE RESOLUTION FRAMEWORK IN NIGERIA

Over the years, and especially since 1952 when the first Banking Ordinance was promulgated in Nigeria, several statutes have been put in place to serve as legal backbones for the monetary authorities' actions in regulating the banking industry. The current ones include the Central Bank of Nigeria (CBN) Decree 24 of 1991; the Banks and Other Financial Institutions (BOFI) Decree 25 of 1991; the Nigeria Deposit Insurance Corporation (NDIC) Decree 22 of 1988; the Company and Allied Matters (CAM) Decree of 1990 and lately the Failed Banks (Recovery of Debts) and Finance Malpractices in Banks Decree 18 of 1994.

Specifically, the CBN and the Nigeria Deposit Insurance Corporation (NDIC) constitute the nation's regulatory/supervisory authorities for the nation's banking sector. Their enabling Decrees, especially the BOFI Decree 25 of 1991 and the NDIC Decree 22 of 1988, both contain the major legal

provisions (resolution framework) for handling failing and failed financial institutions. These provisions contain series of measures to apply depending on whether banks are in failing condition or have been declared failed in an attempt to ensure banking confidence and financial stability in the system. Aside from the provisions in the enabling statutes, there are other administrative and funding issues. All these issues are discussed below:

5.2.1 Legal/Operational Issues

a. i *Provisions Of The Banks And Other Financial Institutions Decree 25 of 1991*

The implementation of the doctrine of financial liberalisation policies in the late 80s created new problems and challenges which the old statute (the 1969 Banking Decree) could not address, hence the need for its revision. The BOFI Decree undertook some revisions especially, with respect to failure resolution options for failing and failed institutions.

On the prevention of bank failure, section 31 of the Decree strengthens the ability of the CBN to enforce its recommendations on a bank based on the findings from its routine examinations. Section 33 to 38 of the BOFI Decree (1991) empower the CBN to take such measures as it may deem necessary to reverse the declining fortunes of a "failing" or "failed" bank. For example, Section 33 empowers the CBN to effect a change in bank management with the approval of the President. Section 34 and 35 empower the CBN to assume control of a failing or failed bank or appoint a person to assume control of a bank and carry out financial and operational restructuring consisting of appropriate changes in the policies of the bank and implementation of cost-cutting measures until the Central Bank is satisfied that the condition of the licensed bank is satisfactory.

If the condition of the bank remains unsatisfactory, Section 36 through 38 empower the CBN (on application to the High Court) to purchase or

appoint a person to purchase on its behalf, the failed bank, for nominal fee for the purpose of restructuring and subsequent sale, or revoking the bank's license and causing its business to be wound-up, provided the actions are in the interest of the bank, its depositor, creditors and the public generally. For the purpose of winding-up a bank, the BOFI Decree specifically empowers the CBN to appoint the NDIC or any other person as the official receiver or a provisional liquidator (with appropriate powers conferred under the Companies and Allied Matters Decree 1990).

ii *Provisions Of NDIC Decree, 1988*

Section 5, 23 through 29, and Section 34 of the NDIC Decree 1988, indicate the actions which the NDIC could take in assisting insured banks either when they are failing of when they have failed.

b. ***Action The NDIC May Take When A Bank Is Failing***

The Corporation may, at the request of an insured bank and under such conditions as may be specified by the Corporation, take one or a combination of certain actions to assist a failing bank. These actions include the granting of loans, giving or guaranteeing loans taken by the failing insured bank, and acceptance of accommodation bill on behalf of the failing insured bank for a specified period of time.

Also, when an insured bank has not been considered terminally distressed, the NDIC may, subject to the approval of the President on the recommendation of the Central Bank, carry out some operational restructuring on ailing banks such as:

(a) taking over the management of the bank until its financial position has substantially improved;

(b) arranging specific changes to be made in the management of the bank;

(c) arranging a merger with another bank or contracting to have the deposit liabilities assumed by another insured bank;

(d) the purchase of bad assets of a failing bank or;

(e) taking over the bad assets of a failing bank as collateral for sums advanced to the receiving bank.

