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Miscellaneous matters and prudential guidelines

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MISCELLANEOUS MATTERS AND PRUDENTIAL GUIDELINES

INTRODUCTION

I am delighted to be here not only as a participant but also to lead the discussion on Prudential Guidelines and Provisions of Banking and Non-Bank Financial Institutions (BOFI) Decree No. 25 covered by sections 45 to 55 under Miscellaneous Matters.

The banking industry is generally considered to be more regulated than any other sector of the economy. This is largely due to the crucial role of financial intermediation played by the operators in the industry. The review of the banking laws particularly in an era of deregulation should therefore be seen as an important effort to enhance the efficiency, soundness and stability of the banking system. Perhaps it is necessary to point out that deregulation does not mean the absence or regulation, rather it is an attempt to rationalise regulations. The various deregulation measures introduced in the Banking Industry which, I believe, are well known to all of you, have brought about benefits, opportunities and problems. The industry is now more competitive and this has, to a large extent, increased the risk exposure of banks. There has also been increasing concern about abuses and violations within the industry. It is in the light of the foregoing that the need for Prudential Guidelines and the recent review of the banking Decree, should be seen.

There is no doubt that the new Decree has introduced considerable changes, particularly in the area of banking supervision and regulation. These changes are generally aimed at enhancing the supervisory powers of the Central bank with a view to making the Banking industry more responsive to the important changes that have taken place in the industry and the economy in general, since the introduction of SAP.

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Part One, Section 45-55 of Decree No. 25 Miscellaneous matters

General Observations

The provisions of the Decree under miscellaneous matters relate to issues that have not been specifically provided for in other sections, but which are considered important for comprehensive and effective supervision of banks. They are general provisions aimed at reinforcing sanctions for specific offences stipulated elsewhere in the Decree to ensure prompt and proper compliance, accountability and responsible management of the affairs of banks.

Most of the sections here deal with one area of reform which was considered long overdue relating to sanctions for breaches of banking laws and regulations by banks and their officers. Although the repealed banking Act contained provisions which stipulated penalties in the form of fines and in some cases, imprisonment for contravention, it had long

become obvious that those provisions lacked the required deterrent force to prevent flagrant breaches by banks. The fines imposed, though compoundable, were so paltry that the banks found it more convenient to contravene the regulations and pay them rather than comply. Consequently, the penalties became an ineffective administrative enforcement supervisory tools in the hands of the Central Bank. This unsatisfactory situation was no doubt in the minds of the authorities in the promulgation of the new Decree which has increased the quantum of penalties both in terms of the amount of fine and imprisonment. For example, a breach of S. 20 of the new Decree qualifies a bank to be levied with a fine of N1,000 for each day the breach continues while a similar breach under the repealed Act attracted a fine of only N100.00 daily. Similarly, failure by Directors and Managers to disclose their interests in loans and advances now attracts a fine of N100,000 instead of N10,000 under the repealed law. (see section 18(2))

POWER TO COMPOUND OFFENCES

It appears that the Governor's power to compound offences under section 34 of the repealed law has not been retained in the new Decree with the result that new penalties can only be imposed by a court of competent jurisdiction, after due trial and conviction. This constitutes an obvious encumberance on the effectiveness of the Central Bank as the apex regulatory authority in the exercise of administrative enforcement powers necessary for the proper discharge of its supervisory authority in superintending over the affairs of banks and other non-bank financial institutions. However, one is happy to note that S.60 has attempted to ameliorate the full effect of the absence of power to compound offences. This section confers on the Governor the power to impose a penalty of up to N100,000 on a bank or financial institution for breach of any rules, regulations, guidelines or administrative directives issued by the Central Bank. It is however arguable if not entirely doubtful, if the power extends to contraventions of substantive provisions of the Decree for which definite sanctions have been prescribed. The section is also clearly applicable to banks and financial institutions only and does not cover individual directors, managers or officers of such institutions that may have caused the breach.

Classification of Penalties

A glance at the penal provisions shows that banks and financial institutions are the only offenders for certain contraventions and in some cases, their directors, managers, officers and employees are the only offenders while in other situations, both banks and financial institutions as corporate entities and their directors/officers are liable for a number of contraventions. Similarly, while only fines are prescribed for certain contraventions, both fines and terms of imprisonment are stipulated for other breaches. This classification was obviously made to reflect the gravity or nature of the offence committed.

In order to avoid possible loopholes arising from the classification of contraventions into corporate and non-corporate offences, S.45 provides that where an offence was committed by a bank or firm, a director, manager or secretary of the bank or firm would also be liable for such offence unless such persons can prove that the offence was committed without their consent or connivance and that he exercised all due diligence to prevent the commission of the offence having regard to the nature of his functions in that capacity.

