ALP | NG & Co.
AFRICA LAW PRACTICE NG & COMPANY
WWW.ALP.COMPANY

CENTRAL BANK OF NIGERIA: REVIEW OF MINIMUM CAPITAL REQUIREMENTS FOR BANKS

AUTHORS

KEHINDE ADEGOKE
ASSOCIATE

BABATUNDE SHOBAYO
ASSOCIATE

Introduction

On 28 March 2024, the Central Bank of Nigeria (CBN) issued a circular to all commercial, merchant, and non-interest banks, and promoters of proposed banks on the upward review of minimum capital requirements for banks in Nigeria (the CBN Circular). The apex bank announced that it had introduced this upward review in furtherance of its statutory responsibility to promote a safe, sound, and stable banking system in line with Section 9 of the Banks and Other Financial Institutions Act (BOFIA) 2020.

Meaning of the Banks' Recapitalisation Programme

Recapitalisation is the process of injecting new equity into a company to strengthen its balance sheet.[1] It involves bolstering a bank's long-term capital to meet regulatory requirements and safeguard shareholders' investments, often to enhance financial stability or restructure its financial framework.[2] The CBN Banking Sector Recapitalisation Programme (the Programme) is a regulatory initiative of the CBN that requires banks to increase their minimum paid-in common equity capital to a specified amount according to their license category within a specified period of time.[3] The Programme, which is designed to apply to commercial, merchant, and non-interest banks, aims to ensure that each institution maintains adequate capital that is commensurate with the risk profile, scale, and scope of its operations. It must be noted that the Programme will not affect the day-to-day operations of the banks.

1 FreshBooks, 2003, Recapitalisation: Definition & How It Works https://www.freshbooks.com/glossary/financial/recapitalization Accessed on 30 March 2024

2 Business Day Newspaper, 29 March 2024, https://businessday.ng/news/article/from-mas-to-capital-raise-what-to-expect-from-banks-recapitalisation/ Accessed 30 March 2024

3 The CBN: Circular to all Commercial, Merchant, and Non-Interest Banks; and Proposed Promoters of Bank. March 2024. Recapitalization_MARCH_2024.pdf (cbn.gov.ng) Pg. 4. Accessed 30 March 2024

Brief History of Banks' Recapitalisation in Nigeria

The history of bank recapitalisation in the Nigerian banking system dates back to 1958 when the 1952 Banking Ordinance was reviewed and a new Banking Ordinance was enacted.[4] Since then, the Nigerian banking sector has undergone numerous recapitalisation programmes. In 2004 the then CBN Governor, Charles Soludo, announced the increase of the minimum capital requirements for banks from N2 billion to N25 billion, effective 31 December 2005. This resulted in the consolidation of banks, through mergers and acquisitions, bringing the total number of banks in Nigeria to 24.

Purpose of the CBN Banks' Recapitalisation

Following the previous recapitalisation programme in 2004, the current capital requirements have become largely insufficient to cater for the demands and opportunities presented by Nigeria's expanding economy. The Programme therefore aims to ensure that banks have enough capital to absorb unexpected losses as well as capacity to contribute to economic growth and development. The overarching purpose of the Programme is to support the achievement of a US$1 trillion economy by the year 2030,[5] by developing strong and resilient banks with large capital bases.

4 International Research and Development Institute. 2009. Journal of Management and Enterprise Development. Vol. 6, No. 3 https://www.lasu.edu.ng/publications/management_sciences/sikiru_ashamu_ja_09.pdf Accessed 30 March 2024

5 The CBN Circular. Op Cit. at Pg. 4

6 Ibid. at Pp. 1, 4, and 5

7 A private placement involves a sale of equity or debt instruments to pre-selected investors such as Eligible Institutional Investors and High Net Worth Individuals, rather than on the open market.

8 A rights issue is a method through which a company can raise capital by offering existing shareholders the opportunity to purchase additional shares at a predetermined price, typically below the current market value. This strategy is commonly employed by companies seeking to recapitalise or bolster their financial position. This is an attractive means to recapitalise as it is a quick and efficient way to raise capital and, in addition, shareholders purchase new shares at discounted prices. The major disadvantage is the fact that there is a restriction on the maximum amount of capital that a rights issue can raise as it is usually tied to a company's equity value.

9 Offer for subscription involves an invitation to the general public to subscribe for new shares in a company. This is different from offer for sale which involves shareholders selling part of their shares to the general public.

