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**Nigeria: Publication of Financial Sector Assessment Program Documentation—
Technical Note on Crisis Management and Crisis Preparedness Frameworks**

This technical note on Crisis Management and Crisis Preparedness Frameworks for Nigeria was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed in May, 2013. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of Nigeria or the Executive Board of the IMF.

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FINANCIAL SECTOR ASSESSMENT PROGRAM

NIGERIA

CRISIS MANAGEMENT AND CRISIS PREPAREDNESS
FRAMEWORKS

TECHNICAL NOTE

MAY 2013¹

INTERNATIONAL MONETARY FUND
MONETARY AND CAPITAL MARKETS DEPARTMENT

THE WORLD BANK
FINANCIAL SECTOR VICE PRESIDENCY
AFRICA REGION VICE PRESIDENCY

¹ This note is prepared on the basis of information received as of September 2012

Contents	Page
Glossary	3
Executive Summary	4
I. The Nigerian Banking Crisis of 2008–2009 and the Policy Response.....	7
II. Institutional Framework	10
A. Institutional Framework and Coordination Arrangements for Systemic Risk Monitoring and Crisis Management.....	10
B. Macroprudential Supervision	13
C. Intra-Group Resolution.....	15
D. Cross-Border Cooperation & Coordination	17
III. Supervisory Early Intervention of Problem Banks	21
IV. Crisis Management Tools	24
A. Official Financial Support.....	24
B. Orderly and Effective Resolution.....	27
V. Deposit Insurance Framework	43
VI. Legal Protection	47
 Tables	
1. Table of Recommendations.....	6
2. Prompt Corrective Action Framework.....	22
3. Summary of Resolution Measures	29
4. Systemic Crisis Management Framework in Part 4 of SIF.....	34
5. AMCON in International Perspective	40
 Figure	
1. Structure of the Nigerian Financial System	11
 Boxes	
1. Timeline of Nigerian Banking Crisis	9
2. The Financial Services Regulation Coordinating Committee.....	13
3. Proposed FSRCC Sub-Committee for Systemic Risk Monitoring and Crisis Preparedness/Management.....	16
4 Cross-Border Crisis Resolution: The Key Attributes.....	20
5. Bail-in Within Resolution	31
6. AMCON Guidelines: Eligibility of Banking Assets and Collateral Valuation	36
 Annex	
1. Overview of the Nigerian Financial System, 2011	49

GLOSSARY

AMCON	Asset Management Corporation of Nigeria
AMCON Act	AMCON Act 2010
BCEAO	Banque Centrale des Etats de l’Afrique de l’Ouest
BOFIA	Bank and other Financial Institutions Act 1991 (as amended 1999)
BSD	Banking Supervision Department, CBN
CAMA	Companies and Allied Matters Act, 2004
CAR	Capital adequacy ratio
CBN	Central Bank of Nigeria
CBN Act	Central Bank of Nigeria Act, 2007
CMG	Crisis Management Group
COBAC	Commission Bancaire de l’Afrique Centrale
DIF	Deposit Insurance Fund
DMO	Debt Management Office
EBA	Eligible Bank Asset
EFI	Eligible Financial Institution
ELA	Emergency liquidity assistance
Failed Banks Act	Failed Banks (Recovery of Debts) and Financial Malpractices in Banks Act, 1994
FSB KA	Financial Stability Board Key Attributes of Effective Resolution Regimes for Financial Institutions
FSR	Financial Stability Report
FSRCC	Financial Services Regulation Coordinating Committee
M&A	Merger and Acquisition
MoU	Memoranda of Understanding
MoF	Ministry of Finance
₦	Nigerian Naira
NDIC	Nigeria Deposit Insurance Corporation
NDIC Act	Nigeria Deposit Insurance Corporation Act, 2006
NPLs	Nonperforming loans
OBA	Open bank assistance
P&A	Purchase and assumption
PCA	Prompt Corrective Action
RRP	Recovery and resolution plan
SIF	Supervisory Intervention Framework of 2011
SIFI	Systemically important financial institution

EXECUTIVE SUMMARY²

This note elaborates on the recommendations made in the Financial Sector Assessment Program (FSAP) for Nigeria in the areas of contingency planning, crisis management and bank resolution. It summarizes the findings of the FSAP mission undertaken during September 4–19, 2012 and is based upon analysis of the relevant legal and policy documents and extensive discussions with the authorities and private sector representatives.

The Nigerian financial system experienced a banking crisis in 2008-2009, partly triggered by the global financial crisis and by domestic events. A special examination revealed that 10 banks, accounting for about a third of the banking system assets were either insolvent or undercapitalized. The authorities responded with a comprehensive range of measures that ultimately mitigated the shock of the banking crisis. The Central Bank of Nigeria (CBN) injected ₦620 billion of liquidity into the banking sector, granted a guarantee of inter-bank deposits, introduced a blanket guarantee on all deposits and foreign credit lines and replaced management in eight Nigerian banks. The Asset Management Corporation of Nigeria (AMCON) was established to purchase nonperforming loans (NPLs) of banks and to recapitalize banks.

The decisive crisis response effectively stabilized the banking system, but the challenge now is to devise a credible exit strategy and to strengthen the resolution framework. This technical note discusses the lessons learnt and makes a number of recommendations.

- *Institutional framework.* The CBN played the primary role in managing the crisis. Although the CBN remains the lead agency for financial stability matters, the mission recommends that the inter-agency committee, the Financial Services Regulation Coordinating Committee's (FSRCC) mandate be expanded to include financial stability and crisis preparedness/management, to promote a more engaging interagency policy dialogue across the various agencies on these matters. As Nigerian banks have numerous subsidiaries in the region, existing cross-border cooperation agreements for supervision should be enhanced and extended to cover resolution issues.
- *Supervisory early intervention.* Since the crisis, the authorities have enhanced enforcement and issued a Supervisory Intervention Framework of 2011 (SIF), which includes a prompt corrective action (PCA) regime. However, the early intervention powers in the Bank and Other Financial Institutions Act (BOFIA) and the SIF need to be aligned to ensure that the PCA framework has a sound statutory footing. The CBN should also consider implementing recovery and resolution planning for banks that are systemically important financial institutions (SIFI) in Nigeria.
- *Official financial support.* The CBN took a number of crisis measures which exposed its balance sheet. Moving forward, the mission recommends that the CBN's role be limited to providing an emergency lending facility for banks facing liquidity problems, with a comprehensive framework to be developed. For banks that face solvency problems, the

² This note was prepared by Dawn Chew (IMF) and Miquel Dijkman (WB).

Federal Ministry of Finance (MoF) should step in to provide financial support. The Nigerian Deposit Insurance Agency's (NDIC) unusual statutory role in providing emergency liquidity assistance and guarantees should be removed. Financial support from the NDIC to banks should be limited to assisting resolution measures and subject to a cap. The authorities should also consider measures to unwind the blanket guarantee.

- *Crisis Management Tools.* The CBN and the NDIC have a broad resolution toolkit which was put to use during the crisis to resolve the intervened banks. The authorities arranged mergers and acquisitions (M&A), set-up bridge banks to take over assets and liabilities of problem banks and established an asset management company (AMC) to deal with NPLs and recapitalization of banks. Legislative amendments should be made to allow resolution authorities to override the rights of shareholders, prevent a suspension or reversal of proceedings if there are challenges to a resolution action, with appropriate safeguards such as judicial review and payment by way of monetary compensation. Resolution tools could also be enhanced by providing for mandatory recapitalization, power to write-down capital and statutory bail-in.
- *Systemic Crisis Management framework.* While it is acknowledged that certain measures have to be taken in the event of a systemic crisis, the mission recommends that the public framework set out in the SIF be withdrawn as it creates expectations that banks will be bailed-out using public funds, raising moral hazard issues. Bank liquidation is effectively ruled out in the framework, even for non-viable banks. Private sector solutions should be favored and the industry should bear the costs
- *AMCON.* This agency has been a central element in the authorities' response to the financial crisis but it should only have a temporary purpose, and continuation of its activities when normal banking business is restored becomes counterproductive. While AMCON notionally has a life of around ten years, this is not formally assured. It is important to establish formally a sunset provision ensuring that AMCON winds down its activities within that timeframe, or better earlier. To reinforce this, AMCON should no longer purchase any assets from banks, and should be given a time path and annual targets for disposal of its assets. The appointment of advisors to determine the future of the three "AMCON banks" is welcome; as with the assets, early restructuring and divestiture or resolution would be appropriate. AMCON's funding arrangements require strengthening too. It is important that the bill establishing the Resolution Cost Fund be approved, and that the proceeds are clearly earmarked for the repayment of the outstanding bonds. In light of the sizeable redemptions in 2013-2014, a rollover strategy urgently needs to be devised.
- *Deposit Insurance.* The deposit insurance scheme is structured as a risk-minimizer. The NDIC has broad supervisory and resolution responsibilities. The deposit insurance coverage is broadly adequate and the scheme is ex-ante funded. However, the NDIC should be exempted from the Fiscal Responsibility Act so as to build up the fund. Further, the NDIC should have a credit line to the MoF rather than the CBN. The statutory 90-day pay out period is too long and should be shortened significantly.
- Lastly, *legal protection* for the CBN, NDIC, AMCON and their staff could be enhanced to deal with the numerous challenges faced. Recommendations made relate to reversing the

burden of proof, elevating the threshold for commencing action and providing for an express indemnity for legal costs for the staff.

This note is structured as follows: Chapter II sets out an overview of the Banking Crisis of 2009; Chapter III analyses the institutional framework and coordination arrangements for systemic risk monitoring, crisis management and cross-border coordination; Chapter IV assesses the approaches to intervene with potential problem institutions at an early stage; Chapter V covers crisis management tools including official financial support, the resolution framework, AMCON; Chapter VI reviews the deposit insurance framework, and Chapter VII address the issue of legal protection.

Table 1. Nigeria: Table of Recommendations

Recommendations and Authority Responsible for Implementation	Timeframe
Introduce an explicit statutory mandate for systemic risk monitoring and crisis preparedness/ for the FSRCC and strengthen the analytical framework for financial stability monitoring (FSRCC, CBN)	1-2 years
Revive the regular meetings of the Technical and Executive Committees of the CBN-NDIC (CBN, NDIC)	6-12 months
Amend CBN Act to formalize PENCOM's membership in FSRCC	1-2 years
Withdraw the CBN circular restricting recapitalization of foreign subsidiaries by Nigerian parent banks (CBN)	6-12 months
Expand cross-border and domestic MoUs to cover crisis management and resolution aspects (CBN, FSRCC)	1-2 years
Establish Colleges of Supervisors for Nigerian banks and Crisis Management Groups and implement recovery and resolution planning (CBN, NDIC)	2-3 years
Amend the BOFIA and NDIC Act to ensure that the PCA framework has a statutory footing (CBN, NDIC)	1-2 years
Amend BOFIA and NDIC Act to strengthen the resolution regime by having the power to override shareholder's rights, prevent a suspension or reversal of resolution proceedings on challenge, expand resolution toolkit, harmonize and expand resolution triggers (CBN, NDIC)	1-2 years
Develop an ELA framework for the CBN and take measures to ensure that the MoF can provide solvency support on an urgent basis (MoF, CBN)	1-2 years
Amend NDIC Act to remove possible NDIC liquidity support to banks and cap any financial assistance for resolution measures to amount of payout of insured deposits (NDIC)	1-2 years
Discontinue AMCON's acquisition of problem assets and remove relevant prudential requirements, earmark cash flows for repayment of bonds, sunset clause for disposal of NPLs and assets with specific disposal targets, divest ownership in the three banks, and establish a firm end-2017 closing date (MoF, CBN, AMCON)	6-12 months
Withdraw Part 4 of the Supervisory Intervention Framework relating to systemic crisis management (CBN)	6-12 months
Unwind the blanket guarantee introduced during the crisis with appropriate communication (CBN)	6-12 months
Reinstate CBN's authority to appoint NDIC as liquidator immediately upon revocation of license and exempt banks from Company Winding Up Rules (CBN)	1-2 years
Exempt the NDIC from the Fiscal Responsibility Act of 2007 (MoF)	6-12 months
Divest CBN's shareholding in NDIC and replace the credit line to the CBN with a credit line to the MoF (MoF, CBN)	1-2 years
Shorten statutory payout period for insured deposits to 15 days and change to gross payout	1-2 years

I. THE NIGERIAN BANKING CRISIS OF 2008–2009 AND THE POLICY RESPONSE

- 1. The Nigerian financial system underwent major structural changes leading up to the 2008–2009 crisis and beyond.** The banking system currently accounts for over 80 percent of financial sector assets and represents about 53.6 percent of GDP. Following a program of consolidation and recapitalization, the number of banks was reduced from about 90 in 2005 to 24 by 2006 and by end–2011, there were 20 commercial banks, with ₦18.2 trillion assets and ₦12.5 trillion in deposits (about US\$81 billion), and one Islamic (non-interest) bank. Three banks, Stanbic, Standard Chartered, and Citibank, are foreign-owned. They hold about 14 percent of assets in the industry. Three banks, Enterprise, Keystone, and Mainstreet, are publically owned. They hold about 5 percent of industry assets. The others are domestic and privately-owned (see Annex 1 for an overview of the financial system).
- 2. The banking crisis had its origins in the forced consolidation of the sector in 2005-2006.** The consolidation was not accompanied by sufficient supervision to ensure that the capital of merged institutions was adequate. During this period, there was a high growth rate of credit to the private sector and most of the expanded credit was used to purchase equities, in many cases in the stocks of domestic commercial banks that were extending the credit. When the equity bubble burst, NPLs rose from 6 percent to 28 percent of total loans in December 2009. Ten banks were particularly hit because of their large exposure to equity-related loans. The crisis triggered a sustained depreciation of the domestic currency and a sharp fall in the highly inflated stock market. Excessive margin lending and unhedged loans to oil importers that became nonperforming, as well as other credit malpractices, resulted in a spike in NPLs in the banking system.
- 3. A special examination in the autumn of 2009 of all banks by the CBN and the NDIC revealed that 10 banks, accounting for about a third of the banking system assets, were either insolvent or undercapitalized.** The examination reports were finalized in August 2009 and revealed that banks had sizable off balance sheet instruments that concealed NPLs while, in other cases, NPLs were rolled over or otherwise classified as performing. Serious governance problems were also identified. There were serious cases of connected lending and undercapitalization. The CBN replaced management in eight banks and proceeded to take action against the ex-CEOs and directors. Soundness indicators showed that the ratio of liquid assets to total assets for the system stood at 17.9 percent by September 2009 and NPLs was over 26 percent (on the basis of the special examination). In relation to the 10 banks, weighted capital to assets was a negative 24 percent and NPLs were at 65 percent of loans. Three banks reported moderate insolvency with negative 3.5 percent capital to assets or less while the other seven banks showed severe insolvency at negative 18 percent (Oceanic) and 69 percent (FinBank).
- 4. The authorities intervened decisively by injecting liquidity into the troubled banks and providing broad guarantees, which was crucial in safeguarding stability.** The

CBN injected ₦620 billion (about US\$4.1 billion) of liquidity into the banking sector in the form of unsecured and subordinated debt and provided a guarantee of all interbank lending transactions (expired end-December 2011), foreign credit lines, and pension deposits.

