



The Legal Luminary

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A.B. Nyako

From the Editor!

Welcome once again to another fresh and interesting edition of "The Legal Luminary". This month Nigeria marked her 52nd Independence Anniversary. It was indeed a time for Nigerians from all works of life to reflect on the state of our economy. While our nation is still not the Nigeria of our dreams there is hope that eventually we shall get there and take our proper place in the Committee of Nations.

This month our feature article is an excerpt from a paper delivered by the able and erudite Director Legal and Board Secretary A. B. Nyako at a recently concluded sensitization seminar for Judges organized by the CBN. It's a summary of some of the distress resolutions options available in Nigeria. As always we look forward to your comments and questions.

Q. WHAT IS PURCHASE AND ASSUMPTION (P&A) TRANSACTION?

A. P&A is a resolution transaction in which a healthy institution *purchases* some or all of the assets of a failed bank and *assumes* some or all of the liabilities, including all insured deposits. P&A is less disruptive than payoffs and other methods of resolution. P & A is one of the resolution methods used the Central Bank and the Nigeria Deposit Insurance Corporation. Other methods used in failure resolution include deposit payoffs, open bank assistance and bridge banks. It is noteworthy that bridge bank is considered as a variation of P& A transaction in some jurisdictions.

Some categories of assets *never* pass to the assuming banks in a P&A; they remain with the liquidator, e.g claims against former directors and most times loan assets as experience has

shown especially during 2006, when some healthy banks namely Zenith Bank, Ecobank and Afribank purchased and assumed the assets of some eleven banks that were under liquidation. The assuming banks showed little or no interest in the loan assets of the acquired banks

The merits of P&A include:

1. Giving depositors easy access to their funds without conditions.
2. Facilitating continuity of banking services in the same premises used by the failed banks.
3. Encouraging depositors to establish banker-customer relationships with acquiring banks.
4. Promoting banking culture which is critical to savings mobilization for economic development.

However, for all its advantages P&A is not without some challenges, notably liquidation-related cases by the owners of the failed banks. This often combined with protracted or lengthy process of adjudication of Nigerian

DISTRESS RESOLUTION OPTIONS IN THE NIGERIAN BANKING SECTOR

Notes & Quotes

The biggest mistake that you can make is to believe that you are working for somebody else...The driving force of a career must come from the individual. Remember: Jobs are owned by the company, you own your career! - **Earl Nightingale**

Most folks are about as happy as they make up their minds to be. - **Abraham Lincoln**

NEWS

Outrage has followed the brutal killing of four students of the University of Port Harcourt by residents of Aluu community in Rivers State. Police has arrested 8 suspects implicated in their death.

Shareholders of First City Monument Bank (FCMB) and FinBank have unanimously approved the proposed merger of the two banks.

15 killed and 100 people killed in suicide bomb attack on St Rita's Catholic Church, Kaduna

FIRS has collected N3.81 trillion as revenue and has surpassed its 2012 target.

Banking sector credit to the private sector has increased to N14.928 trillion.

Gov. Suntai of Taraba State and five other critically injured after a plane piloted by him crashed.

Although, banking is a commercial business, it is a business with a difference. It is so important to the economy of any nation that nowhere in the world is that business left to the whims and caprices of the business owners [shareholders] without appropriate regulation/supervision. The main objectives of regulation and supervision are to promote safe and sound banking system, minimize the risk of failure, provide protection for depositors in the event of failure thereby promoting public confidence in the system and ensuring the stability of the financial system, a necessary ingredient for a vibrant economy.