c. *Imposition of Holding Actions On Failing Banks*

Holding actions are usually imposed on an ailing bank in order to arrest the drift to collapse and minimize losses. Typical holding actions that can be imposed on failing banks may include all or some of the following directives on the management of the bank:

i. to stop further advertisement for deposits without prior consent of the CBN;

ii. not to grant further loans and advances until the regulatory authorities are satisfied with the bank's liquidity position;

iii. to take necessary steps to ensure adequate internal control measures to safeguard its books, records and assets;

iv. to inject further capital funds;

v. to engage in aggressive debt recovery drive;

vi. to take steps to perfect all collateral securities pledge for loans and advances (and kept in protective custody);

vii. to segregate all dormant accounts within a specified time limit;

viii. not to embark on new capital projects without clearance from the CBN;

ix. to reconcile all long outstanding items within a given deadline;

x. not to dispose of any fixed assets of the bank without prior consent of the CBN; and

xi. to embark upon possible rationalization of staff if considered necessary to enhance efficiency and restore viability.

In addition to these, holding actions may also require the bank to prepare and submit to the CBN and the NDIC details of a strategic plan to revitalize and effectively manage the bank.

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d. ***Actions The NDIC May Take When A Bank Has Failed***

When, however, an insured bank is terminally distressed, the NDIC Decree 1988 provides certain restructuring actions which the NDIC could take on behalf of the Government and in collaboration with the Central Bank of Nigeria.

(a) The CBN could opt for bank closure and the NDIC ensures the liquidation of the bank's assets and liabilities upon the instructions from the CBN in accordance with the provision of Section 24 and 25 of the Decree.

(b) In the event of bank closure, NDIC could opt for pay-off of each depositor up to a maximum of N50,000.00 stipulated in the Decree or arrange for each depositor a transferred deposit in a new bank or in another insured bank in an amount equal to the insured deposit of such depositors in accordance with Section 26 and 27 of the Decree.

From the foregoing, the success or failure of the current efforts, therefore, depends not only on the insurer, but largely on the willingness of the CBN to seek the approval of the President, its ability to convince the Federal High Court and its willingness to allow the NDIC adopt certain failure resolution options. However, it should be noted that there are exogenous factors militating against the realization of the current efforts.

5.2.2 **Administrative Issues**

The CBN and the NDIC constitute the nation's regulatory/supervisory authorities for the banking system. These two institutions are jointly responsible for handling bank distress and failure resolution in Nigeria. To ensure compliance with set regulations and, of course, to timely identify problems in banks, the CBN and the NDIC, individually and/or jointly carry out on-site examination and off-site supervision of banks. It is on the basis of these examinations that reports on the state of health of a particular bank are forwarded to appropriate quarters for joint actions.

As part of the administrative framework, the NDIC and the CBN have equally maintained joint committees on problem banks both at the Technical and the Executive levels. While the Technical Committee studies and makes recommendations to the Executive Committee on measures to take in resolving bank distress, based on special and routine examination reports and appraisals from off-site supervision departments, the Executive Committee takes the final decision on appropriate failure resolution options to adopt. The broad objectives of this joint committee approach, among others, are:

i. harmonization of all information and data from both institutions; and
ii. enhancement of the quality of decisions as regards any failure resolution option to be adopted.

5.2.3 Funding of Failure Resolution

With respect to the funding of bank failure resolution in Nigeria, both CBN and the NDIC are jointly involved. As a bankers' bank, the CBN, by statute, is the lender-of-last resort. Towards maintaining monetary stability as well as promoting the development of the money market, the CBN's discount facility in the term of short-term and largely overnight loans is often used to solve temporary liquidity problems. When the situation gets to a critical stage, the NDIC is the major funding source for failure resolution in the system. These expenses are met from the Deposit Insurance Fund (DIF) of the NDIC. To date, there is no direct contribution from government for the purpose of resolving bank distress and failure in Nigeria even at a critical period like this.

5.3 INHIBITIONS TO EFFECTIVE SUPERVISORY INTERVENTION IN THE SYSTEM

Like what obtains in other parts of the world, the Government, the Central Bank of Nigeria (CBN) and the Nigeria Deposit Insurance Corporation (NDIC -since it commenced operation in 1989), had on various occasions come out with various policies aimed at ensuring the stability of the banking

system. These, as discussed in the previous section, included the use of some failure resolution options, such as holding actions, assumption of managing and control as well as outright liquidation of banks, among others. With some of these resolution options available to handle failing and failed banks, most people and even government have assumed that banking in Nigeria is under control with dangers of failures, panics and runs abolished by careful regulation coupled with the system of deposit insurance scheme in place. This however, seems not to be the case considering recent developments in the system.

