Agusto&Co. ECONOMIC NEWSLETTER

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Agusto & Co. Economic Newsletter: The Review of the BOFIA 2020

The "Banks and Other Financial Institutions Act" 2020 ("BOFIA 2020" or " the New Act") was signed into law by President Muhammadu Buhari on 13 November 2020 and repeals the extant BOFIA 1991 (as-amended in 1997, 1998, 1999 and 2002). The BOFIA 2020 introduces and amends major provisions that govern the activities of banks, specialised banks and other financial institutions, reflecting the evolution of the Nigerian financial sector over the last three decades. The Act, among other things, seeks to strengthen regulatory oversight and increase investor confidence in the financial sector.

The BOFIA 2020 has six major new provisions. These new provisions include sections on the creation of a new banking sector resolution fund, the creation of a new tribunal for the enforcement and recovery of eligible loans and closure of banks during strikes, epidemic or pandemic. The other new provisions include sections on restrictions on operations of banking agents, cybersecurity and netting arrangements.

The Establishment of a Banking Sector Resolution Fund

Without prejudice to the Asset Management Corporation of Nigeria (AMCON) Act, the BOFIA 2020 establishes a banking sector resolution fund ("the Resolution Fund"), which will function like a bridge bank. The resolution fund will be floated by the CBN, the Nigeria Deposit Insurance Corporation (NDIC) and the banking industry. At the start of the Resolution Fund, the CBN and the Nigeria Deposit Insurance Corporation (NDIC) will be expected to contribute the sum of ₦10 billion and ₦4 billion respectively (or such amount as the Board of the CBN may determine) on the first business day in each calendar year. Also, from the commencement date, an annual levy of an amount equivalent to 10 basis points (or as determined by the CBN) of the total assets of banks, specialised banks and other financial institutions as at the date of its audited financial statements for the preceding year will be paid on the commencement date and on or before the 30th day of April in each subsequent calendar year following the commencement date.

The formation of a bridge bank in the context that is proposed by the Banking Sector Resolution Fund will bring some level of stability to the financial services sector in Nigeria. However, we remain cautiously optimistic on the anticipated success of the initiative, especially considering that the current AMCON project has performed below expectations. We recognise the negative impact this development will have on the banking Industry's profits due to an envisaged rise in regulatory induced costs which currently account for an estimated 15% of the banking industry's total operating expenses. The initiative could also create a moral hazard because access to contributed funds in the event of distress may trigger more risky behaviours by banks.

The Establishment of a special tribunal for the enforcement and recovery of eligible loans

BOFIA 2020 introduces a credit tribunal to improve the lending landscape and loan recovery activities in the financial system. Contained in Sections 102-132 of the Act, the tribunal will have and exercise jurisdiction on matters pertaining to the enforcement and recovery of eligible loans by banks, specialised banks and other financial institutions. It will be involved in matters connected with or pertaining to the enforcement of security or guarantee or attachment on any assets under an eligible loan made by any bank, specialised bank or other financial institutions in Nigeria to its customers. The risk profile of lending landscape in Nigeria remains high because of the weak macroeconomic terrain and structural bottlenecks that impede the bankability of businesses. The recovery process on non-performing loans is also challenging since the legal framework is weak, thus constraining the enforcement of contracts. We believe that the establishment of a special tribunal for the enforcement and recovery of eligible loans will encourage private sector lending in the medium to long term, which is required to achieve the much-needed growth in the Nigeria economy.

Closure of banks during strikes, epidemic or pandemic

Section 45 of the New Act makes provisions for unforeseen events such as a pandemic or a strike that could result in the inability of a bank, a specialised bank or other financial institutions to open for business. The law states that no bank, specialised bank or other financial institution will incur any liability to any of its customers by reason only of failure on the part of the bank, specialised bank or other financial institution to open for business during a strike, an epidemic or a pandemic. The novel coronavirus pandemic (COVID-19) and the #Endsars protests that followed almost immediately propelled the need for a provision such as this, which protects the banking industry from the accumulation of liabilities incurred from force majeure events. However, we believe that policy and contract documents may also need to be reviewed to address other challenges that may arise from any unforeseen events.