5. **To instill public confidence, the authorities made a public commitment to protect depositors and creditors against losses and that no bank would be allowed to fail.** These quick measures stabilized the banking system and allowed the authorities time to design a strategy to resolve the intervened banks.

6. **After the initial crisis containment phase, the key focus of the authorities under the bank resolution phase was to restructure the banks.** Most intervened banks showed negative capitalization and high levels of NPLs. There was an urgent need for new capital through recapitalization and relief from problem assets. In addition, there were widespread governance issues, such as insider abuse and involving criminal activity.

7. **In 2010, the authorities set up the AMCON to purchase NPLs of banks.** NPLs were purchased by AMCON in exchange for tradable three-year zero coupon bonds issued by AMCON and guaranteed by the federal government, to bring five of the eight insolvent banks to zero equity.

8. **By September 2011, AMCON had purchased all the NPLs of the intervened banks and the recapitalization of the intervened banks were completed.** The health of the banking sector significantly improved at end–December 2011. The industry’s average CAR was 17.9 percent, with the lowest CAR at 10 percent and highest at 31 percent at end–December 2011. The industry’s ratio of NPLs to total loans declined to 5 percent, from 15.5 percent at end December 2010. All banks met the minimum liquidity ratio of 30 percent at end-December 2011. The banking industry’s cash reserve ratio was 8 percent. Box 1 provides a timeline of the crisis response measures.

9. **The authorities removed the CBN guarantees on all interbank liabilities at the end of 2011.** This was based on their assessment that there had been no new problems with the recapitalized banks. Outstanding interbank guarantees at end–December 2011 were ₦275.2 billion. However, no official announcement has been made in relation to the public commitment to protect depositors and creditors against losses.

10. **The decisive crisis response effectively stabilized the banking system, but the challenge now is to devise a credible exit strategy.** Thanks to a decisive and timely initial policy response, stability was maintained amidst a series of unprecedented shocks. However, maintaining support measures can carry significant costs in terms of public resources and moral hazard. Going forward, as the financial system is strengthening; it is time to gradually unwind some of the support mechanisms introduced in the crisis. The remainder of this note makes recommendations on what steps should be taken to unwind these mechanisms as well as how to strengthen the crisis management regime, guided by international good practices.

Box 1. Timeline of Nigerian Banking Crisis

August 14, 2009	CBN releases audit reports on 10 banks. Intercontinental Bank Plc, Oceanic Bank Plc, Afribank Plc, Union Bank of Nigeria Plc and Finbank Plc (31 percent of banking system) fail the stress tests—the largest, Union had negative capital and the other four had weak capitalization and high levels of NPLs. CBN replaces senior management and injects ₦420 billion into five banks.
August 18, 2009	Enforcement Financial Crimes Commission arrests three ex-CEOs and nine others.
August 19, 2009	CBN publishes list of bank debtors.
August 31, 2009	Enforcement Financial Crimes Commission arraigns sacked bank CEOs.
October 2, 2009	CBN fires ETB, Spring Bank Plc and Bank PHB Plc CEOs and executive directors. Gives these three banks a ₦200 billion lifeline. Wema and Unity Banks get June 30, 2010 deadline to recapitalize.
October 14, 2009	CBN releases fresh debtors' list.
January 25, 2010	CBN limits bank CEOs' tenures.
February 15, 2010	CBN performs fresh audit of banks.
June 30, 2010	CBN extends recapitalization deadline for Wema and Unity Banks.
July 19, 2010	President signs the Asset Management Corporation of Nigeria Bill.
August 16, 2010	CBN unfolds plan to sell the eight rescued banks.
January 1, 2011	AMCON takes over ₦2 trillion of nonperforming loans from the rescued banks and other banks.
May 12, 2011	Shareholders lose bid to stop CBN from selling the eight rescued banks.
June 2, 2011	CBN gives rescued banks till September 30 to recapitalize or face liquidation.
July 2011	Finbank, Intercontinental and Union Banks sign binding Transaction Implementation Agreements with First City Monument Bank Plc, Access Bank Plc and African Capital Alliance for recapitalization.
July 18, 2011	CBN extends interbank credit guarantee for Finbank, Union and Intercontinental Banks to December 31, 2011.
July 29, 2011	Ecobank Transnational Incorporated, parent company of Ecobank Plc, signs a Transaction Implementation Agreement with Oceanic Bank.
August 4, 2011	CBN extends interbank credit guarantee for Oceanic Bank to December 31, 2011.
August 5, 2011	CBN and NDIC create three bridge banks to take over Bank PHB, Spring Bank Afribank. These banks were almost immediately recapitalized by AMCON.

II. INSTITUTIONAL FRAMEWORK

A sound institutional framework for crisis management and bank resolution requires clear and effective legal underpinnings both within each institution's legal framework, as well as among the relevant institutions. For example, each institution should have a strong and clear mandate. In addition, there should be an adequate allocation of labor across the institutions and explicit coordination mechanisms between the institutions, including solid legal bases for the exchange of confidential information.

A. Institutional Framework and Coordination Arrangements for Systemic Risk Monitoring and Crisis Management

11. **The Nigerian financial system comprises the following regulatory agencies, with the CBN being the only agency with an express financial stability mandate:**

- The **MoF** is the government department responsible for the control and management of the public finance of the Federation. Its functions include preparing annual estimates of revenue and expenditure for the Federal government, formulating policies on fiscal and monetary matters, maintaining internal and external value and stability of the Nigerian currency, supervising the insurance industry etc.
- The **CBN** is the central bank and prudential regulator and supervisor for the banking sector. The objectives of the CBN are set out in the Central Bank of Nigeria Act, 2007 (CBN Act)³ and its principal objectives include ensuring monetary and price stability and promoting a sound financial system in Nigeria. The BOFIA empowers the CBN to supervise and regulate the activities of banks.⁴ The CBN is also consulted by the NDIC on resolution actions.
- The **NDIC** administers the deposit insurance scheme (DIS), supervises banks⁵, and is the resolution authority as well as bank liquidator.
- The **National Securities Exchange Commission (SEC)** is the corporate organization charged with the function of registering all securities proposed for subscription by the public or to be sold in the market. It has the responsibility to maintain surveillance over the securities market and to protect its integrity.
- **The National Insurance Commission (NAICOM)** is responsible for administration, supervision, regulation and control of insurance business in Nigeria while the

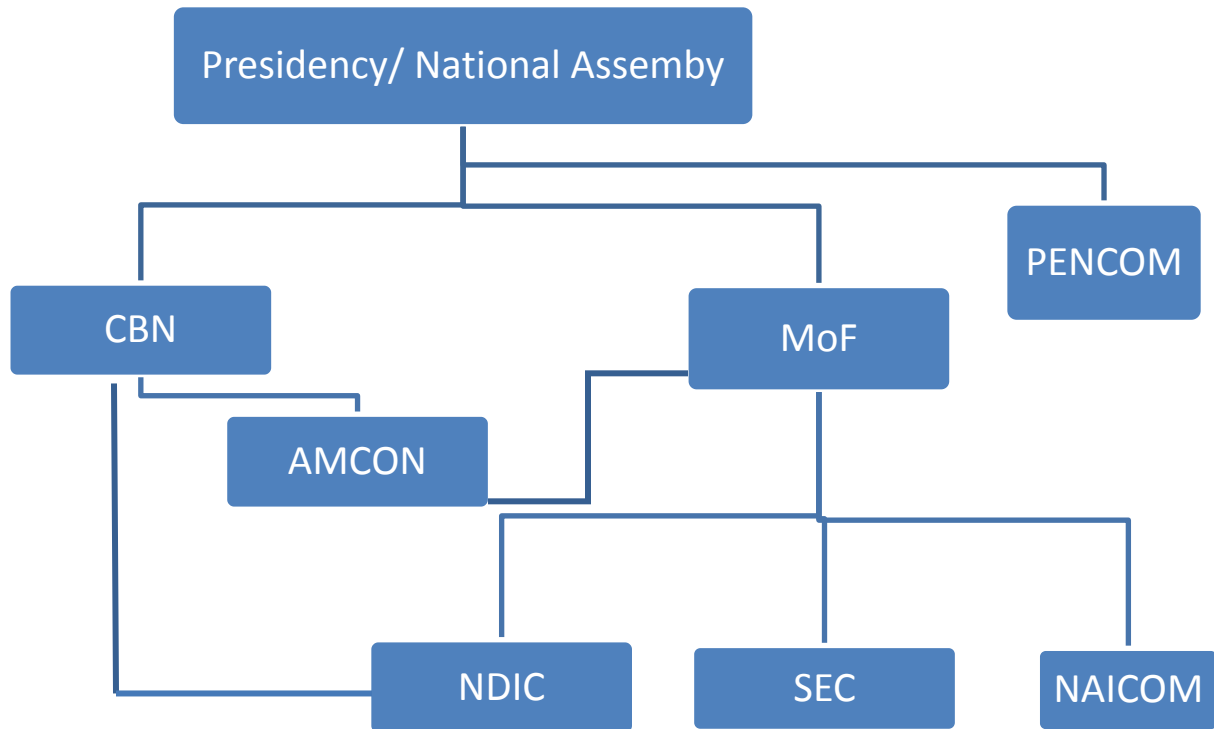
³ Section 2 of CBN Act.

⁴ Sections 31 & 34 of BOFIA.

⁵ Part VI of NDIC Act.

National Pension Commission (PENCOM) is the body that regulates, supervises and ensures the effective administration of pension matters. Figure 1 gives an overview of the structure of the Nigerian Financial System.

Figure 1. Nigeria: Structure of the Nigerian Financial System



12. **In addition to the financial safety net players, the judiciary also plays a role.** The Federal High Court hears the winding up petition of the NDIC, appoints the NDIC as the liquidator of the banks and adjudicates claims under the Failed Banks (Recovery of Debts) and Financial Malpractices in Banks Act, 1994 (Failed Banks Act).

13. **Amongst the members of the financial system, the CBN is the only agency with an express mandate for financial stability.** Section 2(d) of the CBN Act provides the CBN with the mandate to promote a sound financial system in Nigeria. The CBN has a Financial System Stability Directorate, headed by a Deputy Governor. This Directorate has four departments, including the Banking Supervision (BSD) and Financial Policy and Regulation departments (FPRD) and the mandate for financial stability is split between these two departments. A CBN Board Committee on financial stability is charged with the responsibility of ensuring the stability of the financial system. This Board Committee receives input from a committee on financial stability made up of departmental directors.

The Financial Services Regulation Coordinating Committee

14. **The Financial Services Regulation Coordinating Committee (FSRCC)⁶ is an inter-agency committee that coordinates the supervision of financial institutions.**

Established in April 1994 to facilitate a formal framework for the coordination of regulatory and supervisory activities in the financial sector, it was accorded legal status in 1998 and formally inaugurated by the Governor of CBN in May 1999. Box 2 elaborates on the membership and sub-committees. PENCOM's membership needs to be formalized.

15. **There is a multilateral Memorandum of Understanding (MoU) for information sharing between members of FSRCC and a website through which information is shared among member agencies.** The MoU identifies the types of information that are shared amongst the members of the FSRCC, such as that relating to the identity of licensed entities, their status, enforcement action taken against them. The FSRCC sub-committee on information sharing has developed an information sharing portal on the FSRCC website for member agencies, with different types of information accessible by staff of varying levels of seniority.

16. **Although the FSRCC existed during the banking crisis of 2008–2009, it did not play any role in managing the crisis.** The FSRCC did not meet for two years during the crisis and the crisis was instead managed primarily by the CBN.

17. **The FSRCC does not have an express statutory mandate for financial stability.** The charter to the FSRCC suggests that the FSRCC may consider issues relating to financial system distress, examine resolution options and recommend actions. This is however not reflected in the statutory mandate. The FSRCC currently functions as more of a forum for information sharing and coordination of regulatory initiatives e.g., in relation to corporate governance and consolidated supervision issues.

18. **The objectives of the FSRCC could be expanded to include systemic risk monitoring and crisis preparedness/ crisis management.** A more engaging dialogue on financial stability matters is called for as this would bring considerable advantages in terms of preparing for the eventuality of crises. Considering that the FSRCC comprises all the financial sector safety net players, it is the natural platform for coordination and information exchange about financial stability issues at the national level. Even so, the CBN remains the lead agency for financial stability matters. In fact, periodic interagency discussion on the financial stability outlook should be centered on the CBN's bi-annual Financial Stability Report (FSR).

⁶ CBN Act (Section 43), initially established as the Financial Services Coordinating Committee, renamed the FSRCC in May 1994.