Bank failure resolution refers to the set of principles, options or measures adopted by the bank supervisory authorities to resolve the distressed condition of an insured institution. The distress could be liquidity problem, capital deficiency, management weakness, etc. The main objectives of failure or distress resolution are: the maintenance of public confidence and stability in the banking system, by minimizing the risk of loss of depositors' fund and achieving a minimum disruption in the payment system. There are essentially two broad forms of failure resolution:

- [i] Open Bank Assistance; and
- [ii] Closed Bank Resolution

Open Bank Assistance

In open bank assistance, all efforts are geared towards the resuscitation of a distressed bank, with a view to restoring it to a viable status with adequate capital and sound management. In that regard, the Corporation and the Central Bank of Nigeria could adopt a number of open bank resolution measures like:

- Granting of financial assistance which could be in form of loans, guarantee for loans or the grant of accommodation bill facilities. This type of support is generally appropriate where the bank is suffering from temporary liquidity constraints.
- Imposition of Holding Actions which basically tells the bank to take or not to take certain actions relating to its operations - This is usually adopted to avert further dissipation of assets and to increase capital base
- Changes in Management which entails removal of key staff who may have acted in a manner detrimental to the interest of the bank and the appointment of replacements.

- Takeover of control and management which entails the dissolution of the Board or removal of the entire Management Team.

SOCIAL DIARY

Eid Mubarak in arrears to our Muslim brothers and sisters on the successful celebration of Eid-el Edha.

Congrats to Bernard Iorhuna of the LSU, (Legal dept) who wedded his sweetheart Blessing Ngumimi on the 27th October, 2012 at Markudi, Benue State. Luminary wishes the newlyweds a blissful married life.

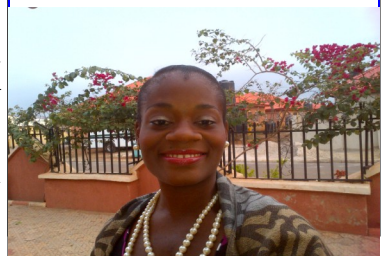
Promotion examination for the year 2012 which was slated to hold on the 26th has now been postponed to the 12th of November, 2012. We are wishing all the candidates success

Hip! Hip! Hurray

Happy birthday to our amiable colleague Opeyemi Rafiah Yusuf of the Board Secretariat Unit, Legal Dept who added a year on 20th October.

REPLY BRIEF

Congratulations! to our loyal reader and staff of IAD, Mrs Nneka Ajaero who celebrated her birthday on Independence day! Wish you many more joyous years!



Closed Bank Resolution

Where the financial condition of the bank is considered grave, especially where the bank had become insolvent, the resolution option could take a more serious dimension and could involve the closure of the bank, even if another bank could emerge from the closed bank. These options include:

Outright liquidation and deposit payout

The adoption of this option would require the revocation of the licence of the bank by the Central Bank of Nigeria, consequent upon which the Corporation automatically assumes the role of Liquidator pursuant to the provisions of Section 40 of NDIC Act. The Corporation thereafter, takes over control of the bank and prepares the Statement of Affairs which basically determines the total assets and liabilities of the institution as at the closing date. Simultaneously, the Corporation files a petition for Winding Up of the closed bank with a view to obtaining a Winding Up Order and also gives notice to depositors and other creditors with a request for them to file their claims.

As deposit insurer, the insured deposits are paid by the Corporation from its Deposit Insurance Fund [DIF]. As the liquidator, it commences realization of assets and payment of uninsured depositors and other creditors in line with the order of priorities established by law. The process is concluded by the termination of liquidation, the dissolution of the bank and discharge of the Corporation as a liquidator.

It is important to note that liquidation is usually adopted as a last resort resolution as if not well managed, it could destroy depositors confidence in the banking system. This is why the following alternative resolution options are usually considered:

Purchase and Assumption This ultimately entails the revocation of a distressed bank's licence. However, rather than proceeding to outright liquidation and deposit payoff, a healthy bank is approached, usually through competitive process to bid for the assumption of the liabilities and the purchase of all or some of the assets of the failed bank. Upon the consummation of the transaction, all the depositors of the failed bank would be transferred to the healthy bank where they would continue their banking relationship. The acquiring bank usually acquires the Branches of the failed bank together with other good assets. This would facilitate the continuation of banking business in the same building or as close by as possible. The residual assets and liabilities left over at the failed bank are thereafter, liquidated by the Corporation and the failed bank is eventually dissolved as a legal entity. A well consummated P&A would typically result in the closure of a failing bank after banking hours on Friday and the resumption of banking business by Monday in a different name.

The main challenge with the P&A approach is the usual variance between the liabilities to be assumed and the viable assets available for purchase by the acquiring bank. Typically, a deposit insurer can only guarantee the transfer of the insured deposits to the P&A partner, since it cannot fund the entire deposit liabilities.