There are some observed problems militating against the working of some the failure resolution options currently being adopted. Some of these problems include the slow pace of due processes and legal procedures that are outside the control of the regulators/supervisors; inadequate resources for failure resolution and other operational problems. Some of these inhibitive factors are examined below:

i. *Lack of Established Threshold for Supervisory Invention*

Most banks that were taken over by the CBN/NDIC under the assumption of management and control option were already dead before the take-over, such that whatever control mechanism that was put in place could (and did) not work. This situation no doubt, could be traced to the absence of threshold for regulatory/supervisory intervention. In many countries, interventions are made to take place before a bank fails or before its finance condition reaches a critical stage. In Nigeria however, most interventions are done when a bank is already at a negative capital base as a result of which it has become extremely difficult, if not impossible, to resuscitate such banks.

ii. *The Problem Created By The Legal Framework*

Another problem is that of the legal framework for interventions. As expressly stated in Section 36 of the BOFI Decree 25 of 1991, "not withstanding anything contained in any law or memorandum and articles of

association of a bank, where the Bank (CBN) or an appointed person had pursuant to an order under Section 34 of this Decree, assumed control of a bank whose paid-up capital is lost of unrepresented by available assets, the Bank (CBN) may, with the approval of the president:

a) apply to the Federal High Court for an order for the Bank or a person nominated by the bank to purchase or acquire the bank for a nominal fee for the purpose of its restructuring and subsequent sale;

b) make an order revoking the bank's license and requiring its business to be wound-up.

The experience of the regulatory/supervisory institutions in this regard has no doubt, been very painful. For example, attempts made to obtain the Presidential approval to liquidate a bank in the early 90s did not succeed due to interest groups that were able to influence government position on the bank thereby keeping it alive for political reasons. This happened despite the fact that it was obvious that if liquidation of the affected bank had been allowed to take place at the appropriate time, a precedence would have been set in dealing with distressed banks when their financial conditions fell below acceptable standards.

Another frustrating aspect is the requirement that a suit must be filed at the Federal High Court before a bank could be acquired for restructuring and subsequent sale or for outright liquidation. From available evidence, regulatory authorities experience at the Federal High Court has been very frustrating. An application to the Federal Court to acquire some banks in the system for restructuring has been slow due to challenges in court by some interest groups leading to adjournment of cases adinfinitum. Yet delays in failure resolution could be very costly.

iii. *Lack of Delineation Of Responsibility Between The CBN And NDIC*

Another inhibition to the effective working of the current regulatory intervention framework in the system is the lack of clear cut role definition

between the Central Bank of Nigeria (CBN) and the Nigeria Deposit Insurance Corporation (NDIC) as practiced in other countries. The practice in some other countries, (for example, in the United States of America), where an explicit deposit insurance scheme exists side by side with a Central Bank, such institution, apart from being charged with the responsibility of insuring deposit liabilities of insured financial institutions, is also to address bank failures.

In Nigeria however, Section 34-37 of the BOFI Decree 25 of 1991, empower the Central Bank of Nigeria and not the NDIC to address bank distress. This role conflict no doubt, has a significant implication for prompt supervisory intervention in the nation's banking system. Considering the recent development in the system, NDIC should be given adequate power to deal with distress in the nation's banking sector. In our view, rather than mere pay-off after liquidation, the Corporation should be armed with more powers to safeguard the Nigerian payment system.

iv. *Inadequate Resources For Failure Resolutions*

The Government has no various occasions come out with various laudable policies designed to ensure the stability of the banking sub-sector of the economy. The unfortunate thing however, is that Government over the years has neither made and explicit provision in the national budget to address in the financial sector in order restore public confidence nor made a categorical directive on how to expedite action in solving the problem. Efforts to deal with distress in our banking system without an adequate provision on how to financial it can only yield little or no results.

Since 1995, the implementation of the Failed Bank Decree No.18 of 1994 has been intensified to enhance debt recovery as well as penalize financial malpratices in all financial institutions in order to restore sanity and confidence to the financial sector. Recently, plans by the government to expand the scope of coverage of the Failed Bank Decree to include some other cases in the work of the tribunals is laudable. However, Government has not made an explicit provision in the national budget for the implementation

of the provisions of the Decree. The implication appears to be that the NDIC will have to bear the expenses arising from the various litigations, prosecutions and liquidation. This no doubt, would go a long way to put pressure on the slim amount of resources available to the Corporation in form of Deposit Insurance Fund (DIF).