B. Macroprudential Supervision

19. **The FSRCC would also be the natural forum for macroprudential policymaking.** Macroprudential policy transcends the responsibilities and mandates of individual regulatory agencies. The formulation of a coherent package of macroprudential policies therefore requires strong cooperation and coordination mechanisms between the players represented in the FSRCC. Considering the amplitude of the financial cycle and the volatility of the real economy, there is a strong case for establishing a robust framework for macroprudential policymaking.

Box 2. The Financial Services Regulation Coordinating Committee

Membership: The FSRCC is chaired by the Governor of the CBN and comprises of the Managing Director of the NIDC, the Director-General of the SEC, the Commissioner for Insurance, the Registrar-General of the Corporate Affairs Commission (the body that administers the provisions of the Companies and Allied Matters Act) (CAC); and a representative of the MoF. The Director-General of PENCOM has also been admitted as a member of the FSRCC but the CBN Act needs to be amended to formalize this. The Nigerian Stock Exchange, Abuja Securities and Commodities Exchange and the Federal Inland Revenue Service send observers to the FSRCC. The CBN serves as the Secretariat of the FSRCC.

Objectives: Its objectives include: (i) to coordinate the supervision of financial institutions especially conglomerates; (ii) to reduce arbitrage opportunities; (iii) to deliberate on problems experienced by members with any financial institution; (iv) to eliminate any information gaps; and (v) to articulate strategies for the promotion of safe, sound and efficient practices by financial intermediaries. Under Article 4 of the Charter of the FSRCC, the functions are stated as including to:

- Identify the causes of distress in the financial system, examine resolution options adopted so far and recommend any other solutions and measures to avert future distress;
- Examine the regulatory and supervisory standards of each member and recommend areas that require joint supervision and enforcement.

Sub-Committees: The FSRCC has five standing sub-committees:

- Financial Sector Soundness (Chair: CBN) that conducts surveillance over potential risks and recommends measures to avoid systemic crisis.
- Harmonization and Coordinating (Chair: NDIC) that examines regulatory and supervisory standards, recommends joint supervision and enforcement and capacity building.
- Information sharing (Chair: NSEC) that identifies mechanisms and processes for information sharing.
- Legal and enforcement (Chair: CAC) that identifies overlaps, gaps, conflicts, inconsistencies and enforcement cooperation.
- Financial Market Development (Chair: NAICOM) that identifies and recommends areas to improve the financial system.

Decision making: FSRCC decisions are taken on a consensual basis and implemented via the individual member agencies.

20. **A successful conduct of macroprudential policies requires the presence of a well-established analytical framework on the basis of which policymakers can make informed choices.** The current framework falls short in a number of aspects. Coverage of non-bank financial institutions (which accounts for more than 20 percent of financial system assets) in the FSR is limited as the other supervisory agencies are not involved in the drafting. This hinders the adoption of a holistic, system-wide perspective.

21. **Besides widening the scope, the CBN faces the challenge of developing a conclusive methodology for assessing systemic risks.** The current FSR is rather narrative and descriptive. It does not provide conclusive guidance as to where the main sources of systemic risk in the financial system lie. Macroprudential analysis should periodically assess the level of systemic risk that has accumulated in the financial system at a given point in time (i.e., the so-called time series dimension of systemic risk). The objective is to identify the key risks to financial stability, and to propose measures to halt the accumulation of systemic risk. This calls for the identification of a broad range of financial soundness and real economy sector indicators that are to be included in the monitoring exercise, and the adoption of methodologies for trigger points that denote building imbalances.

22. **The CBN is also in the process of developing criteria for the identification of SIFIs.** In line with practices elsewhere, the identification of SIFIs involves an analysis of indicators for banks' size, interconnectedness and their substitutability. The CBN is finalizing the set of criteria and corresponding thresholds, but it has indicated that the list of SIFIs banks overlaps with the Nigerian parent banks with foreign subsidiaries—which are required to keep additional capital buffers compared to their domestic peers (i.e., 15 percent compared to 10 percent). The exercise only involves domestic indicators for systemic relevance and does not consider the systemic importance of banks in foreign jurisdictions.

23. **With the assistance of external consultants, the CBN is in the process of strengthening these analytical underpinnings of the macroprudential framework.** Although its current headcount of twenty-six employees seems adequate, it faces skill shortages in specific specialized areas, including statistics and legal, which it intends to address by hiring additional staff. Besides macroprudential analysis, the consultancy project covers a broader range of areas, including crisis handling and resolution (i.e., Early Warning Systems, scenario analysis, and CBN's contingency planning arrangements), the microprudential framework (i.e. mandates, powers, resources and processes) and the legal underpinnings of the CBN's operations. A theme that cuts across the different aspects of the consultancy project is the adequacy of data (e.g., coverage, availability, timeliness and reliability).

CBN-NDIC coordination

24. **Although there is no MoU between the CBN and the NDIC, there appears to be appropriate information sharing arrangements between the CBN and NDIC, in the**

form of express legislative provisions and in operational arrangements. The CBN and the NDIC conduct joint on-site supervisions and share a common electronic financial analysis surveillance system (eFASS) database for off-site supervision. Section 53 of NDIC Act provides that the corporation shall have access to reports of examination of the CBN and shall make reports of its examination available to the CBN. CBN shall also make available to NDIC information on insured institutions and is required to inform the NDIC of all contraventions of an insured institution of the NDIC Act.

25. **The CBN and NDIC have established joint Executive and Technical Committees on Supervision.** While these two committees have been established for the purposes of information sharing and coordination, these committees do not meet regularly and did not meet during the crisis. When dealing with distressed banks, there is an obvious need for both agencies to cooperate intensively, and a strengthening of the coordination arrangements is called for.

26. **Moving forward, the CBN proposes to establish ad hoc Crisis Management Units (CMU).** Such units, to be composed of the CBN and the NDIC staff, will be constituted whenever there is a crisis and intended to be a forum to coordinate crisis response measures. This unit however does not include representation by the MoF.

27. **The mission recommends that:**

- Instead of establishing ad-hoc CMUs whenever there is a crisis, the FSRCC should have an explicit statutory mandate for financial stability. It should carry out risk monitoring and be the forum for crisis preparedness/coordination. Box 3 illustrates the recommended role for the FSRCC.
- The meetings of the CBN-NDIC Executive and Technical Committees should be revived to enhance coordination between the CBN and the NDIC in their dual roles as bank supervisors and resolution authorities and provide a forum for information sharing at both the technical and highest levels within each institution.
- The CBN Act should be amended to formalize PENCOT's membership in the FSRCC.

C. Intra-Group Resolution

28. **As part of the regulatory reform in response to the banking sector crisis, the CBN has repealed earlier universal banking guidelines.** With the repeal of these guidelines in November 2010⁷, Nigeria reintroduced a narrow banking model. Nigerian banks will no longer be allowed to perform nonbanking activities. Banks are required to

⁷ Regulation on the Scope of Banking Activities & Ancillary Matters, No. 3, 2010.

submit plans for divestiture of nonbanking assets (insurance and securities activities), including the possibility of reconstituting the bank into a holding company that in turn owns separate banking and nonbanking subsidiaries.

29. **The framework for the regulation of bank financial holding companies is being worked out in the proposed amendments to the BOFIA.** In line with the Financial Stability Board Key Attributes of Effective Resolution Regimes for Financial Institutions, October 2011 (FSB KA), the authorities should ensure that the resolution regime for financial institutions should extend to (i) holding companies of a firm; (ii) non-regulated operational entities within a financial group or conglomerate that are significant to the business of the group or conglomerate; and (iii) branches of foreign firms.⁸

Box 3. Proposed FSRCC Sub-Committee for Systemic Risk Monitoring and Crisis Preparedness/Management

Systemic risk monitoring and crisis preparedness/management could be delegated to the Financial Sector Soundness Sub-Committee, with a regular reporting and recommendation making requirement to the main committee. The legal mandate of each member of the FSRCC should be able to support macroprudential and crisis preparedness and management policies by having the mandate to contribute to or to foster financial stability.

For the purposes of systemic risk monitoring, the FSRCC should:

- Meet regularly (e.g., quarterly or more frequently as needed) to monitor and assess systemic risks and to formulate plans and strategies to address them. Such a contingency plan should identify the necessary human resources, legal basis, lines of communication with other institutions and action plans for failure of a SIFI or a systemic crisis. Such a plan should also include formal communication channels with other supervisory agencies and foreign supervisors/regulatory authorities.
- Develop a framework for macroprudential supervision. This calls for a significant strengthening of macroprudential surveillance so that policymakers represented in the FSRCC can make informed choices. The scope of the FSR should be widened to include non-bank financial institutions, and a methodology that allows for a more conclusive assessment of systemic risk (i.e., financial soundness and real economy indicators and thresholds) needs to be adopted.
- Advance the work on the identification of systemic banks. The identification of systemic banks should not only cover their importance in a domestic setting, but also their relevance for jurisdictions abroad.

For the purposes of crisis preparedness/management, the FSRCC should:

- Agree on a road map for crisis management, including having clarity on the individual roles and responsibilities for each agency. In this regard, the mandate vested upon each agency would need to be taken into account.
- Be made responsible for crisis planning and preparedness, including undertaking simulations to test the capacity of the authorities. In addition, stress tests should also be conducted on a regular basis and the results acted upon.

Further, the FSRCC should:

- Ensure that there are no legal and operational hurdles for information exchange among the members. In this regard, the current MoU of the FSRCC and the web database for sharing information could be expanded to also cover information exchange relating to systemic risk monitoring and crisis preparedness/management.
- Produce an annual report to Parliament/ President on its systemic risk monitoring and crisis preparedness activities.

⁸ FSB KA 1.

D. Cross-Border Cooperation & Coordination

30. **In recent years, regional integration of the Nigeria’s banking system has increased substantially.** Nigerian banks have set up subsidiaries across the continent, which has led to the emergence of pan-African banking groups. The cross-border operations of Nigerian banks typically account for a relatively small share of overall group assets (e.g., around 20 percent in the case of United Bank of Africa). Nonetheless, in some West-African countries, Nigerian subsidiaries represent the lion’s share of the banking system. From a host perspective, four foreign banking groups (Standard Chartered, Citibank, Stanbic/IBTC and Ecobank) have a presence in Nigeria.

31. **In tandem with the regional expansion, the CBN has gradually enhanced cross-border oversight, covering key aspects of going concern supervision.** The CBN has created a unit dedicated to the supervision of cross-border institutions in the BSD and it has put in place a Framework for the Supervision of Cross-Border Institutions (Cross-Border Framework). The framework is intended to provide guidance on the supervision of Nigerian banks with offshore subsidiaries and also on the level of cooperation expected from host countries in the supervision of cross-border entities.

32. **Bilateral MoUs have been established with a significant number of jurisdictions with Nigerian banking presence.** The CBN has entered into bilateral MoUs with all English Speaking West African Countries, Bank of Ghana, Banking Commission for Central Africa (COBAC), China Banking and Regulatory Commission, Bank of Uganda, U.K. Financial Services Authority (FSA), South Africa Reserve Bank, National Bank of Rwanda, Bank of Zambia, Central Bank of Kenya, Central Bank of West-African States (BCEAO), Central Bank of the Gambia, Bank of Sierra Leone, Western African Monetary Zone (WAMZ) (Gambia, Ghana, Guinea & Sierra Leone), Bank Negara Malaysia, Central Bank of Liberia and Central Bank of Guinea. The MoUs contain details on information sharing, on-site examinations, confidentiality of shared information and consolidated supervision⁹; they do not cover aspects related to crisis management and resolution. In recent times, the establishment of MoUs with host regulatory authorities has become a prerequisite for the initiation of Nigerian banking operations in foreign jurisdictions.

33. **The CBN is also a member of the College of Supervisors of WAMZ, held quarterly.** The WAMZ College is a generic college aimed at enhancing coordination and cooperation among supervisors, rather than the strengthening of supervision of individual

⁹ Section 33(6) of the CBN Act empowers the CBN, in exercise of its powers and on the basis of reciprocity, to enter into agreement or arrangements with other regulatory authorities in Nigeria or in other countries exercising similar responsibilities for the promotion of mutual cooperation and exchange of information for enhancing supervision and regulation, conditional upon assurances of confidentiality.

banks—whose geographical mapping does not match the composition of the college. The college meets quarterly. Its stated objectives are to facilitate the exchange of information among supervisors in the WAMZ area and to enable supervisors to develop a common understanding of the risk profile of a banking group as a starting point for risk based supervision at both the solo and consolidated levels. There is a portal for information-sharing among supervisors. The CBN and relevant host country Central Bank have commenced joint examination of Nigerian banks in West African countries (The Gambia, Ghana, Guinea and Sierra Leone). The CBN also participates in the core college established by FSA for Standard Chartered Bank held annually as a host authority.

34. **According to the CBN, initial experiences have been encouraging, but it faces some serious challenges in further strengthening of cross-border supervision.** Among the obstacles are differences in quality of supervision, divergences in reporting requirements and off-site monitoring systems and language barriers (particularly with francophone Africa). Some of the Nigerian banks have expanded significantly into jurisdictions where supervisory and enforcement capacity is weak, data reliability problematic and prudential returns are not subject to rigorous supervisory scrutiny. The CBN is aware that it has a vested interest in strengthening capacity in these jurisdictions and it has opened its supervisory training program for foreign inspectors. The CBN is also actively promoting the harmonization of reporting requirements and off-site monitoring tools through the adoption of eFASS in the region.

35. **Ecobank, a pan-African financial conglomerate, presents particular cross-border supervisory challenges.** Headquartered in Lome, the Togolese authorities are responsible for exercising consolidated supervision. In light of the supervisory weaknesses observed in some of the constituencies, this is a challenging task. Another factor is that the Togolese operations account for only a small share of the group's asset and deposit base. While the CBN supervises the Nigerian operations on a stand-alone basis, challenges in exercising comprehensive group-wide supervision could be associated with a hidden build-up of intra-group exposures and double gearing of capital. The CBN therefore has an enlightened self-interest in ensuring that these risks are appropriately monitored and addressed by the home supervisor.