10 Mergers involve two or more entities coming together to become one stronger entity while acquisition involves a stronger entity (the acquirer) acquiring a weaker entity (the target) by controlling its assets and operations, thus becoming stronger.

11 Especially for low-tier banks, we might experience situations where banks which are unable to meet the required minimum capital for their license authorisations downgrade to lower authorisations.

12 The CBN Circular. Op. Cit. at Pg. 2

13 An IPO is the process whereby a company publicly sells its stock for the first time.

14 Example is bond issuance where investors purchase bonds from the issuer by advancing money to the issuer in the form of loan and collecting periodic interest and principal upon maturity.

15 This is the conversion of illiquid assets usually mortgages, loans, etc. into marketable securities to be sold to investors for the purpose of raising immediate cash.

16 This is the amount of money received by a company from investors for shares sold on the primary market, usually through initial public offering (IPO). Paid-up capital can only be created when a company sells its shares to investors on the primary market. Sales amongst shareholders on the secondary market do not bring additional paid-up capital to the company as proceeds from such sales go to the selling shareholders rather than the company.

17 Share premium is the excess money received for issued shares above the par value

Breakdown of the Minimum Capital Requirements

The Programme requires a minimum capital requirement of N500 billion for commercial banks with international authorisation, and N200 billion and N50 billion for banks with national and regional authorisations, respectively. Merchant banks with national authorisation are required to have a minimum capital of N50 billion. Non-interest banks with national and regional authorisations require N20 billion and N10 billion minimum capital, respectively.[6]

To meet these minimum capital requirements, banks may consider injecting fresh equity capital through private placements,[7] rights issues,[8] and/or offer for subscription.[9] Other available options include mergers and acquisitions[10] and/or upgrade or downgrade of licenses.[11][12] It must be noted that, of all the stated options, only rights issues and a downgrade of licenses will not have a dilutive effect on the bank's shareholding structure. Although the CBN was specific about the options available for banks to inject fresh capital, this list is not exhaustive and other options open to banks include initial public offering (IPO),[13] issuance of fixed-interest securities,[14] securitisations,[15] etc

6 Ibid. at Pp. 1, 4, and 5

7 A private placement involves a sale of equity or debt instruments to pre-selected investors such as Eligible Institutional Investors and High Net Worth Individuals, rather than on the open market.

8 A rights issue is a method through which a company can raise capital by offering existing shareholders the opportunity to purchase additional shares at a predetermined price, typically below the current market value. This strategy is commonly employed by companies seeking to recapitalise or bolster their financial position. This is an attractive means to recapitalise as it is a quick and efficient way to raise capital and, in addition, shareholders purchase new shares at discounted prices. The major disadvantage is the fact that there is a restriction on the maximum amount of capital that a rights issue can raise as it is usually tied to a company's equity value.

9 Offer for subscription involves an invitation to the general public to subscribe for new shares in a company. This is different from offer for sale which involves shareholders selling part of their shares to the general public.

10 Mergers involve two or more entities coming together to become one stronger entity while acquisition involves a stronger entity (the acquirer) acquiring a weaker entity (the target) by controlling its assets and operations, thus becoming stronger.

11 Especially for low-tier banks, we might experience situations where banks which are unable to meet the required minimum capital for their license authorisations downgrade to lower authorisations.

12 The CBN Circular. Op. Cit. at Pg. 2

13 An IPO is the process whereby a company publicly sells its stock for the first time.

14 Example is bond issuance where investors purchase bonds from the issuer by advancing money to the issuer in the form of loan and collecting periodic interest and principal upon maturity.

15 This is the conversion of illiquid assets usually mortgages, loans, etc. into marketable securities to be sold to investors for the purpose of raising immediate cash.

For existing banks, only paid-up capital[16] and share premium[17] shall be considered for the purpose of meeting the new minimum capital requirements.[18] Shareholders' fund, bonus issues, retained earnings, other reserves and additional tier 1 (AT1) capital shall not be considered. In taking this approach, the CBN aims to ensure that only funds directly injected into the economy are considered and not mere accounting entries. Despite the capital increase, banks are expected to ensure strict compliance with the minimum capital adequacy ratio (CAR)[19] requirement applicable to their licenses. Banks that breach the CAR requirements shall, in line with extant regulations, be required to inject fresh capital to regularize their position. Banks have between 1 April 2024 and 31 March 2026 to comply with this new requirement.[20]