Restrictions on operations of agents of banks

BOFIA 2020 empowers the CBN to regulate the operations of agents of banks through guidelines. According to the Act, an agent is described as any person or entity contracted by an institution and approved by the CBN to provide the services of the bank on behalf of the bank in such a manner as may be prescribed by the CBN. An agent is not permitted to accept any withdrawals by cheque; or be a direct member of the Nigeria Bankers Clearing System. In addition, agents are not allowed to accept any deposits above an amount that will be prescribed by the CBN from time to time. This provision recognises the growing importance and relevance of agents in driving the financial inclusion strategy of the Central Bank of Nigeria in the near term. The number of banking agents rose from 38,416 in December 2018 to 236,940 agents as of December 2019[1] . Given the growing number of agents, both in the urban and rural areas of the country, it is important that activities of this support segment are well described and regulated to achieve the purpose of their function and prevent fraudulent practices.

Cybersecurity regulation

According to BOFIA 2020, the CBN may issue regulations and guidelines to the financial sector to address cybersecurity issues in the delivery of financial or banking services. Cybersecurity is an emerging challenge in the banking industry, given a growing acceptance of technology and a spike in the number of customers added on to various electronic platforms within a short period. The COVID-19 pandemic has caused many organisations to adopt various forms of technology without prior planning and testing. So, while we view positively the improved usage of technology among financial services operators in Nigeria, Agusto & Co. also believes that it comes with heightened

1 The Central Bank of Nigeria

risks which need to be monitored and managed to prevent significant losses arising from cyber thefts.

Netting Agreements

The netting provision in BOFIA 2020 protects netting agreements in the event that a bank or financial institution is wound up. According to the Act, where the license of a bank or other financial institution is revoked pursuant to the provisions of the Act or is wound up by an order of a court of competent jurisdiction, or a liquidator is appointed for the bank or other financial institution, any provision contained in a written netting agreement to which the bank or other financial institution is a party or any netting rule or practice applicable to the bank or other financial institution shall be binding upon the liquidator. We view this development positively particularly with the recent licenses granted by the Securities and Exchange Commissions (SEC) for the establishment of Central Counterparty entities in the Nigerian financial services sector. The Central Counterparty entitites are expected to assume counterparty clearing risks between parties to a transaction and provide clearing and settlement services for trades in foreign exchange, securities, options and derivative contracts. With this provision, we expect increased confidence and participation especially in the derivatives segment where netting is required in settlements. This will also deepen the financial market in Nigeria in the medium to long term.

KEY AMENDMENTS ON BOFIA 2020

Under the new Act, some provisions were modified to cover more scenarios. Some sections that previously had one or two subsections were revised to cover more events and regulations. In the paragraphs that follow, we have highlighted eight major provisions that were amended to reflect current realities in the Nigerian financial sector and to strengthen regulatory oversight, going forward. The amendments cover changes in penalties, minimum capital ratio, opening and closing of branches, display of information, restriction of certain banking activities, failing banks and rescue tools, functions of CBN Examiners and Operations of Foreign banks in Nigeria and offshore banking.

Penalties

All penalties mentioned in the BOFIA 1991 were revised upwards to accommodate the impact of inflation and devaluation on the domestic currency. BOFIA 2020 charges significant monetary penalties on officials within the financial services sector, which, in our opinion, would encourage accountability, ownership of responsibility and potentially pare back high-risk behaviours. Financial institutions will also ensure that provisions under this Act are obeyed to minimise charges arising from breaches.

Minimum Capital Ratio

In addition to maintaining minimum capital ratios, the CBN may now prescribe a higher or lower capital adequacy ratio for any category of banks. The CBN may require any bank that has a holding company, a subsidiary or both to calculate and maintain minimum capital ratios on a consolidated basis. This is an amendment from the old Act which empowers the CBN to prescribe higher or lower capital ratios at its discretion. For instance, for systemically important banks (SIBs), the CBN had proposed higher capital adequacy ratios above the regulatory minimum to ensure that enough capital is set aside in these big sized banks to absorb unforeseen losses. We note that the proposed capital adequacy ratio for SIBs was never implemented.

Opening and closing branches

This provision includes cash centres and representative offices to the coverage of offices that banks are to obtain consent from CBN before opening or closing. In addition, the six months' notice period was introduced as a requirement for any bank intending to close any of its branches, outlets or subsidiaries. We believe that this provision will encourage banks to be more strategic in establishing and shutting down branches and outlets, especially as it regards the potential impact on customers and bank staff.