S.46 complements S.45 by imposing a stiff penalty against directors and managers who fail to take reasonable steps to ensure compliance with the provision of the Decree or the correctness of any statement submitted pursuant to the Decree. It is important

to note here that directors and managers are liable under this section even if the contravention is occasioned merely by negligence on their part. The section has increased the fine for breach of its equivalent provison in the repealed law from N1,000 to N5,000 and the term of imprisonment from 2 years to 5 years.

- Section 47. This section is indeed a miscellaneous provison which applies to situations where compliance with certain requirements are prescribed but by omission or otherwise, no penalty was provided there of.

- Section 48. This section has removed the jurisdiction to try offence under the Decree from the Chief magistrate Court under the repealed law, and confers same on the Federal High Court or other Tribunal as may be established to do so. The change in the court of competent jurisdiction is presumably because banking business falls under the exclusive Federal legislative list in the 1989 Constitution. Also, the provision which envisages, speculatively though, the establishment of a tribunal to try offences under the Decree is a welcome development. This will tend to avoid protracted delays and cumbersome court procedures, congestion in courts, etc. to ensure prompt enforcement of sanctions for non-compliance and punish cases of fraud by Directors and Managers.

- Section 49 is more or less an exemption clause granting immunity designed to protect key institutions and officers concerned with the implementation of the new Decree. Thus, under this section, neither the Federal Government, the Central Bank, the Minister of Finance or their agents will be liable for acts of commission or omission done or omitted to be done in the exercise of their powers under the Decree. However, this immunity is qualified, since the acts of commision or omission must be done in good faith for the protection conferred by the section to apply. The onus of proving otherwise is obviously on the plaintiff who initiates any action, claim or makes any demand against the affected parties.

- Section 50 is a very important section in the context of the new Decree even though it merely restates the old provision in the repealed law.

The section provides that where a bank is to meet its obligation or suspends payments, the assets of the bank in the Federation shall be available to meet all the deposit liabilities of the bank and such deposit liabilities shall have priority over all other liabilities of the bank. This is an exact replication of S.37 of the repealed law. The cummulative effect of this section, considered together with S. 53 which subordinates the application of the Companies and Allied Matter Decree 1990 to the new Decree, entitles the CBN and NDIC to recoup any financial exposure to a failed bank whether arising from arrangements for the take over of the deposit liabilities of such bank or outright pay off to depositors in the event of bank failures in priority over all categories of preferential debts to creditors/claimants listed in section 494 of CAMD in the event of liquidation (i.e. local rates, charges, taxes due to Government, deductions under the NPF Act; all wages and salaries of any servant in respect of services rendered to the company; all accrued holiday remuneration to employees; amounts due in respect of any compensation and liability accrued before the commencement of liquidation; and costs of winding up). This priority in my opinion, would extend to the preferential claims of secured creditors; even though their rights to realise or otherwise deal with their security notwithstanding the appointment of a receiver is preserved under S.10(2) of the Bankcruptcy Decree, 1979 since its application has been subordinated to the new Decree.

- Section 51 grants a qualified exemption to the NPF and all

the development banks from the application of the Decree, but under its proviso, surrenders them to the power of the Governor to order special examinations into their books and affairs where he considers it in the interest of the economy to do so. Similarly, under section 228(1)(b) of the CBN Decree 24 of 1991, the Bank can compel them to supply certain information, issue guidelines to and impose sanctions on them for non-compliance.

- Section 52 recognises the peculiar nature and scope of operations of Community Bank and Profit and Loss sharing banks by conferring on the Government the discretionary power to exempt them from the application of some provisions of the Decree ostensibly to ensure the realisation of the need and objectives behind the recognition and establishment of such banks. Some of the peculiar characteristics of the banks for example, include the absence of provision for interest charges in favour of the more participatory approach characteristic of Profit and Loss sharing banks while in the case of Community Banks, the scope of their operations is circumscribed and are governed by different requirements relating to capital adequacy, liquidity ratios etc.