For proposed banks, the minimum capital requirement shall be paid-up capital and applicable to all new applications for banking licenses submitted after 1 April 2024. Processing of all pending applications for banking licenses for which capital deposit has been made and/or approval-in-principle (AIP) granted shall continue. Promoters of such proposed banks shall, however, supplement the disparity between the capital deposited with the CBN and the new capital requirement not later than 31 March 2026.[21]

In determining the new minimum capital requirements, the CBN considered the following factors: risk profile of banks; global and domestic headwinds and their potential impact on banks' balance sheets; impact of inflation; stress tests of banks' balance sheets, to gauge their resilience to absorb current and unexpected shocks.[22] It is expected that the CBN will issue guidelines to regulate the approaches to meeting the new capital requirement.[23]

As part of its obligations to monitor and ensure compliance with the new requirements, the CBN has requested all banks to submit an implementation plan (clearly indicating the chosen option(s) for meeting the new capital requirements and timelines for implementation).[24] The implementation plan will provide the CBN with a clear-cut view on how the respective banks plan to meet these requirements. The implementation plan is to be submitted not later than 30 April 2024

Anti-Money Laundering Check/Fit and Proper Check

To prevent the use of illicit funds for the recapitalisation process, the CBN has put in place robust anti-money laundering regulations which shall be strictly enforced in collaboration with relevant law enforcement agencies. Banks will also be required to ensure that appropriate anti-money laundering screening/checks, i.e. Know Your Customer, Customer Due Diligence, and Suspicious Transactions Monitoring, etc., are conducted.[25] This is essential to curb any attempt to meeting this new minimum capital requirement through illegitimate funds

16 This is the amount of money received by a company from investors for shares sold on the primary market, usually through initial public offering (IPO). Paid-up capital can only be created when a company sells its shares to investors on the primary market. Sales amongst shareholders on the secondary market do not bring additional paid-up capital to the company as proceeds from such sales go to the selling shareholders rather than the company.

17 Share premium is the excess money received for issued shares above the par value

18 AT1 capital are special type of bonds with no fixed maturity. They act like equity but are different, in that they are able to absorb losses prior to, or at the point of insolvency.

19 CAR is a means by which regulators determine capital adequacy for banks. A minimum CAR helps to ensure that banks have enough financial cushion to absorb a reasonable amount of losses before becoming insolvent. The CAR can be calculated by dividing a bank's capital by its risk-weighted assets.

20 The CBN Circular. Op. Cit. at Pg. 2

21 Ibid. at Pg. 2

22 Ibid. at Pg. 6

23 Ibid. at Pg. 7

24 Ibid. at Pg. 3

25 Ibid. at Pg. 6

Furthermore, the CBN will ensure strict enforcement of fit and proper checks for all prospective and significant shareholders, directors and senior management staff of banks.[26] This is to prevent unfit persons assuming management positions of banks

CBN's role in the Recapitalisation Process

The role of the apex bank in the recapitalisation process will be to monitor and supervise compliance with set guidelines. In doing so, the CBN will conduct on- and off-site reviews, verify capital, intervene periodically where necessary and conduct broad stakeholder engagements.[27]

The CBN will also collaborate with the Nigeria Deposit Insurance Corporation (NDIC) to ensure that depositors' interests are protected during the Programme.[28]

Finally, the CBN will enforce sanctions for non-compliance in line with the provisions of extant laws and regulations.[29]

CONCLUSION

The prevailing macroeconomic issues in the national economy and the attendant economic challenges underscore the urgent need for banks' recapitalisation in Nigeria. The Programme is positioned to provide Nigerian banks with the much-needed resilience to withstand and absorb unexpected economic tremors and place them in a better position to contribute to the growth of the economy. However, the Programme may also present some shortcomings. For instance, the mergers of some banks, especially low-tier banks, that are unable to meet the new capital requirement and the acquisition of others by stronger banks could likely lead to monopolies in the Nigerian banking sector.

26 Ibid. at Pg. 6
27 Ibid. at Pg. 7
28 Ibid. at Pg. 7
29 Ibid. at Pg. 8; Section 9(2) of BOFIA 2020

AUTHORS

Kehinde Adegoke
Associate
Corporate, Commercial, and Business Advisory
kadegoke@alp.company

Babatunde Shobayo
Associate
Corporate Commercial, Commercial Litigation
& Dispute Resolution
bshobayo@ap.company