Display of information

In the BOFIA 1991, this provision was titled "Display of interest rates". However, this has been expanded to "Display of information". In the New Act, banks are required to display information at their offices and on their websites (not included in the old Act). In addition to interest and lending rates, banks are also now required to display foreign exchange rates, certified true copies of certificates of incorporation, and abridged versions of the last approved audited accounts. We believe this provision will enhance transparency and competition in the banking industry.

Restriction on certain banking activities

The BOFIA 2020 prohibits banks, specialised banks or other financial institutions (without the prior approval in writing of the CBN) from granting any unsecured advance, loan or credit facility except it is in line with the regulation on collateralisation as may be issued by the Central Bank of Nigeria. We recognise that the banking industry grants short term loans (or overdrafts) to low risk and large conglomerates on a cash flow basis. These credits are granted in repeated cycles, helping the Industry's profits, especially as interest rates on these loans tend to be slightly higher than longer tenored credits. In addition, personal loans such as "pay day" loans which are based on expected salary cash flows may be affected by this provision. However, this new provision does raise a few rhetorical questions. What would be the likely implication of this provision on the credit environment in Nigeria given that a considerable volume of credits by the banking industry are unsecured overdrafts? What implications would this have on operational efficiencies in the loan administration process of financial institutions which will now hasve to obtain regulatory approval for unsecured lending?

Failing banks and rescue tools

Where a bank is adjudged to have failed under the conditions provided in Section 34 (1), the CBN governor may suspend any payment or delivery obligations pursuant to any contract to which the bank is a party. This is not contained in the old act. In addition, the governor may transfer the whole bank or only part of the banking business to third party private purchasers or employ any other intervention tool as the CBN may deem fit. The CBN now has powers to acquire the shares of any falling bank up to a level that guarantees its control of the bank. If everything else fails, and the state of affairs of the bank concerned still does not improve, CBN may invoke its power to revoke the license of the bank.

In the old Act, the Nigerian Deposit Insurance Corporation (NDIC) had the responsibility to take over the control and management of a failing bank and in a worst-case scenario recommend other resolution measures including the revocation of the bank's license. However, with the BOFIA 2020, the NDIC's function has been somewhat removed. With a perceived overlapping mandate between the CBN and the NDIC, there is need for clarity especially in the area of resolution of failing banks where NDIC is known to be the primary actor in the resolution process. We believe that an overlap of regulatory responsibility may lead to inter-agency conflicts, duplication of regulations and ultimately increase ambiguity in the financial sector.

CBN Examiners

In the new Act, the Governor may appoint examiners who shall have the right to attend (as observers) management and board meetings of banks, other financial institutions and specialised banks to which they are assigned. We believe that this law somewhat contradicts the efforts made by the regulatory body over the years in terms of corporate governance, which resulted in stronger independent boards and corporate governance structures. In our opinion, the presence of CBN examiners at these management and board meetings would impair expressiveness and may be counterproductive in the long run. We believe that if this provision remains, it should be applied strictly to banks in financial distress.

Operations of Foreign banks in Nigeria and offshore banking

The CBN may grant to any bank registered in Nigeria or a foreign bank a license to undertake domestic (absent in the old Act) or off-shore banking business within a designated free trade or special economic zone in Nigeria. This provision, which is an amendment to the prior, somewhat contradicts an existing law that says licenses to carry on banking business in Nigeria may only be granted to companies duly incorporated in Nigeria. Thus, foreign banks seeking to obtain banking licences in any part of Nigeria including designated free trade or special economic zone should also incorporate a Nigerian subsidiary for that purpose. Agusto & Co. believes that this provision may place Nigerian banks at a disadvantaged position over the foreign counterparties in the long term.

CONCLUSION

We believe that there are grey areas in the new Act that need to be clarified or amended to achieve the purpose for which the BOFIA was reviewed. We expect these to be addressed in the near term as certain provisions within the Act are considered to be inimical to initiatives targeted at attracting domestic and foreign investments, promoting industrialisation, developing Nigerian enterprises and generally improving the ease of doing business in Nigeria.

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