36. **A recent circular, restricting Nigerian banks' capacity to capitalize their foreign subsidiaries, is not in the spirit with enhancing cross-border cooperation and exposes Nigerian parent banks to considerable reputational risks.** CBN Circular to banks of May 18, 2012¹⁰ states that the CBN does not permit parent Nigerian banks from providing further capital outlays to foreign subsidiaries to augment their capital needs. Instead, banks are encouraged to consider alternative options such as M&As and sourcing fresh capital from the host country capital markets. Where such capital cannot be replaced, parent banks are

¹⁰ BSD/DIR/GEN/RFS/05/024.

required to submit exit strategies from those jurisdictions not later than June 30, 2012. Although the CBN claims that it would allow for exemptions for well-capitalized parent banks, the circular is drafted as a blanket prohibition. Such measures risk undermining the goodwill and trust of host authorities necessary to strengthen home-host cooperation and coordination. Nigerian parent banks may also be exposed to considerable reputational risk in case they are unable to come to the rescue of distressed foreign subsidiaries.

37. **Home-host cooperation in the context of crisis management has received limited attention so far.** The crisis did have a bearing on a number of foreign jurisdictions as the three intervened banks which had its assets and liabilities transferred to bridge banks had operations in Sierra Leone and Liberia. The governors of the host countries were given advance notice of the Nigerian authorities' intention to temporarily transfer the banks into bridge banks, and then recapitalize them with AMCON. The CBN's Cross-Border Framework attempts to set out a framework for cross-border crisis resolution. However, further work has to be done as the current framework envisages binding legal instruments or an international treaty, providing for burden sharing, contingency planning etc. Such a framework has yet to be translated into the legal framework in Nigeria and would also require the cooperation of foreign authorities.

38. **Experiences in various constituencies during the global financial crisis have highlighted that crisis management and resolution is rendered more complex in a cross-border context.** As such, the framework for early intervention and resolution should reflect the fact that banks are increasingly part of larger, international groups.¹¹ In times of crisis, the coordination between home and host presents considerable challenges, while divergence in incentives often stand in the way of finding a cooperative solution that is in the best interest of both home and host authorities.

39. **Advance preparation for the eventuality of crises can be helpful in reducing these challenges to more manageable proportions, so that home and host authorities pursue policies that consider international spillovers.** As an illustration, Australia and New Zealand have statutory arrangements in place for the prudential regulators to support each other in meeting prudential regulation and financial stability responsibilities and to consult where practicable before taking action that might have a detrimental effect on financial system stability in the other country. The FSB KA seeks to provide a framework for cross-border coordination. Box 4 summarizes some of the features of this framework.

40. **To enhance cross-border coordination and information sharing, particularly for resolution purposes, the mission recommends:**

¹¹ See IMF, *Resolution of Cross-Border Banks – A Proposed Framework for Enhanced Coordination*, 2010, p. 25-27. <http://www.imf.org/external/np/pp/eng/2010/061110.pdf>

- The immediate removal of the CBN Circular banning recapitalization of foreign subsidiaries. Rather than a ban, the CBN should consider recapitalization needs on a case-by-case basis, which is already the case as existing prudential requirements would require CBN approval for outflows of capital.
- Expanding the scope of cross-border MoUs to include crisis management. Ideally, home and host authorities pre-agree on key aspects, such as exchange of information, decision-making powers and procedures. It is especially important that the interests of smaller host countries, where Nigerian banks have a dominant presence but whose share in group assets and deposits is fairly low, take part in the arrangements.

Box 4. Cross-Border Crisis Resolution: The Key Attributes

A common theme reflected in the FSB KA is the requirement that national resolution authorities consider the impact of a resolution action on financial stability in other jurisdictions. Moreover, the FSB KA establishes several important principles for cross-border cooperation that are to be enshrined in national resolution frameworks.

- **Statutory mandate:** The mandate of a resolution authority should empower and strongly encourage the authority, wherever possible, to act to achieve a cooperative solution with foreign resolution authorities.
- **No discrimination:** National laws and regulations should not discriminate against creditors on the basis of nationality, the location of their claim, or the jurisdiction where it is payable.
- **Branches:** The host resolution authority should have resolution powers over local branches of foreign institutions and the capacity to use its powers either to support a resolution carried out by a foreign home authority or, exceptionally, to take measures on its own initiative where the home jurisdiction is not taking action or acts in a manner that does not take sufficient account of the need to preserve the local jurisdiction's financial stability.
- **No automatic action:** Legislation in jurisdictions should not contain provisions that trigger automatic action in that jurisdiction as a result of official intervention or the initiation of resolution or insolvency proceedings in another jurisdiction. However, the FSB KA recognize that resolution authorities should be able to take discretionary national action, when necessary, to achieve domestic stability in the absence of effective international cooperation and information sharing.
- **Recognition and effect:** Jurisdictions should provide for transparent and expedited processes to give effect to foreign resolution measures, either by way of a mutual recognition process or by taking measures under the domestic resolution regime that support and are consistent with the resolution measures taken by the foreign home resolution authority. Recognition or support of foreign measures should be provisional on equitable treatment of creditors in the foreign resolution proceeding.
- **Information sharing:** The resolution authority should have the capacity in law, subject to adequate confidentiality requirements and protections for sensitive data, to share information with relevant foreign authorities, where sharing is necessary for recovery and resolution planning or for implementing a coordinated resolution. Jurisdictions should provide for confidentiality requirements and statutory safeguards for the protection of information received from foreign authorities.
- **Legal protection:** The FSB KA provides for the protection for the resolution authority and its staff against liability for actions taken or omissions made in good faith domestically as well as in relation to actions taken in support of foreign resolution proceedings.

- In its capacity as a home supervisor, the CBN should take the lead in initiating the dialogue with host authorities.
- Colleges of Supervisors for specific banks should be established. Authorities in host countries where the bank has a material presence should participate. Within such colleges, Crisis Management Groups can be set up to ensure that relevant information is shared and recovery and resolution plans prepared on a group wide basis. The current “college” form WAMZ can be used to form bank specific colleges and expanded to include membership of all host authorities.
- Mechanisms for the mutual recognition of decisions made in other jurisdictions in the context of insolvency or reorganization proceedings, subject to conditions such as non-discriminatory treatment of foreign creditors and reciprocity.
- Ex-ante burden sharing arrangements,¹² enabling home and host authorities to act quickly during a crisis and avoid protracted negotiations, but not to an extent that it implicitly cedes sovereign rights and compromises domestic depositors and creditors.¹³

III. SUPERVISORY EARLY INTERVENTION OF PROBLEM BANKS

Early identification of problem banks and prompt remedial action is important to mitigate increased moral hazard risk.

41. **Regulatory forbearance contributed to the banking crisis of 2008–2009.** The lack of prompt enforcement action in relation to regulatory breaches and holding banks to remedial programs resulted in the authorities having to intervene in the eight banks.¹⁴

42. **Since the crisis, the authorities have enhanced enforcement and issued the SIF.** This framework sets out general and specific triggers for a range of corrective actions as well as a PCA regime, with corrective actions tied to prudential thresholds relating to capital adequacy ratios (CAR), asset quality, liquidity, earnings, risk management, internal control and system failures. Table 2 below sets out the PCA regime based on CAR.

43. **The corrective and remedial powers of the CBN and the NDIC are generally adequate.** Where the bank is not complying with laws, regulations, is engaging in unsafe or unsound practices that threaten the interests of depositors etc., the provisions of the BOFIA

¹² See for example, the Nordic-Baltic Stability Group MoU on burden-sharing.

¹³ See the FSB Key Attributes and IMF, *Resolution of Cross-Border Banks – A Proposed Framework for Enhanced Coordination*, 2010, p. 23 – 25, on <http://www.imf.org/external/np/pp/eng/2010/061110.pdf>

¹⁴ See Sanusi Lamido Sanusi, “The Nigerian Banking Industry: what went wrong and the way forward,” February 2010.

and the NDIC Act contain a range of corrective supervisory tools ranging from conducting special examinations, prohibiting further extensions of credit, removing directors and managers to the ultimate revocation of license and liquidation of the bank.¹⁵ Further, bank directors, managers and other officers can face criminal penalties if they failed to prove that due diligence was exercised or failed to take reasonable steps to secure compliance by the bank of regulatory requirements.¹⁶

44. **The SIF categorizes the supervisory tools into informal and formal actions.** The choice of actions are guided by (i) the nature of the situation; (ii) the cause and/or motivation; (iii) the history of compliance; (iv) the systemic impact; (v) the risk exposure or profile; (vi) the parties involved; (vii) the management attitude; and (viii) prospects. Informal action is taken when the composite risk rating is low or moderate; such actions are not to be publicly disclosed by the institutions and are generally not enforceable in law. Formal actions are legally enforceable agreements requiring a bank to take remedial measures towards enforcement and applied when the composite risk rating is above average or high, informal actions have been unsuccessful, unsafe and unsound practices are evident and there are violations of laws and regulations. Such actions are publicly disclosed.

Table 2. Nigeria: Prompt Corrective Action Framework

Bank Classification	Trigger	CBN Supervisory Action
Undercapitalized bank	5%<CAR<10% for period in any one month	<ul style="list-style-type: none"> • Restrict investment in other subsidiaries/related companies • Restrict investment in fixed assets • Restrict dividend payment
Undercapitalized bank	5%<CAR<10% for period of at least three months	<ul style="list-style-type: none"> • All of the above, plus • Conduct special examination • Place bank in CBN/NDIC Watch List and inform bank of placement
Significantly undercapitalized bank	2%<CAR<5%	<ul style="list-style-type: none"> • All of the above, plus • Restrict new lending to recoveries made • Request a business plan for fresh funds to be injected • CBN to review business plan within two weeks and communicate acceptability or otherwise • CBN to make the final capital call on the bank within four months from time of acceptance of business plan • Within two months of final capital call, CBN may take over management and control of the bank and hand to NDIC • CBN may appoint NDIC
Critically undercapitalized bank	0%<CAR <2%	<ul style="list-style-type: none"> • All of the above, plus • CBN to take over management immediately and/or • Inject funds to stabilize bank and demand that shareholders capitalize within six months or sell bank
Insolvent banks	CAR<0%	<ul style="list-style-type: none"> • Revocation of license

¹⁵ Sections 12, 33, 35 to 36 of BOFIA, Sections 30 and 32 of NDIC Act.

¹⁶ Sections 49 and 50 of BOFIA, criminal actions were taken against the ex-directors and CEOs of the intervened banks and there has been one completed prosecution to-date (Cecelia Ibru).

45. **While the PCA framework appears to be fairly well structured, with increasingly intrusive actions taken as the CAR or other indicators fall, it does not appear to be fully supported by the BOFIA.** The BOFIA only expressly provides for the action that can be taken when the CAR falls between 2 percent and 5 percent and even then, the type of action that is envisaged to be taken under the SIF is not fully aligned with Section 37 of the BOFIA. The BOFIA also does not provide for a PCA framework based on liquidity, asset quality, earnings triggers etc. This lack of specific provisions in the BOFIA is acknowledged in the introduction to the SIF. Further, proposed amendments to the BOFIA that provide for the possibility of the CBN acquiring shares in a failing bank creates conflict with the role of the CBN as the bank supervisor and should be deleted. The provision of solvency support to distressed banks is ultimately a responsibility of the MoF. Such support is only to be provided as a measure of last resort when private sector solutions have been exhausted and when there is a demonstrable risk to financial stability.

46. **To enhance the early intervention (as well as the resolution) regime, the CBN should implement recovery and resolution planning (RRP) for banks that are SIFIs in Nigeria.** Recovery planning will form part of the supervisory framework while resolution planning, part of the resolution framework.¹⁷ RRP's aim to guide the recovery of a distressed firm or, if this no longer proves feasible, facilitate an orderly wind-down while minimizing the need for public money. A recovery plan is developed by the firm's senior management while a resolution plan is prepared by the resolution authorities, based on information provided by the firm, and is intended to facilitate the effective use of resolution powers to protect systemically important functions, without severe disruption or exposing taxpayers to loss.

47. **The mission recommends that:**

- The CBN review and align the PCA framework set out in the SIF with the BOFIA to avoid inconsistencies and ensure that the SIF framework has a sound statutory footing.
- The CBN not proceed with the proposal for the CBN to acquire shares in a failing bank.
- The CBN should implement RRP's for SIFIs in Nigeria.

¹⁷ FSB KA 11, Essential elements of RRP's are set out in Annex III to the FSB KA.

IV. CRISIS MANAGEMENT TOOLS

The tools for crisis management and bank resolution should include solid but flexible arrangements for official financial support (emergency liquidity assistance and solvency support) of banks; prompt intervention with robust resolution powers for banks as a going concern; a mechanism for orderly liquidation as a gone concern; and a well-designed deposit guarantee scheme.

A. Official Financial Support

The framework for official support should include well functioning arrangements for the central bank to provide emergency liquidity assistance, and for the government to provide solvency support, in a rapid and legally robust manner.

Emergency Liquidity Assistance (ELA)

48. **It is widely accepted that central banks should provide liquidity both to individual banks and to the system when necessary.** To guard against moral hazard, this support should be provided to banks facing temporary liquidity problems but are nevertheless solvent. Such liquidity is usually provided at a penalty interest rate and against good collateral, and the banks receiving support should be subjected to intensified supervision to ensure that the liquidity shortage does not mask an insolvency problem.

49. **The CBN has broad statutory powers to provide liquidity assistance but there is no ELA facility beyond 90 days.** Sections 29(1)(c) and 42(2) of the CBN Act provide that the CBN may exercise its powers as lender of last resort by granting temporary advances to banks at such rate of interest and under such terms as the CBN may determine to any bank having liquidity problems. The CBN currently has an overnight standing lending facility, a repurchase facility (up to 90 days, with an option to roll-over) and a rediscount facility. Although the repurchase facility can be rolled over, the CBN currently has no longer term ELA facility available to assist individual solvent banks facing liquidity problems and banks currently rely on the inter-bank market for longer term liquidity needs.