The Corporation had consummated P&A transactions involving 11 banks closed in January, 2006 pursuant to the bank consolidation programme. However, it was a peculiar P&A framework as CBN had gratuitously guaranteed all Private Sector deposits in the 13 banks that remained closed pursuant to the consolidation programme. Consequently, in structuring the P&A transaction, the Corporation as Liquidator transferred not only the insured deposits but also all private sector deposits to the acquiring banks. The acquiring banks selected the assets of the failed banks in which they were interested, at agreed prices, often referred to as "Cherry Picking." The short-fall between the assets acquired and the deposit liabilities assumed by the healthy banks were then funded by CBN through the issue of promissory notes which the banks could discount for cash. However, like typical P&A arrangements, the unassumed liabilities and leftover assets remained with the estate of the failed banks and being liquidated by the Corporation in its capacity as liquidator and the proceeds used to pay public sector depositors and the subrogation rights of CBN and NDIC.

It is significant to note that contrary to the wrong assumption in some quarters the healthy banks involved in the P&A arrangement did not acquire the failed banks as going concerns and could not therefore be described as successors-in-title to the liabilities of the respective closed banks. Rather, the Corporation as liquidator in the course of realization of assets of failed banks in liquidation, by contract transferred responsibility for payment of only private sector deposits and insured public sector deposits. They did not step into the shoes of the failed banks and therefore, the joining of the healthy banks as Parties in the suits against the closed banks is in error.

Bridge Bank Resolution This resolution mechanism is the most recent addition to the list of resolution options available to supervisory authorities in Nigeria. While the option had been one of the traditional measures adopted by the Federal Deposit Insurance Corporation [FDIC] of the United States for decades, the option was introduced in Nigeria in 2006 following the amendment of the NDIC Act.

The Bridge Bank's option is an interim resolution measure, adopted where there is no P&A partner among the healthy banks readily available for the consummation of P&A transaction, and outright liquidation is considered not an appropriate option, either because of the size of the bank or other considerations. In such situations, the Corporation is empowered under Section 39 of the NDIC Act, 2006 to incorporate a limited liability company and obtain a bridge bank licence from CBN. Its main objective is to acquire assets and assume deposit liabilities of a failing bank and then continue providing banking services until a P&A partner is sourced or otherwise recapitalized by another investor, usually within 2 years or an extended period. The bridge bank could provide banking services and is also allowed to operate with insufficient capital and enjoys forbearance from regulatory requirements.

There are a number of legal and prudential reasons for the adoption of the bridge bank option. Firstly, it is a legal channel of removing the authority of the shareholders of the failing institution. One of the guiding principles for failure resolution is that public funds are not to be provided for distressed banks, primarily for the benefit of shareholders who as the owners are regarded as the cause of the failure of their banks. After all, they appointed the Board members and are supposed to have provided oversight on management. Moreover, by the time the capital of the bank is eroded to insolvent status, the shareholders have technically lost their investments. In general terms, they are not to benefit from failure resolution.

It is important to recognize that all the key resolution measures, especially those that entail the revocation of banking licence are expected to result in shareholder resistance. Therefore, if the shareholders are aware that the Central Bank of Nigeria would revoke the licence of their banks, they would surely approach the Court for injunctive relief. The risk however, is that by the time the injunctive proceedings would be over, the bank would be as good as closed as a result of deposit run. That informed the basis for the absolute confidentiality required for any serious resolution measure. In the case of bridge bank resolution, the need for confidentiality is even more paramount, because of the complex process of incorporation of companies, application for bridge bank licence and the consummation of P&A with the bridge bank. Any leakage at any stage of the process could result in adverse litigation. That is why the Corporation first incorporated shelf companies with uncommon names that were later changed at the critical time, and the process executed swiftly for the success of the resolution option. So, for the first time, NDIC was able to emulate the Federal Deposit Insurance Corporation model of closing a bank on Friday and resumption of banking business on Monday under a different structure.

The above are the key distress resolution options available and NDIC has been able to employ all of them successfully.