Furthermore, the application of Capital Gains Tax to failure resolution transactions constitutes another erosion of the available funds for failure resolution. At a critical stage like this, government should ensure that all funds generated from failure resolution transactions are utilised for that purpose in view of the severe resource constraint facing the NDIC in the discharge of its statutory responsibility of redressing the problem of bank distress.

v. *Ineffectiveness Of Holding Actions*

The experience of the regulators so far with the application of Holding Actions has shown that this approach has not been effective in arresting the deteriorating conditions of the banks concerned. Since 1991 when the regime was introduced, about 50 banks have been affected and only four (4) banks have been able to meet the conditions for lifting the Holding Actions. Even in the case of these four banks, it has been argued that their improved conditions could not have been a direct consequence of the imposition of the Holding Actions. Rather than improve their lot, many banks never recover from the announcement effects of the imposition of Holding Actions. Most of them have suffered from deposit run while some fraudulently-minded staff, including Management staff, on sensing that their banks could eventually fail, have perpetrated all sorts of fraud in the banks, thus leaving them irredeemably distressed.

The failure of the current regime of Holding Actions has been attributed to several factors. In the first place, the imposition of Holding Actions has so far been carried when a bank's networth has become substantially negative. In fact, most of the banks now under Holding Actions had long qualified for the regulatory intervention, (i.e. liquidation), before Holding Actions were imposed on them.

Furthermore, the restriction on some vital operations of the banks has been a major factor impeding their recovery. The liquidity positions of the banks will continue to deteriorate so long as the restriction on deposit mobilization is in place . The banks' earning capacity and, by extension, profitability will also be weakened by the embargo place on their lending activities and their frequent exclusion from the foreign exchange market. So long as the earning capacity of an unhealthy bank is curtailed, a substantial part of loan recoveries and/or capital injection made is expended to overheads. This in itself is a limiting factor in Management's efforts to turn the bank around.

All these problems have made the noble objective of resolving the problem of distress in the nation's banking system a painful exercise to regulatory/supervisory agencies. Meanwhile, public expectation is focused on these agencies. The delays and the seeming inactions in dealing with distressed banks in the system have no doubt, prompted public accusations of the CBN/NDIC through the media for some time now.

5.5 SUMMARY AND CONCLUSION

The Nigerian financial system has evolved over the years. From an undeveloped financial market with only a few banks and insurance companies in the 60's, the financial services industry has grown to a more diversified and competitive industry with many banks and non-bank financial intermediaries. Following a myriad of problems, ranging from economic recession and political instability to poor management, the industry had become unstable in recent years. To avert the collapse of the system, various measures have been put in place by both the regulatory / supervisory authorities and government. The effectiveness of the measures aimed at sanitizing the system however depends on improved quality of management in the financial system.

In this research work, an attempt has been made to discuss some distress management measures that have been adopted by the regulatory / supervisory authorities in Nigeria. But beyond the discussion of these measure, it has also examined some preventive strategies necessary to stem the tide of distress on a permanent basis in the nation's banking system. In all, the way forward is for all parties concerned to contribute to a favourable banking environment. In this regard, the operators should adhere strictly to the rules of the game; the regulatory / supervisory authorities should enhance the supervisory capacity while the government should put in place enabling legal, macroeconomic and political frameworks. For it is only a resilient real sector that can provide the primary guarantee, all things being equal, for stability in the financial system.

5.5 RECOMMENDATION

Based on the findings of the study, a number of recommendations are proffered with the objective of addressing the problem of distressed banks in Nigeria.

1. A threshold for regulatory/supervisory intervention should be established so that interventions are effected before a bank fails or before its finance condition reaches a critical stage.

2. Clear-cut definition of roles between the Central Bank of Nigeria (CBN) and the Nigeria Deposit Insurance Corporation (NDIC) should be made. The NDIC apart from being charged with the responsibility of insuring deposit liabilities of insured financial institutions, should also address bank failures.

3. The Regulatory authorities as represented by the CBN and the NDIC must significantly improve their response time in cases of manifest distress banksso as to regain and maintain the confidence of depositors, creditors and the general public in the nation's banking industry.

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