50. **An expanded discount window facility was temporarily provided during the crisis, from September 2008 to August 2009.** Under this facility, the CBN provided loans extending up to 360 days in duration and the range of eligible collateral was increased to include non-federal government securities, such as commercial paper and bank acceptances. To enhance systemic liquidity, the CBN granted a blanket guarantee on interbank claims and provided ₦620 billion in liquidity.

51. **The NDIC is also statutorily empowered to provide liquidity assistance.** Under the NDIC Act¹⁸, where an insured institution has difficulty meeting its obligations to its depositors and other creditors; persistently suffers liquidity deficiency; or has accumulated losses which have nearly or completely eroded the shareholders fund, the NDIC may grant loans, provide guarantees for loans or accept an accommodation bill with interest for a period not exceeding 90 days maturity, subject to renewals of not more than seven times.

52. **The NDIC's role in providing liquidity support is unorthodox.** The provision of emergency liquidity is a central bank role and not the role of a deposit insurance agency. The key objective of deposit insurance is to protect depositors, not to prevent failures. Such a role in providing liquidity support is not ideal as it exposes the deposit insurance fund to losses and reduces the available funds in the event that a deposit insurance payout is needed. While this facility has not been used in the last 20 years, and no operational framework is in place, this facility continues to be available under the NDIC Act.

53. **The mission recommends that:**

- The CBN develop a comprehensive framework for a longer term ELA facility, up to 180 days. Included in such a framework should be clear policies, guidelines, and procedures for this function, including a solvency test, eligibility requirements, applicable interest rates (typically penal) and acceptable collateral. Banks who access such a facility should be subject to enhanced supervision by the CBN and NDIC.
- The NDIC Act to be amended to remove the possibility of the NDIC providing liquidity support to banks. Financial support from the NDIC to banks should be limited to assisting resolution measures and should be subject to a cap and a least-cost test.¹⁹ Assistance can be provided when facilitating a purchase and assumption transaction (P&A) or a bridge bank transaction, and such assistance should be capped at the amount of insured depositors' funds that would have been paid out by the NDIC if the bank had instead been liquidated.

Solvency support

54. **The framework for conditional solvency support should allow the state (or an agency of the state) in a systemic crisis only** (i) to enter in a legally robust manner into transactions that buttress the solvency of systemic banks (recapitalization, guarantees, etc.,)

¹⁸ Sections 2(1)(b) and 37.

¹⁹ The NDIC should establish that the financial assistance is the least costly to the insurance fund of all possible methods for resolving the institution (e.g., liquidated payout). Requiring the least costly method in resolving a failing institution will provide incentives for the shareholders and large creditors to impose more discipline on management to operate safely and soundly.

and (ii) to execute those transactions rapidly.²⁰ Providing solvency support in a systemic crisis is typically the role of the fiscal authorities, rather than the central bank.

55. **To minimize moral hazard, any solvency support should be complimented by a robust early intervention framework and resolution framework.** The provision of public financial support should be accompanied by the attribution of losses first to the existing shareholders and then to unsecured creditors, as well as other measures to mitigate moral hazard such as the removal of the Board and senior management and restrictions placed upon compensation to management and payment of dividends to shareholders. Plans should also be put in place to secure new capital from shareholders with a clear exit strategy mapped out in advance for the official sector support.

56. **Ideally, central banks should not provide support to banks at the risk of insolvency.** The central banks role should be limited to providing liquidity assistance to illiquid but solvent banks, so as not to pose substantial credit risks to the central bank. In the event such support is nevertheless provided by the central bank, there is a need for the fiscal authorities to underwrite the credit risks taken on by the central bank.

57. **During the banking crisis, CBN's support extended well beyond the provision of liquidity to solvent banks.** The CBN provided solvency support to the banking sector through AMCON and guaranteed inter-bank claims and provided the blanket guarantee on deposits. The CBN also contributed to the capital for AMCON and will contribute ₦50 billion annually to the Banking Sector Resolution Cost Fund from 2011 to 2020 (established for the purposes of paying the AMCON bonds). The MoF contributed by contributing to the initial capital for AMCON and guaranteeing its bonds.

58. **The blanket guarantee on deposits has not been unwound and proposals to amend the BOFIA provide for a statutory blanket guarantee undermine market discipline and fuel moral hazard.** Once the banking system has stabilized, emergency measures that were taken in response to the crisis should be gradually unwound. Proposed amendments to BOFIA envisage that upon revocation of a bank license, the CBN shall pay all private deposit liabilities that are not covered by deposit insurance and shall seek to recover such payment out of the liquidation estate. In the event there is a shortfall, the federal government will indemnify the CBN. Establishing a statutory blanket guarantee in the BOFIA would seriously misalign incentives, as the expectation of being rescued in times of distress unduly encourages risk-taking.

59. **The mission recommends that:**

²⁰ See IMF, *An Overview of the Legal, Institutional and Regulatory Framework for Bank Insolvency*, 2009. <http://www.imf.org/external/np/pp/eng/2009/041709.pdf>.

- The provision of solvency support beyond liquidity assistance for illiquid but solvent banks is the role of the MoF, not the central bank. The MoF should take all necessary steps (e.g., standing budgetary authorization or standing legislation) to ensure that such support can be made available on an expedited basis. If the MoF is not able to do so and the CBN provides such support instead, there should be an express indemnity from the MoF to the CBN.
- The blanket guarantee announced by the CBN during the 2008–2009 crisis should be officially unwound, with proper public communication. This has to be properly communicated and packaged together with other announcements to show that decisive measures have been taken towards a more robust financial system, through strengthened supervision and enforcement and an off-loading of toxic assets.
- Proposed amendments to BOFIA to provide a statutory blanket guarantee should be deleted.

B. Orderly and Effective Resolution

In terms of concrete tools, a legal framework for bank resolution should include powers for intervention and resolution before a bank reaches actual insolvency (going concern powers) as well as powers to close and liquidate a bank in an orderly fashion (gone concern powers). The FSB KA has set out in further detail the resolution powers that should be included in effective resolution regimes—including P&A, bridge bank and bail-in powers.²¹

Going concern resolution

60. **The current legal framework under the BOFIA²² and NDIC Act²³ empower the CBN and the NDIC with a range of powers to intervene in problem banks.** The resolution process and the interaction between the CBN and the NDIC as resolution authorities can be summarized as follows:

- *CBN Management and Restructuring of Failing Banks.* Where a bank is likely to become unable to meet its obligations under the BOFIA, is about to suspend payment, is insolvent or the CBN is satisfied that the bank, after an examination, is in a grave situation, the CBN may impose prohibitions on the bank, require certain action to be taken, remove any director, manager or officer of the bank and appoint any person to advise the bank in relation to its business.

²¹ See http://www.financialstabilityboard.org/publications/r_111104cc.pdf.

²² Sections 35 to 25 of BOFIA.

²³ Sections 37 to 38 of NDIC Act.

- *Turning Over Control of Failing Banks to NDIC.* Where the situation of the bank does not improve after the intervention by the CBN or where the CBN considers appropriate, section 36 of BOFIA empowers the CBN to turn over the control and management of the bank to the NDIC on such terms and conditions as the CBN may stipulate.
- *NDIC Management and Restructuring of Failing Banks.* After assuming control of a bank, where the bank is significantly under-capitalized (CAR is between 2 and 5 percent), the NDIC can require the bank to submit a recapitalization plan, impose prohibitions, require the bank to take certain action, and with the approval of the CBN, remove any director, manager, officer or employee of the bank and appoint a person as the director. Where the bank cannot be rehabilitated, the NDIC has a duty under section 39 of BOFIA to recommend to the CBN other resolution measures including revocation of the license of the failing bank. In the case of a revocation of license, the NDIC has to apply to the Federal High Court for a winding up order of the affairs of the bank.²⁴
- *Resolution tools.* The NDIC, in consultation with the CBN, can (i) take over the management of the failing bank or direct specific changes to the management of the failing bank; (ii) arrange an M&A; (iii) carry out a P&A with NDIC providing financial assistance; (iv) acquire, manage and dispose of impaired assets of a failing bank either directly or through an asset management company; or (v) establish a bridge-bank.

61. **The resolution framework was tested during the crisis where the authorities, after conducting the special examinations, invoked various resolution measures to resolve eight banks.** Table 3 below summarizes the resolution measures taken.

²⁴ Section 40 BOFIA.

Table 3. Nigeria: Summary of Resolution Measures

Resolution Tool	Relevant Time	Banks Involved
Replaced management in eight banks	August 2009 and October 2009	Intercontinental Bank Bank PHB Spring Bank Wema Bank Oceanic Bank Union Bank FinBank AfriBank
Recapitalization with shareholder's vote	September 2010	Wema Bank ²⁵ Unity Bank
AMCON bought NPLs	January 2011	Intervened banks and others
M&A with shareholder's approval and court sanction	July 2011	Intercontinental Bank (Access Bank) Oceanic Bank (EcoBank Transnational) FinBank (FCMB) Equatorial Trust Bank (Sterling Bank) Union Bank (African Capital Alliance)
Bridge-banks and recap by AMCON	August 2011	Keystone Bank (Bank PHB) Enterprise Bank (Spring Bank) Mainstreet Bank (AfriBank)

62. **The authorities were able to use their existing resolution powers to resolve these banks.** However, these powers were not invoked without challenges, both legal and procedural. The authorities were bound to follow general company law requirements under the Company and Allied Matters Act (CAMA), relating to shareholder's rights to vote (adhering to a 21-day notice period for convening a general meeting of shareholders) and a requirement for court sanction, which added to the duration of the resolution proceedings. During this process, there were also several legal actions commenced, challenging the authorities' powers. These relate to challenges by individual directors as to their removal from the intervened banks and challenges by shareholders in relation to the recapitalization process and bridge-bank measures taken by the authorities.

63. **While the existing legal provisions in the BOFIA and NDIC Act empower the authorities to take a range of resolution measures, these powers can be enhanced.** Recognizing that banks are highly vulnerable to losses of confidence and contagion risks and there is a need to take into account broader public policy and financial stability objectives, there is a justification for creating a special resolution regime for banks, which dis-applies certain provisions of the general company law or insolvency law. As a reversal of resolution measures can have destabilizing effects, there should be a mechanism whereby resolution measures cannot be reversed by the courts and if the resolution authorities had acted wrongly, the aggrieved party should be compensated by way of monetary damages.

²⁵ Bank not currently meeting minimum capital requirements and has a deadline of May 2013 to recapitalize.

64. **The mission recommends as follows:**

- *Power to override shareholder's rights.* To enable resolution authorities to exercise resolution powers with the necessary speed and flexibility, relevant provisions of the CAMA relating to shareholder's rights should be dis-applied. These include the ability of the resolution authority to administratively (without involving the courts) (i) carry out a mandatory recapitalization without the pre-emptive rights of shareholders; (ii) carry out a P&A transaction involving the transfer of any type of assets and liabilities without having to obtain shareholder's approval; and (iii) carry out an M&A transaction without a shareholder's vote at a general meeting and court sanction.²⁶
- *No suspension or reversal of actions.* The legal framework should be amended to provide that (i) in the event that there is any challenge to resolution actions (going concern and liquidation), there should be no suspension of resolution proceedings; and (ii) there should not be a possibility of a reversal of the measures taken by resolution authorities. Redress for wrongful measures should take the form of monetary compensation.²⁷
- *Expanded resolution toolkit.* The resolution toolkit can be enhanced to include (i) mandatory recapitalization of the bank without pre-emptive rights of existing shareholders; (ii) power to write down capital; and (iii) bail-in powers (see Box 5 for further details on bail-in).
- *Triggers.* The statutory triggers should be harmonized under the BOFIA and the NDIC Act to include both quantitative triggers (tied to CAR, liquidity ratios etc.) and qualitative triggers (e.g., breaches of laws and regulations, carrying on business in a manner detrimental to the interests of depositors), to grant the CBN/NDIC greater discretion in invoking resolution proceedings.²⁸

²⁶ The power to override rights of shareholders is expressly recognized in FSB KA 3.2(v) and 3.3. At the same time, the FSB KA acknowledge that the exercise of these powers should be subject to appropriate safeguards to ensure that due process is respected and that the authorities act within the scope of their legal authority, and judicial review is available (FSB KA 5).

²⁷ FSB KA 5.5.

²⁸ FSB KA 3 provides that the resolution regime should provide for timely and early entry before a firm is balance-sheet insolvent and before all equity has been fully wiped out.

Box 5. Bail-in Within Resolution¹

The FSB KA call for resolution authorities to have the power to unilaterally restructure the debt of a financial institution or a successor entity through “bail-in.” Bail-in encompasses the power to write down equity and unsecured and uninsured creditor claims to absorb losses, convert unsecured and uninsured creditor claims into equity, and convert or write-down any outstanding contingent capital instruments that have not already been triggered according to their terms.

The **objective** is to return the financial institution to compliance with prudential requirements and restore its viability. Such a unilateral debt restructuring directly imposes losses on the private stakeholders of the ailing bank, one of the key aspects of an effective resolution regime.

Generally, the **triggers** should be consistent with those used for other resolution tools—for example, where a financial institution is no longer viable or is likely to be no longer viable and has no reasonable prospect of becoming so. This threshold should be before the institution is balance-sheet insolvent and before all equity has been wiped out.

Bail-in must respect the **hierarchy of claims** in liquidation. Equity should absorb losses first, then subordinated debt (including all regulatory capital instruments), and, finally, senior unsecured debt. Creditors should have the right to compensation where they do not receive at least the amount they would have received in a liquidation of the ailing financial institution. The FSB KA exclude secured creditor claims and insured deposits and leave open the possibility of excluding other liabilities that are of systemic or strategic importance (e.g., inter-bank deposits, payment and settlement obligations, and trade-finance obligations).

As is the case with other resolution powers and in the interests of financial stability, it would be preferable if, subject to a country’s own constitutional framework, bail-in could be exercised as part of an **administrative process** (as opposed to judicial) that is subject to **ex-post judicial review** to ensure that the authorities act within the scope of their legal powers.

