

KEYNOTE ADDRESS

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AT THE

SEMINAR ON PROBLEM BANKS RESOLUTION

***ORGANISED BY:
NDIC TRAINING CENTRE
LAGOS***

***ON JUNE 20 - 22, 2005
AT DUSMAR PRESIDENTIAL HOTEL
KUTO, ABEOKUTA***

CONTEMPORARY CHALLENGES IN RESOLVING PROBLEM BANKS IN NIGERIA

PROTOCOL

1.0 INTRODUCTION

- 1.1 I am delighted to have been invited to present a keynote address at this August occasion. This seminar on Problem Bank Resolution could not have come at a better time, given that the on-going Bank Consolidation Programme has barely six months left for its conclusion. I therefore, see this seminar as a golden opportunity to strategise for post-consolidation challenges including effective exit mechanism for banks that fail to meet the bank consolidation requirements.

- 1.2 Distinguished participants, permit me to note that the bank consolidation programme has made some progress. The latest information available indicates that 21 prospective merger groups involving 64 banks have emerged and that new equity capital to the tune of ₦210 billion have been raised from the capital market. You will no doubt agree with me that it is however, too early to forecast the ultimate outcome of the bank consolidation programme.

- 1.3 It is significant that the Seminar was designed for the Senior Staff of the Operations Division of the Corporation and that majority of participants are from Departments under that Division. The Seminar should therefore, be an avenue to discuss lessons from our past experiences and to x-ray

contemporary issues in problem-bank resolution, identify emerging challenges and propose proactive measures to address the identified challenges.

1.4 The rest of this paper is divided into four sections. Section 2 briefly highlights the Corporation's objectives while section 3 covers contemporary challenges in resolving problem banks. Section 4 presents possible measures to address the challenges while section 5 concludes the paper.

2.0 CORPORATION'S OBJECTIVES

2.1 As you are aware, the Deposit Insurance System (DIS) being administered by the Corporation was designed as a **risk minimiser** with the mandates of insuring banks' deposit liabilities, supervising insured institutions to monitor its risk exposure and ensuring orderly resolution of failing or failed insured institutions. In keeping with its mandate, the Corporation's vision and mission statements were crafted to encapsulate its major objectives. Such objectives include:

1. responsiveness to the needs of stakeholders
2. ensuring an effective supervision of insured institutions
3. provision of financial/technical assistance to eligible insured institution
4. prompt payment of insured sums to depositors of failed institutions; and
5. orderly resolution of failed institutions.

2.2 As laudable as the aforementioned objectives are, their realisation depends on the availability of an enabling environment. Given the myriad of problems facing the Corporation, it is clear that there are a number of inadequacies and challenges in its operating environment. This Seminar is therefore, another opportunity for us to undertake a very rigorous environmental scanning.

3.0 CONTEMPORARY CHALLENGES

There are numerous contemporary challenges in problem-bank resolution in Nigeria. However, this address has been deliberately written to focus on those challenges that hinder or could hinder the Corporation's ability to effectively and efficiently execute its mandate. Some of the challenges are highlighted hereunder:

3.1 **Failure to Implement Contingency Planning Framework**

In 2001, the CBN/NDIC Executive Committee on Supervision facilitated the introduction of a Framework for Contingency Planning for Systemic Banking Crises. Under the Framework, the roles and responsibilities of both the Regulatory Authorities and licensed banks were clearly enunciated. Specific thresholds for prompt corrective actions to resolve liquidity and solvency problems were articulated. Similarly, supervisory

intervention measures to address specific distress indicators were articulated. Each bank was required to submit its Contingency Plan duly approved by its Board of Directors to the CBN for appraisal. Unfortunately, subsequent events revealed that some Contingency Plans were either inadequate or unrealistic while no serious efforts were made to implement many of the Contingency Plans submitted. If the Contingency Planning Framework had been faithfully implemented, the lingering distress syndrome as manifested in overdrawn accounts at the CBN, inability to meet pastdue obligations, distress borrowing, and low or negative capital adequacy ratios which preceded the bank consolidation programme would have been significantly ameliorated.

3.2 **Weak Corporate Governance**

Weak corporate governance had manifested in weak internal control systems, excessive risk taking, over-ride of internal control measures, absence of or non-adherence to limits of authority, disregard for canons of prudent lending, absence of risk management processes, insider abuses, fraudulent practices et cetera remain a worrisome feature of the banking system. The pursuit of professionalism and ethical behaviour in banking institutions is sine-qua-non for a safe and sound banking system.

3.3 **Inadequate Legal Framework**

The existing legal framework for distress resolution is grossly inadequate. Some provisions of the NDIC Act are too rigid and inhibit prompt intervention or the exercise of discretionary powers. The deposit insurance coverage fixed by law, the requirement for NDIC to apply to the Federal High Court to be appointed Liquidator of failed banks and absence of indemnity provision for NDIC's Directors and Staff against official actions taken in good faith and without negligence are cases in point. I have no doubt that the paper to be presented on "Legal Issues in Problem Bank Resolution" will expatiate on the legal challenges faced by the Corporation in detail.