- Sections 53 and 54 are provisions of tremendous significance in that they define the relationship and application of the new Decree vis-a-vis the Companies and Allied Matters Decree 1990 and the NDIC Decree No. 22 of 1988, respectively. The former will apply to banks and financial institutions covered by Decree No. 25 except that where its provisions conflict with Decree No. 25 the provisions of the latter shall prevail. S.53 recognises banks and financial intitutions as special species in the handling of certain matters, for example, relating to winding up and the attendant consequences thereof. It also has special significance to the operations of the NDIC, whose enabling law empowers it to act as a Receiver for failing banks, but could not have been able to perform this important traditional role with regards to banks without an amendment to its Decree, specifically exempting the aplication of S.387 of CAMD which prohibits the appointment of a Corporation as a Receiver. This defect has been cured, for the CBN can, in the exercise of its power under Decree No. 25, appoint NDIC as the Receiver of a failing/failed bank. Another significant change introduced that will enhance the effectiveness of NDIC operation has already been explained above under S.50.

With regards to NDIC Decree, 1988 , the new Decree similarly preserves the power and function of the Corporation, while at the same time emphasises its supremacy where the provision of the former are inconsistent with the provision of the latter. It is necessary to note here that the NDIC Decree came into effect at a time when banking regulation and supervision was shared between the CBN and the Federal Ministry of Finance and Economic Development; hence the frequent reference to the Minister of Finance therein. As a matter of fact, the powers of the Corporation in dealing with problem banks, for example, under S.23(3)(d) the NDIC Decree, requires the approval of the Minister of Finance on the recommendation of the CBN. Reference to the Minister of Finance in the NDIC Decree would therefore appear to be inconsistent with Decree No. 25 since the CBN on whose recommendations the Minister is to act is now vested with powers over banking regulation and supervision to the exclusion of the Ministry of Finance. It would appear that this provision attempts to harmonise the provision of the two Decrees, particularly where the NDIC requires the approval of the Minister of Finance, who was until the promulgation of the new Decree, in charge of banking policies.

- Section 55 confers on the Governor the power to make regulations to be published in a Gazette, to give full effect to the objects and objectives of the Decree which extends to rules and regulations for the operation and of NPF and development banks under S.51

I would like to conclude my remarks on the Miscellaneous provisions by:-

(a) Observing that except

for very few additional provisions, the sections dealing with miscellaneous matter are largely substantial re-enactments of their equivalent provisions inthe repealed Decree; and

(b) Emphasising that the frequency and seriousness os contraventions of Decree No. 25, the CBN Decree No. 24, 1991 and the NDIC Decree by banks should be regarded as an indication of the quality of management of such banks, a warning signal to be noted by bank examiners. (Attached is a summary of all penalty provisions contained in the new Decree for ease of refernce)

Prudential Guidelines

The prudential guidelines issued by CBN in November 1990 are aimed at ensuring a stable, safe and sound banking system. It is meant to serve as a guide to banks to:-

(a) ensure a more prudent approach in their credit portfolio classification, provisioning for non-performing facilities, credit portfolio disclosure and interest accrual on non-performing assets.

(b) ensure uniformity of their approach in (a) above, and

(c) ensure the reliability of published accounting information and operating results.

Until recently, users of financial statements of licensed banks have had cause to express concern over the quality of such statements in view of the varied and in most cases inconsistent practices adopted by banks. Specifically, a number of persons felt concerned that banks' earnings were being overstated as interest was being taken on non-performing assets. Also, comparison of banks' performance became difficult.

The prudential gueidelines were therefore issued, to protect the interest of depositors thereby promoting public confidence in the banking system.

The highlights of the guidelines which I believe most participants are by now conversant with include essentially the criterion for the classification of and provisioning for non-performing assets, treatment of interest accrued on non-performing accounts and disclosure requirements for such assets. The guidelines are regarded as minimum requirements and banks with more stringent policies and practices should be encouraged to continue with them.

It is encouraging to observe from the banks' most recent published accounts that the provisions of the guidelines and the Statement of Accounting Standard for banks (i.e. SAS 10) are being complied with. Although the implementation of these guidelines has drastically reduced many banks' reported earnings and as a result their payouts, banks are now under severe pressure to manage their asset properly; unauthorised and fraudulent lending would have to be curtailed; and some banks would be compelled to rationalise their operations to reduce and save costs. The users of banks' financial statements are now able to not only rely on these statements but also compare the performance of banks.

In conclusion, it is pertinent to re-emphasise that these regulations can only assist, but cannot be a substitute for good management of our banks. It is the ultimate responsibility of the Directors and management to ensure the survival and viability of their banks. The regulatory and supervisory authorities are committed to safe and sound banking system and would therefore ensure compliance with all laws and regulations. It would be seen from sections 46 mentioned above and other provisions discussed by previous speakers that the CBN has power to enforce its regulations. It is hoped that with the cooperation of operators in the industry, the CBN will not feel compelled to exercise such powers too often to ensure compliance with banking laws and regulations.