The FSB KA recognizes the need for the authorities to be able to exercise this power **in conjunction with other resolution tools** (e.g., removal of problem assets, replacement of management) to ensure that the restructured bank, after bail-in, will be viable. In addition, as a practical matter, bail-in may need to be coupled with adequate official liquidity assistance to address funding issues until the bank is stabilized.

¹ For a discussion on bail-in, please see IMF Staff Discussion Note, From Bail-out to Bail-in: Mandatory Debt Restructuring of Systemic Financial Institutions, <http://www.imf.org/external/pubs/ft/sdn/2012/sdn1203.pdf>.

Gone concern resolution: Orderly liquidation

A liquidation framework for banks should recognize the unique features of banks (such as the need to protect deposits, lending and payment services) that call for special treatment during the insolvency process and allow for liquidating banks in an orderly manner. This involves rapidly transferring insured deposits (possibly combined with assets) and critical banking functions (payment services, trade finance) out of the insolvent estate before the remainder is liquidated in the traditional fashion.

65. **The liquidation framework for banks is based on the general insolvency law under the CAMA, with specific provisions in the CBN Act (Section 51) and NDIC Act**

(Section 40) to deal with bank specific liquidation issues. The NDIC is the appointed liquidator of a bank whose license is revoked by the CBN. When a license is revoked, the NDIC may apply to the Federal High Court for a winding-up order.

66. **The liquidation regime was, until 1998, an administrative based proceeding with the CBN appointing the NDIC as the provisional liquidator of failed banks.** However, the CBN lost the power to appoint the NDIC when the BOFIA was amended in 1998 and the NDIC is now required to apply to the Federal High Court to be appointed as liquidator and subject to general company winding-up rules under CAMA. Such rules require winding-up petitions to be advertised before appointment of the liquidator can take place.

67. **The NDIC carries out the liquidation proceedings, with CBN monitoring.** As liquidator, the NDIC has the power to (i) realize the assets of the bank; (ii) enforce individual liability of shareholders and directors; and (iii) wind-up the affairs of the bank. It shall pay to itself subrogated claims of the depositors and shall pay to depositors and creditors the net amount available for distribution to them. Although the CBN BSD's responsibility in respect of a bank terminates after withdrawal of the license, it continues to monitor developments in the winding-up process to ensure the protection of deposits and prevent asset stripping.

68. **The NDIC as a liquidator also facilitates the implementation of the Failed Banks Act.** This Act provides for the recovery of debts owed to failed banks and for the trial of offences relating to financial malpractices in banks and other financial institutions. The NDIC gathers information and evidence on bank frauds and malpractices; lodges criminal complaints to the police for investigation and provides the necessary technical and logistical support to the police; appoints solicitors to file applications to recover debts owed to failing banks and monitors the criminal and civil cases.

69. **The bank liquidation regime has been fraught with legal challenges and protracted legal proceedings.** This has led to severe delays and uncertainty for bank depositors and creditors, which erodes confidence in the banking system. In three cases, the courts have reversed the CBN's decision to revoke bank licenses (Savannah Bank Plc, Societe Generale Bank Plc and Citizens Bank Plc). The court proceedings lasted several years (seven years in the case of Savannah) and five years after the courts re-awarded the banks' licenses, the banks have not been able to recommence business due to higher capital requirements and the inability to resume business based on the original bank infrastructure (IT systems, physical premises have deteriorated in condition). In the meantime, depositors' funds have been frozen and debtors have not been servicing the loans.

70. **The current liquidation framework does not provide for an orderly and efficient proceeding.** The FSB KA requires that resolution authorities should have the power to effect the closure and orderly liquidation of the whole or part of a failing firm with timely payout or transfer of insured deposits and prompt (for example, within seven days) access to

transaction accounts.²⁹ The recommendation in paragraph 64 to amend the law to prevent suspension or reversal of resolution proceedings (subject to payment of monetary compensation for wrongful revocations or liquidations) will mitigate this problem.

71. To ensure an orderly liquidation and prompt payout of insured deposits, the mission recommends that the NDIC should be appointed liquidator immediately upon revocation of the bank's license. The CBN should regain legal authority to appoint the NDIC as liquidator immediately upon revocation of the license. The remainder of the liquidation process can proceed as a court-based proceeding. Banks should also be exempted from the Company Winding-Up rules that require winding-up petitions to be advertised before the NDIC can be appointed liquidator.

Systemic crisis management

72. The CBN has set out its systemic crisis management framework in Part 4 of the SIF. A systemic distress is deemed imminent whenever at least two of the following situations occur: (i) bank(s) that are critically distressed control 12.5 percent of the total assets in the industry; (ii) 12.5 percent or more of total deposits are threatened; (iii) 12.5 percent or more of banking system's total loans are not performing; and (iv) 25 percent of the banks in the system have applied for liquidity support in excess of 50 percent of the aggregate takings from the CBN window or total interbank funds in the market or have been suspended by their settlement banks for failure to meet clearing obligations.

73. In the event of a systemic banking distress, the CBN and NDIC would jointly establish a CMU to determine the condition of all banks in the system and take immediate remedial actions, ranging from CBN loans, NDIC liquidity support, blanket guarantees, inter-bank guarantees and the use of AMCON to purchase NPLs. The details of the framework are set out below in Table 4.

74. While it is acknowledged that decisive measures have to be taken in the event of a systemic crisis, the mission has grave concerns regarding the framework and its public nature. An effective resolution regime should not create an expectation that public solvency support will always be available and that AMCON has an indefinite lifespan. Private sector solutions should be the favored approach rather than the use of public funds and where possible the industry should bear the costs of bank failures. If private sector solutions are not possible, then public solvency support may be needed. However, in such a case, there needs to be a very stringent systemic risk test³⁰ with a decision to be taken at the

²⁹ FSB KA 3.2(xii).

³⁰ Legislative amendments could provide legal underpinnings for such a test, to allow assistance to be provided only when the institution is considered systemically important or there is a systemic crisis and current tools for emergency liquidity assistance and bank resolution cannot adequately address the situation.

highest level of government and the CBN.³¹ Such provision of support will need to be accompanied by strict conditions, such as the dilution of existing shareholder's interest, a restriction on executive compensation, suspension of dividends, replacement of management and intrusive supervision.

Table 4. Nigeria: Systemic Crisis Management Framework in Part 4 of SIF

Condition of the Banking Industry	Supervisory Action
<p>A. Total Assets The bank(s) that are critically distressed control 15 percent of industry total assets in the industry.</p>	<p>Any one or a combination of (a) – (c):</p> <p>(a) Inject funds as bridging loan into identified bank(s) in sufficient amount to stabilize the bank(s).</p> <p>(b) Dissolve board and management of identified weak banks. CBN assumes full management and control.</p> <p>(c) NDIC to provide partial/full liquidity support.</p>
<p>B. Total Deposits Any (i) or (ii):</p> <p>(i) 12.5 percent of total deposits in the system are threatened due to banks' inability to honor obligations arising from macro –economic shocks or changes in government policy.</p> <p>(ii) The deposits of any bank that controls up to 10 percent of total market share are threatened to the tune of 25 percent i.e., such high impact banks have lost at least 25 percent of their deposits.</p>	<p>Any one or a combination of (a) – (c):</p> <p>(a) Guarantee all private deposits, interbank, foreign credits and pension funds.</p> <p>(b) Inject funds to threatened banks in order to improve their liquidity positions.</p> <p>(c) Investigate the cause of the loss of deposits and where necessary, to dissolve and takeover management and board of affected banks.</p> <p>(d) NDIC to provide partial/full liquidity support.</p>
<p>C. Asset Quality 12.5 percent of banking system's total loans and advances are not performing.</p>	<p>Any one or a combination of (a) – (e):</p> <p>(a) Inject funds in form of loan to the tune of toxic assets in the affected bank(s).</p> <p>(b) Investigate the cause of toxic asset and sanction erring boards/ management where necessary.</p> <p>(c) Restructure toxic assets and sell to willing buyers.</p> <p>(d) Affected banks to restructure their delinquent risk asset.</p> <p>(e) Transfer ailing banks delinquent risk asset portfolio to Asset Management Company of Nigeria.</p>
<p>D. Liquidity</p> <p>(i) When 25 percent of the banks in the system have applied for liquidity support in excess of 50 percent of the aggregate takings from the CBN window.</p> <p>(ii) 25 percent of the banks in the system have been suspended by their settlement banks for failure to meet clearing obligations.</p>	<p>Any one or a combination of (a) – (c):</p> <p>(a) CBN to provide financial support as lender of last resort.</p> <p>(b) CBN to guarantee financial obligations to foreign banks.</p> <p>(c) NDIC to provide liquidity bridging support.</p>

³¹ In the U.S., the systemic risk exemption which in effect needs to be triggered before OBA can be provided by the FDIC, is an extraordinary procedure, requiring the approval of super majorities of the FDIC Board, the Federal Reserve Board, and the Secretary of the Treasury in consultation with the President. A methodology for conducting such a systemic risk assessment is proposed in Dijkman (2010) A Framework for Assessing Systemic Risk, World Bank Policy Research Working Paper 5282. See <http://elibrary.worldbank.org/content/workingpaper/10.1596/1813-9450-5282>.

75. **The framework essentially adopts a zero bank failure policy.** Beyond the initial crisis containment stage, bank liquidation should not be ruled out for non-viable banks. The framework also does not envisage a role for the MoF in providing solvency support. Financial support is instead envisaged to be provided by the CBN (exposing the CBN's balance sheet) and the NDIC (exposing the resources of the deposit insurance fund).

76. **The mission recommends that Part 4 of the SIF setting out the systemic crisis management framework be withdrawn immediately.** Apart from the concerns raised above, such an approach would also be in line with the FSB KA, which provides that an effective resolution regime should not rely on public solvency support and *not create* an expectation that such support will be available.

AMCON

77. **AMCON has played a key role in restoring the financial health of the banking sector through the absorption of toxic assets and the injection of capital in a number of intervened banks.** Its stated objectives are - a. to assist eligible financial institutions (EFIs) to efficiently dispose of eligible bank assets (EBAs); b. to efficiently manage and dispose of the EBA it acquires; and c. to obtain the best achievable financial returns on eligible banking assets, having regard to the need to protect or enhance the long-term economic value of the assets, the cost of acquiring and dealing with those assets etc.³² While it appears to be the general perception that AMCON has a lifespan of ten years, this is not set out in the AMCON Act 2010 (AMCON Act).

78. **AMCON was formally established in 2010.** The AMCON bill was passed into law on July 28th, and a professional board was appointed and confirmed on November 5, 2010 by the Senate.³³ The initial capital for AMCON was provided jointly by the CBN and the MoF. Currently, AMCON employs some one hundred and eighty staff members and is supervised by the CBN.

79. **AMCON has a 10-man board of directors made up of five non-executive directors, four executive directors and one independent director.** The oversight functions of the board are performed through the Board Audit Risk and Compliance Committee, Board Credit and Asset Management Committee and Board Compensation and Performance Committee. The executive management team comprises the managing directors and three executive directors in charge of finance and operations, credits and asset management.

³² Section 4 of AMCON Act.

³³ AMCON's Board consists of a part-time chairman nominated by the MoF, a Managing Director nominated by the CBN, three Executive Directors appointed by the CBN in consultation with the MoF, and five other non-executive directors, of which two are nominated by the MoF, two are nominated by the CBN and one by the NDIC.

Absorption of problem loans

80. **The creation of AMCON was motivated by the need to reduce the exposure of the Nigerian banking system to toxic assets.** As noted before, troubled loan categories included especially the oil and gas sector (which got into difficulties following a steep decline of oil prices), margin loans made available for speculation on the Nigerian stock exchange and insider lending as weak risk management systems enabled banks to bypass insider lending limits.

81. **AMCON has wide discretionary powers to acquire eligible assets.** The operational aspects of AMCON are spelled out in the AMCON Guidelines.³⁴ The Guidelines establish eligibility criteria for the acquisition of assets, and a valuation framework (see Box 6).

Box 6. AMCON Guidelines: Eligibility of Banking Assets and Collateral Valuation

Section 5 of AMCON's Guidelines defines **EBAs** as:

- (i) NPLs of EFIs in the substandard, doubtful, or lost category, both collateralized and unsecured.
- (ii) Any loan which poses significant risk to an EFI, i.e., if it is expected to become substandard within three months or may result in a loss of more than one percent of the EFI's balance sheet within half a year.
- (iii) Other instruments or asset classes designated by CBN.
- (iv) Assets of banks whose license has been revoked.

Schedule 1 to the Guidelines stipulates the **valuation criteria** for problem assets:

- (i) **Loans secured by real estate:** EFIs provide AMCON with a good faith estimate reflecting both the forced-sale and the open-market value. AMCON acquires the assets at the average of forced-sale and open-market value. The assets are subject to a revaluation within twelve months of purchase by a real estate valuer appointed jointly by the EFI and AMCON. If it turns out that the assets were overvalued, the EFI pays back the difference in valuation to AMCON with a 10 percent penalty. If it is undervalued, AMCON pays back the difference to the EFI.
- (ii) **Loans secured by listed shares:** AMCON pays the greater of (a) 5 percent of the principal sum; or (b) the 60-day moving average price of the shares plus a 60 percent premium.
- (iii) **Loans secured by unlisted shares:** (a) shares of unlisted public companies are guided by the latest available audited financial statements and are based on the average of Net Asset Value (NAV), PE ratio against comparables, and the valuation of comparable transactions in similar sectors or industries; and (b) shares of a private company are valued on a case-by-case basis, with a minimum valuation of 5 percent of the principal sum.
- (iv) **Unsecured loans** are valued at 5 percent of the principal sum.

82. **Valuation of loans depends on the nature of the underlying collateral.** Valuation generally follows best-estimate market prices, where available, although this poses obvious challenges for some categories of distressed assets that have become illiquid since the crisis or for unsecured loans. Margin shares are acquired at a significant premium.

³⁴ Guidelines for the Operations of AMCON, November 15, 2010.