3.4 **Slow Judicial Process**

The litigations challenging the revocation of the banking licences of Savannah Bank and Peak Merchant Bank remained unresolved in the courts since 2002 and 2003 respectively. I believe you are familiar with some of the frivolous applications and motions that had been filed to protract the litigation processes. A typical example is the challenge of the Federal High Court ruling that the Police should secure and protect the premises of Savannah Bank which took two years to dispose off.

Furthermore, our legal processes do not facilitate the speedy enforcement of financial contracts, debt recovery and realisation of collaterals. Speedy realisation of assets is critical to the Corporation's ability to be responsive to the needs of uninsured depositors. Speedy court processes will also facilitate early termination of liquidation activities.

3.5 **Sustenance of the Deposit Insurance Fund (DIF)**

As you are aware, the premium collected from insured institutions is invested by the Corporation to generate income to sustain its operations and build up reserves. However, as specified by its enabling Act, the Corporation can only invest its DIF in Federal Government Securities. Given the need for safety and liquidity, the bulk of the DIF is invested in Treasury Bills (TBs) and a small proportion in FGN Bonds. However, the recent significant reduction in TB rates poses a great threat to the DIF and unless the trend is reversed, this development will undermine the Corporation's ability to realise its objective of prompt payment of insured sums. Let me underscore what has happened to enable you appreciate the vulnerability of the Corporation's income base. In 2004, 99% of the Corporation's income was generated from investments in TBs and FGN Bonds. Average interest rate on TB investments was 14% in 2004. But by June 2005 TB rates have fallen to as low as 6%.

The threat to the sustenance of the DIF is therefore real and a major cause for concern given that resolution of problem banks either through financial assistance or deposit pay-out requires a robust and adequately funded DIF. This adverse development in the wake of the bank consolidation programme should be a major concern to all staff of the Corporation.

3.6 **Adequacy of Executive Capacity**

Executive capacity is critical to prompt and effective resolution of problem banks. Apart from putting in place Information Technology (IT) resources in terms of hardware infrastructure and software applications, it is essential that the Corporation's staff possess working knowledge of the major banking applications in use by insured banks. Furthermore, the Corporation staff would need to acquire skills in risk assessment and risk management; recognition of early-warning signals; financial analysis; bank restructuring; asset realisation; as well as purchase and assumption transactions.

4.0 **ADDRESSING THE CHALLENGES**

4.1 The on-going bank consolidation is expected to foster the emergence of large and fewer number of banks. Large banks are typically diversified with complex risk matrix. The existence of large banks would trigger new issues of regulatory concern such as "too big-to-fail",

clamour for low premium rate, over-stretching of deposit insurance to cover non-banking activities of large banks, etc. I therefore, challenge participants to brainstorm on these issues and come up with feasible recommendations.

- 4.2 As you may be aware, the Corporation has addressed some of the challenges identified in Section 3 in the proposed amendments to its legislation currently under consideration by the National Assembly (NASS). Thus far, the NASS has shown commendable understanding of the inadequacies in the Corporation's enabling Act. It is my hope that we shall be able to successfully push through the proposed amendments in the near future.
- 4.3 It is inevitable that the Regulatory Authorities must ensure that banks put in place strong corporate governance and robust risk management processes while the Regulatory Authorities enforce zero tolerance for mismanagement and unethical behaviour. The Contingency Planning Framework for systemic Banking Crises must henceforth be implemented by both the Regulatory Authorities and the licensed banks.
- 4.4 With regard to slow judicial process, it is imperative that sanctions should also be applied on judicial officers who grant frivolous injunctions or encourage abuse of court

processes by litigants. In this regard, Nigeria should learn from the experience of Phillipines. In 2004, the enabling law of deposit insurance was amended such that strong sanctions were introduced. The provisions include:

- i) Only the Court of Appeals or the Supreme Court may issue Temporary Restraining Orders or preliminary Injunctions against the Phillipines Deposit Insurance Corporation while performing its receivership and liquidation functions.
- ii) Any Judge that issues restraining order or injunction in violation of the law shall suffer the penalty of suspension for at least 60 days without pay.

4.5 The Corporation will have to review its investment strategy in view of the alarming decline in the TB rates. Also, greater attention will need to be paid to the Corporation's cost structure.

5.0 CONCLUSION

5.1 As highlighted above, we face daunting challenges in problem bank resolution. It is my hope that the issues that I have raised will provoke your thought in the course of this Seminar. I have no doubt that the speakers invited for the Seminar will further provoke your thought. It is my hope that at the conclusion of the Seminar, participants will generate pragmatic recommendations that will enhance the Corporation's ability to ensure effective problem-bank resolution.

5.2 Finally, I wish you fruitful deliberations. Thank you for your attention.

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JUNE 20, 2005