83. **Banks receive AMCON bonds in return for the transferred assets.** The bonds are three year zero-coupon bonds guaranteed by the federal government. According to AMCON's estimates, it has on average acquired loans at around 45 percent of the original book value. The terms of the transfer are specified in a bilateral contract, and AMCON takes full ownership of the collateral and the supporting loan documentation. Compared to the banks, AMCON has wider powers to seize the assets of the distressed debtors than the banks, as it has access to all the debtor's assets (i.e., not only the collateral). In light of the frequently cited problems of selective defaults, this may be helpful in raising the recovery rate on NPLs.

84. **While the initial round of problem loan acquisitions focused on the absorption of margin loans backed by shares, subsequent rounds were focused on a broader set of assets.** AMCON's bad loan portfolio has become increasingly diversified over time and currently involves a wide range of industries and types of collateral. According to the latest publicly available information, 22 percent of the assets is unsecured, 22 percent is backed by shares, 20 percent by mortgages, 15 percent by debentures, 13 percent by a combination of assets, 4 percent by shares and mortgages and 6 percent by "others." The most important sectors are (i) oil and gas (27 percent of the portfolio); (ii) general commerce (18.5 percent); and (iii) margin shares (18 percent). By now, AMCON has acquired a total of more than twelve thousand problem loans.

85. **Following the creation of AMCON, the CBN has imposed a cap of the proportion of NPLs in banks' loan portfolio at five percent³⁵,** prompting banks to transfer the excess to AMCON. NPLs are defined as all loans in the substandard, doubtful or loss category as defined in the Prudential Guidelines issued by CBN. Although the last acquisitions date back to December 2011, AMCON is still available to purchase troubled assets from the banking sector.

86. **Understandably, AMCON has concentrated its recovery efforts on the largest corporate loans.** Some four hundred and sixty problem loans acquired by AMCON represent 80 percent of the total portfolio. AMCON has concluded restructuring arrangements with some of these large corporate debtors. The arrangement typically involves generous debt relief in NPV terms (made possible due to the discounted price at which AMCON acquired the troubled loans from the banks), an initial down payment in the order of 10 to 20 percent of the outstanding amount, due within thirty days upon the restructuring of the loans. In a number of cases, it also involves a debt-for-equity swap. Further down the road, it aims to engage external debt collectors to contact all distressed debtors for the remaining problem loans by the third quarter of 2013.

³⁵ AMCON Guidelines section 6(a).

87. **The use of debt-for-equity swaps can create misalignment of incentives.** In its capacity as a (co-)owner of distressed companies, it is less likely to vigorously enforce its creditor rights aimed at maximizing repayment on its claims. It is also technically challenging to establish an accurate conversion factor for the swap—a task that in some cases is further complicated by the absence of reliable financial data. Ensuring a successful company restructuring is also challenging given the many sectors involved—it seems challenging for AMCON to develop the necessary expertise in-house on the specific characteristics of the industries involved. Moreover, the restructured companies include some tightly regulated industries, such as the aviation industry, where political pressures can stand in the way of a drastic restructuring and liquidation may not be a credible threat.³⁶

88. **AMCON faces significant pressures to facilitate the restructuring of various distressed industries.** In view of AMCON's continued availability combined with the lack of a firm closing date, there is a serious risk of mission creep as the arrangement is widely perceived as a permanent structure. Bail-out pressures are already emerging in the troubled microfinance deposit-taking, brokerage and the investment company sectors, risking AMCON to deviate increasingly from its original objective, to assist banks in the disposal of the troubled assets that set the stage for the 2008–2009 crisis.

89. **AMCON is optimistic about the recovery prospects of the restructured loans, but the level of delinquencies on recently restructured loans is a cause for concern.** AMCON considers the restructured loans among the better quality loans in its portfolio and therefore anticipates a decline in the recovery ratio as it works its way through the portfolio. Delinquencies on the newly restructured loans are in the order of 10 percent, according to AMCON. In light of the generous debt relief in NPV terms and considering that the restructurings were conducted only very recently (i.e., over the past eighteen months), this seems rather high. Similarly, the targeted recovery ratio of 70 percent seems optimistic compared to experiences elsewhere. Indonesia and Malaysia realized recoveries of 33 and 59 percent respectively (see Table 5 on international comparisons).

Bank restructuring and recapitalization

90. **AMCON also assisted in the recapitalization of the eight intervened banks:**

- *It provided five intervened banks with fresh capital to bring them to zero net asset value.* Subsequently, the injection of additional capital to ensure compliance with regulatory requirements was left to private investors. Intercontinental Bank was acquired by Access Bank, Ecobank Transnational acquired Oceanic Bank, FinBank was acquired by FCMB, Sterling Bank acquired Equatorial Trust Bank and African

³⁶ Note that labor disputes have also occurred at the three AMCON-owned banks, impeding enterprise restructuring.

Capital Alliance acquired Union Bank. While shareholder's interests were diluted, they were not written-off completely. Writing-off shareholders interests would have been legitimate given that without the provision of public support, the banks would have failed. The aforementioned legal difficulties in overriding shareholders' rights (a write-down of capital requires a shareholder's vote) have played an important role.

- *AMCON restructured and fully recapitalized three problem banks.* The three remaining banks, Spring Bank Plc, Bank PHB Plc and Afribank Nigeria Plc were assessed as not being able to recapitalize before the deadline of September 2011. On August 5, 2011, the CBN revoked their licenses while the NDIC incorporated three bridge banks—Enterprise Bank (for Spring); Keystone Bank (for Bank PHB); and Mainstreet Bank (for Afribank)—to assume the deposit liabilities and certain other liabilities and the assets of the closed banks. Subsequently, AMCON purchased the equity of the bridge banks (terminating their status as bridge banks) and injected capital up to the statutory minimum. Since taking over, it has replaced the Boards in these three banks, which in consultation with management have set (commercial) targets. The three banks report to AMCON on the fulfillment of the targets on a quarterly basis, but otherwise AMCON is not involved in the day-to-day operations of the banks.

91. **AMCON aims for a timely divestment of Enterprise, Keystone and Mainstreet Banks, but it faces various challenges in doing so.** AMCON appropriately considers the ownership of the three banks as temporary. AMCON claims that two of the banks have been brought back to profitability, yet the third bank is affected by a labor dispute. AMCON has appointed external consultants to explore options for divesting its shares in the concerned banks, a welcome move. The task is however complicated by the problematic reliability of the financial statements, while investor interest is muted due to the absence of a proven performance track record. The options that are under consideration are either a direct sale to investors, listing the banks on the stock exchange or a merger of the banks.

Funding

92. **AMCON relies on a variety of funding sources.** The MoF and the CBN provided its initial capital. AMCON has issued ₦4.5 trillion in three year zero-coupon bonds, falling due in 2013–2014. The AMCON Act stipulates that all AMCON bonds are underwritten by the federal government. The MoF has so far only formally signed off on ₦1.7 trillion.

Table 5: Nigeria: AMCON in International Perspective

	AMCON	Danaharta (Malaysia)	Indonesian Bank Restructuring Agency (IBRA)
Structure	Public body corporate, jointly owned by MoF and CBN .	Public company, wholly owned by Ministry of Finance.	Subsidiary of the MoF.
Objectives	To assist banks to efficiently dispose of eligible bank assets. To efficiently manage and dispose of the acquired assets. To obtain the best achievable financial returns on the assets.	Acquire and manage NPLs of banking system, with the objective of maximizing returns on the assets.	Stabilize and revitalize banking system by restructuring and recapitalizing banks and rapidly returning them to private ownership. Maximize recoveries from assets that have been taken over (NPLs, collateral, equity holdings in banks closed, taken over or recapitalized by IBRA).
Lifespan	Established in 2010. Not fixed, general perception of a 10 year lifespan.	June 1998 to December 2005.	January 1998, initial five year lifespan, subsequently extended and closed in February 2004.
Pricing	Purchased loans at around 45 percent of original book value.	Purchased loans at an average of 45 percent of fair value, based on mutually agreed terms with the bank.	Zero value pricing policy, but the government recapitalized or took over the banks through the issuance of government recapitalization bonds.
Funding	Three year zero coupon AMCON bonds backed by government guarantee, tradable.	Five year zero coupon bonds backed by government guarantee, tradable on the secondary market but little trading took place.	Government issued bonds—variable and fixed coupon bonds, tradable.
Disposition of assets	Ongoing - AMCON's projection assumes an average recovery rate of 70 percent.	Recovery rate of 59 percent overall, rate for NPLs was about 43 percent.	80 percent of NPLs were settled at an average recovery rate of 33 percent, remainder were sold. Recovery on loans overall was about 29 percent of original principal.
Transparency	Quarterly reporting to CBN and MoF. Publication of audited financial statements within six months of conclusion of financial year (delayed). External audit.	Annual report, half-yearly report, operations report al published, website regularly updated and regular press conferences held. External audit.	Annual report, monthly activity report, website regularly updated. External audit.

93. **In addition, the banks and the CBN have signed an MoU to contribute to a Resolution Cost Fund (RCF), aimed at reclaiming part of the cost of AMCON's operations on the banking sector.** There is a lack of clarity surrounding the legal framework; draft legislation creating a statutory basis for the RCF has been prepared, but it may be superseded by a new bill, revising some of the terms. Both the old and the new proposal entail a burden sharing arrangement between the banks and the public sector (i.e., CBN). Under the proposal, the CBN provides an annual contribution of ₦50 billion (= US\$ 31.6 million), while banks pay a flat premium of 30 basis points of their total assets, calculated at the date of its audited financial statements for the preceding year to the RCF. The banks and the CBN have made a first contribution, and currently some ₦154 billion has been amassed. The total contribution of the CBN is capped at ₦500 billion (i.e. 10 annual contributions) while reportedly the cap mentioned in the earlier draft bill (₦1 trillion) for the commercial banks has been lifted. All banks contribute, regardless of their financial state and their use of AMCON. The accumulated funds are kept at an account at the CBN. The investment policy for the RCF is determined by an investment committee that consists of representatives from the banks, the CBN, the MoF and Debt Management Office.

94. **Contributions to the RCF are projected to be by far the main income source, underscoring the need for a quick approval of the draft bill to avoid the occurrence of contingent liabilities for the taxpayer.** Under the assumption of a sustained rapid growth in banks' assets (20 percent year-on-year) it is projected that contributions to the RCF account for more than 60 percent of total cash flows. Delays in the enactment of the RCF bill risk leaving a financing gap, to be backstopped by the public sector due to the guarantees on the zero coupon bonds. Recoveries on acquired assets are expected to contribute another 20 percent (based on the assumption of an average recovery ratio of 70 percent) with the remainder consisting of reinvestment income (8 percent) and disposals (5 percent for the disposal of the three troubled banks, 3 percent for the eventual disposal of AMCON).

95. **AMCON's status as a temporary facility should be fully reflected in its funding arrangements.** In this spirit, current income should be used to retire outstanding debt, rather than for reinvestment or for the acquisition of additional troubled assets.

96. **Significant repayment obligations are coming up as the three year zero-coupon bonds are falling due, which will likely involve rollover arrangements.** It is to be expected that a significant portion will need to be refinanced as the steep redemptions falling due in 2013-2014 will significantly exceed the funds accumulated from recoveries, disposals, reinvestment income and the contributions to the RCF. AMCON is currently investigating financing options and is in the process of setting up an investment policy. An inter-agency investment committee has been constituted for the latter purpose. The feasibility of roll-over arrangements also depends to a large extent on the availability of a government guarantee on the AMCON bonds. AMCON is also considering issuing in foreign currency, and/or issuing longer term domestic bonds (seven-year). Disclosure

97. **Disclosure practices are weak.** AMCON reports to the CBN and the MoF on a quarterly basis. Although the AMCON Act requires publication of the audited financial statements within six months upon conclusion of the financial year, AMCON has yet to produce its first audited financial statements. According to AMCON, the first deadline was missed due to the complications in consolidating its many equity participations. The CBN has provided a waiver of the deadline and AMCON expects to release its final statements by end-September. It is expected that AMCON's first financial statements will post a significant operating loss, as it owes interest on its outstanding bonds, yet on the asset side interest payments only start once a restructuring arrangement has been concluded and the debtor starts repaying.

98. **Going forward, the mission recommends that a credible exit strategy for AMCON is devised, in line with the one-off character of its operations.** AMCON was created in response to the unique challenges that the 2008–2009 financial crisis posed for the Nigerian banking sector. It should therefore be considered a temporary arrangement to be disassembled as soon as circumstances permit. This calls for the following short term policy measures:

- *Earmark AMCON's cash flows for buying back bonds.* Bail-out pressures are already emerging in the troubled microfinance deposit-taking, brokerage and the investment company sectors. It is therefore suggested that the accumulated funds will be clearly earmarked for payment of the outstanding bonds.
- *Immediate closing of the window for the acquisition of troubled loans and adjustment of relevant CBN prudential requirement.* AMCON continues to be available to purchase NPLs of banks. The prudential cap on NPLs combined with AMCON's broad eligibility criteria can encourage banks to transfer post-crisis problem loans. This "pump-priming" is inconsistent with AMCON's one-off character and needs to be avoided. The acquisition of new loans should be discontinued with immediate effect. AMCON's continued acceptance of new loans leaves it exposed to political pressures to engage in debt-for-equity swaps with ailing industries and financially challenged public utilities.
- *Annual disposal targets.* AMCON aims to protect or otherwise enhance the long term economic value of the acquired assets. If left unchecked, the objective of maximizing the long term economic value can revert into buy-and-hold practices as the owner is reluctant to realize steep losses. AMCON has not yet proceeded to liquidate loans. The use of net present value concepts would also be helpful in frontloading recoveries. Given the absence of any disposal targets, the risk of "warehousing" the acquired loans looms large. It is therefore suggested that annual targets are set for the disposal of bad loans, which strike an appropriate balance between ambition and realism, with an emphasis on frontloading the disposal in the first three to five years. Experience in other countries suggests that a rapid offloading of problem loans is

- associated with lower overall resolution costs. AMCON could explore the feasibility of delegating part of its portfolio to private AMCs, which could be helpful in accelerating the winding down of its portfolio.
- *Setting a firm closing date for AMCON for end-2017.* While the general perception is that AMCON has a lifespan of ten years, this is not specifically mentioned in the AMCON Act. In light of the dangers discussed above, it is strongly suggested to set an explicit and ambitious closing date of end-2017. Most other AMCs do not have an indefinite lifespan, e.g., Malaysia's Danaharta existed for seven years and so did the Indonesia's IBRA (see Table 5). In addition, an arrangement would need to be set up for how the residual assets will be dealt with e.g., to whom they will be transferred to. The authorities should also explore options to facilitate the development of private distressed asset firms.
 - *Formalizing the contributions to the RCF.* This should be done by putting the draft legislation that has been prepared through the legislative process.
 - *Preparation of a plan for rollover arrangement of the maturing debt.* In view of the upcoming redemptions, it is important that a detailed rollover plan for handling is developed. Clarification is urgently needed whether AMCON will have access to government guarantees.
 - *Acting on plans for divesting its interests in Enterprise, Mainstreet and Keystone.* AMCON should act quickly once the consultants have finalized their analysis.
 - *Reinforcement of disclosure practices.* In line with the provisions in the AMCON Act, AMCON should disclose its financial statements within six months of the end of the fiscal year. Statements for 2011 should be disclosed as soon as possible.

V. DEPOSIT INSURANCE FRAMEWORK

99. **Responsibility for the Nigerian deposit insurance arrangement rests with the NDIC.** As per Article 2 of the NDIC Act, it is responsible for insuring deposits held with licensed banks and other deposit taking institutions (i.e., deposit-taking money banks, microfinance institutions and primary mortgage banks) so as to engender confidence in the Nigerian banking system. Besides the determination and collection of annual deposit insurance premia, this includes the accumulation and management of the Deposit Insurance Fund (DIF).

100. **In addition to its deposit insurance responsibilities, the NDIC shares supervisory responsibilities with the CBN, and it is the key resolution and liquidation authority.** As per the NDIC Act, the NDIC has the power to conduct on-site examinations of insured institutions with the CBN. The current practice is for the CBN and NDIC to conduct joint examinations on all insured deposit taking institutions. Correspondingly, it has the authority

to take enforcement actions, and the power to prosecute any officer or director of an insured institution who has violated any provisions in the NDIC Act (Article 7). The NDIC Act establishes the NDIC as the lead resolution authority for failing banks, with resolution actions to be taken in consultation with the CBN. It also has authority to provide financial assistance or purchase assets from a failing bank and the ability to act as a receiver.

101. **The current NDIC Act does not explicitly state public policy objectives, which it intends to remedy with an amendment bill.** The amendment bill stipulates the following three public policy objectives: (i) protecting small, uninformed and less financially sophisticated depositors by providing an orderly means of compensation in the event of failure of their insured financial institutions to make payment to depositors; (ii) contributing to the financial system stability by making incidences of bank runs less likely; and (iii) enhancing public confidence and systemic stability by providing a framework for the resolution and orderly exit mechanism for failing and failed insured institutions.

102. **The NDIC is administered by a Board of Directors.**³⁷ The Managing Director acts as the Chief Executive and is responsible for day-to-day management. The Board consists of the Chairman, the Managing Director, two Executive Directors, representatives of the CBN and the MoF and six other members from each of the zones of the country. The directors cannot own or control significant interests in, or be a director or employee of an insured institution. Currently, NDIC has a staff of more than a thousand and an annual operation budget of over ₦13 billion. The NDIC is owned jointly by the CBN (60 percent) and the MoF (40 percent).

Deposit insurance function

103. **Membership in NDIC is mandatory for all deposit-taking institutions, and it covers all deposits with certain stated exceptions.** The coverage limit is variable with limits of ₦500,000 per accountholder for banks and ₦200,000 for other deposit taking entities on a netted basis. Article 16 of the NDIC Act sets forth exemptions that includes certain insider depositors (e.g., bank directors, officers and senior staff) and counter-claims from a person who maintains both a deposit and a loan account, where the former serves as collateral for the loan.

104. **Coverage levels appear broadly appropriate.** As of end-June 2012, the NDIC estimates that out of a total of ₦12.759 trillion deposits, ₦1.784 (around 14 percent) is insured, fully covering around 85 percent of all depositors. These figures suggest that the scheme provides coverage to the vast majority of small retail depositors, but the percentage

³⁷ Sections 5 and 6 NDIC Act.

of insured deposits by amounts is lower than levels seen elsewhere.³⁸ However, in the particular case of Nigeria (and other resource exporters) the figures are somewhat distorted because of the presence of sizable government (oil-related) deposits in the banking system. At the beginning of the 2008–2009 financial crisis, the CBN also publicly announced a blanket guarantee on all deposits. As discussed above, the current legal status of the blanket guarantee is unclear.

105. **The NDIC has transitioned to risk-adjusted insurance premia.** A base rate of 0.4 percent of insured deposits is charged to all banks, in addition to which a risk premium that ranges from 0 to 0.68 percent depending on a bank’s prudential risk profile. The migration towards the current hybrid scheme has led to an average reduction by 35 percent of the annual contribution for the banking sector.

106. **The NDIC, through its rights of subrogation, enjoys depositor preference.** The BOFIA provides for priority of local deposit liabilities over all other liabilities of the banks and the NDIC has rights of subrogation, allowing it to enjoy the same priority.

107. **The DIF has amassed around ₦416 billion in funds, corresponding to some 3 percent of total deposits.** The NDIC Act does not prescribe a specific target fund ratio. Government securities are the only eligible investment categories for the DIF. The investment policy is decided in-house. In practice 40 percent is held in the form of T-bills and 60 percent in Federal Bonds. In case of depletion of the DIF, it can raise insurance premia (up to 200 percent), and it has access to a credit line to the CBN.

108. **The Fiscal Responsibility Act slows down the accumulation of funds.** The investment income on the DIF is used to fund the NDIC’s operating costs. Since the enactment of the Fiscal Responsibility Act in 2007, the NDIC is required to channel back 80 percent of its operating surplus (i.e., the investment income generated on the DIF minus NDIC’s expenses) to the federal government, stalling the accumulation of funds.

109. **The NDIC plans to reduce the ninety day pay out term to thirty days but faces various challenges in delivering on this commitment.** The thirty day pay out term still seems comparatively long: in a bid to boost depositor confidence deposit insurers worldwide are moving increasingly towards shorter payout terms, usually fifteen days or less. In the mainstream banking system, the NDIC faces the problem of a lack of finality of bankruptcy proceedings. Shareholders of failed banks can thus file injunctions before the court, stalling the NDIC’s actions to resolve the bank and proceed to paying depositors. In practice, delays of several years can occur, and in a significant number of cases liquidations were overruled

³⁸ The core principles for effective deposit insurance mention percentages of 80 percent (by number of accounts) and 20-30 percent (by value) as a rule of thumb.

by the court. These difficulties need to be overcome (see recommendation in paragraph 64(b)) for the NDIC to be able to credibly deliver on the shorter statutory payout period.

110. At the operational level, the practice of netting claims can cause complications. Due to its supervisory involvement, the NDIC has good access to depositor information. The NDIC has access to the off-site data systems (eFASS). It receives quarterly updates with detailed depositor information, which it intends to expand with the introduction of a revised eFASS. The NDIC has the authority as per Article 27 of the NDIC Act to prescribe the format for depositor data for the purpose of making insurance calculations. Nonetheless, if deposits have to be netted against accelerated outstanding loans³⁹, it can be time-consuming and labor intensive. Common practice elsewhere is to apply the set-off only to depositors that are delinquent on their outstanding loans, i.e. past due or nonperforming loans, which is also helpful in strengthening repayment discipline following a bank failure. The NDIC also reports that the task of filtering out depositors with multiple accounts can be laborious. These tasks are complicated by the lack of a unique national ID number.

111. In the microfinance deposit taking sector, pay out terms can be especially time-consuming. Over the course of 2011, one hundred and three microfinance deposit-taking banks had their licenses revoked. In this sector, verification of depositor claims has often been problematic due to inadequate IT infrastructure and administrative deficiencies. Also, depositors are often unaware that their deposits are insured, especially in rural areas and are therefore slow to file their claims. Through its six zonal offices, the NDIC has undertaken considerable efforts to raise public awareness.

112. The mission recommends the following-

- The NDIC should be exempted from the Fiscal Responsibility Act and a target size for the DIF should be adopted, taking into consideration the enhanced mandate which also encompasses the provision of financial assistance to facilitate bank resolution arrangements. The provision of financial assistance should be limited to assisting in bridge bank and P&A arrangements, and not for liquidity support and subject to a cap of the amount of payout that would have been made if the bank had instead been liquidated.
- The CBN should divest its shareholding in the NDIC to the MoF and the NDIC's credit line to the CBN should be replaced with a credit line to the MoF, as such support should come from the fiscal authorities rather than the monetary authorities.
- The statutory payout period should be significantly shortened. The proposal of thirty days is still comparatively long.

³⁹ It is the NDIC's interpretation that upon the failure of a bank, all claims against the depositor by the bank fall due. This view is however not universally shared and the supporting legal basis could not be found.

- In line with practices elsewhere, netting should only be applied to delinquent loans.

VI. LEGAL PROTECTION

113. **A strong crisis management framework should include provisions which sufficiently protect the agencies such as the CBN, the NDIC and AMCON as well as its employees in the employment of the respective tools.** Employees of supervisory agencies and resolution authorities should be able to exercise their professional judgment and take the necessary action where the circumstances require, and should not be inhibited by the threat of lawsuits against their actions. In the context of crisis management, liability may occur when the supervisory authority failed to take any action notwithstanding the knowledge of serious problems in the bank, when measures were inadequate in response to the problems or when a shareholder of a bank challenges the resolution measures.

114. **Legal protection is currently afforded to the CBN, the NDIC and their staff and AMCON, but it could be enhanced.** Section 52 of the CBN Act and section 53 of BOFIA both grant protection for the CBN and its officers in relation to acts or omissions done in good faith under the respective Acts. Since the last FSAP, similar protection has been provided to the NDIC and its employees.⁴⁰ AMCON, its shareholders, officers and directors are similarly protected for acts done in good faith.⁴¹ There are however no express statutory provisions for the directors or staff to be indemnified for the costs of defending the proceedings although in practice, the CBN pays for the costs of legal proceedings where their staff have been named as a co-defendant.

115. **Despite the aforesaid statutory provisions, challenges are nevertheless made to regulatory and resolution actions.** In the CBN Annual Report 2011, it was noted that the CBN was inundated with many cases of litigation of which twenty eight were decided in favor of the CBN, two against and one settled out of court. In one case, a libel action was commenced in 2007 against the CBN and the then Deputy Director in the BSD by a director of a now defunct bank. This case is still pending before the courts. Many of these cases arose as a result of the 2009 crisis interventions. Some of the bank management that were removed have challenged their removal, other cases are libel cases filed by bank debtors who allege that they were wrongly listed when the CBN published the names of NPLs.

116. **The judicial process has been exploited with frivolous cases being filed and numerous interim and interlocutory injunctions and stays sought to delay proceedings.** Frivolous appeals are also known to be filed to further delay proceedings. Legal challenges not only delay the supervisory or resolution actions, they are also a strain on the resources of the authorities who have to spend time and expense to defend such proceedings and increase

⁴⁰ Section 55 NDIC Act.

⁴¹ Section 43(3) AMCON Act.

social costs. This problem is exacerbated in Nigeria due to a court system that is overburdened with huge case loads and inadequate resources, resulting in inordinate delay.

117. The mission recommends:

- That legal protection for the CBN, NDIC, AMCON, its directors and staff be enhanced by (i) reversing the burden of proof such that it is the party alleging the wrongdoing that has to show bad faith rather than the relevant authority providing that the act or omission was done in good faith; (ii) raising the threshold for commencing legal action to that of gross negligence or willful misconduct; and (iii) expanding the legal protection for AMCON to include staff of AMCON.
- That there should be express provisions for directors and staff of the CBN, NDIC and AMCON to be indemnified for defending legal action commenced against them personally if they had taken the action in good faith.

Annex 1. Overview of the Nigerian Financial System, 2011

(N billion, unless specified otherwise)

	2006			2010			2011		
	Number	Assets	In percent of total assets	Number	Assets	In percent of total assets	Number	Assets	In percent of total assets
Commercial banks	25	6,738	90.5	24	15,544	94.8	20	18,477	78.7
Private	25	6,738	90.5	24	15,544	94.8	17	17,548	74.7
Domestic	21	6,456	86.7	20	14,217	86.7	13	14,704	62.6
Foreign	4	282	3.8	4	1,327	8.1	4	2,844	12.1
State-owned	0		0.0	0	0	0.0	3	928	4.0
Institutional investors	124	300	4.0	100	565	3.4	91	3,457	14.7
Insurance Companies	107	n.a.		61	565	3.4	61	622	2.6
Pension Funds	13	300	4.0	30	n.a.		21	2,835	12.1
Unit Trusts	8	n.a.		8	n.a.		8	n.a.	
Other Non-Banks Financial Institutions	1,683	409	5.5	1,619	280	1.7	1,403	1,543	6.6
Finance Companies	112	54	0.7	108	31	0.2	n.a.		
Specialized development institutions	6	n.a.	n.a.	6	250	1.5	6	267	1.1
Securities Firms	581	n.a.		580	n.a.		254	n.a.	
Fund Managers							136	1,085	4.6
Mortgage Institutions	90	114	1.5			0.0			
Microfinance Banks	757	55	0.7	800	n.a.		876	191	0.8
Discount Houses	5	186	2.5			0.0	5	n.a.	
Bureaux de Change	126	n.a.		125	n.a.		125	n.a.	
Asset management Companies (AMC)							1	n.a.	
Other	6	n.a.							
Total financial system	1,826	7,447	100.0	16,389	100.0		23,477	100.0	

Source: CBN.