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Dealing with bank insolvency: regulatory intervention and criminal prosecution

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Introduction
Regulatory intervention
Use of criminal prosecution as a tool to manage bank insolvency

Introduction

In 2009 the impact of the global economic crisis in Nigeria shifted from the capital market to the banking sector due to the negative effects of unregulated bank margin lending practices in the capital markets and bank exposure in the oil and gas sector. This shift was unsurprising as the bulk of capital market transactions were, and still are, tied heavily to dealings in bank shares. Fifty percent of all capital market activities on the Nigerian stock exchange involve banking stocks. By 2009 an estimated $10 billion of toxic assets were held by banks whose assets suffered capital erosion due to the market collapse,(1)making the recapitalization of banks a key imperative. In terms of insolvency practice, a significant development arising from this situation has been the fact that statutory regulatory agencies involved with intervening in bank insolvency have resorted to criminal prosecution in managing bank insolvency, as opposed to using the civil aspects of insolvency law.

Regulatory intervention

In 2009 the government intervened in order to protect financially troubled banks from the impact of the global financial crisis, or at least to lessen the effects of the crisis on them. Following a regulatory special audit of 24 banks, carried out in two rounds, the Central Bank of Nigeria (CBN), in conjunction with the Nigeria Deposit Insurance Corporation (NDIC), sacked certain managing directors, chief executive officers and executive directors of eight banks(2) on account of alleged mismanagement, lax governance, insider dealing and financial malpractice. However, the CBN stopped short of declaring the affected banks to be financially distressed within the technical meaning of the Failed Banks (Recovery of Debts) and Financial Malpractices in Banks Act (Cap F2, LFN 2004). Instead, the CBN injected N420 billion into the sector as a bail-out package.(3)

The basis of these statutory powers of intervention as a tool for managing bank insolvency - and, more specifically, business rescue and restructuring - was said to come from several particular banking laws, such as the CBN Act 2007 and the Banks and Other Financial Institutions Act (Cap B3 LFN, 2004). Other banking statutes were also said to create a specific framework for the liquidation and/or sale of financially distressed banks and their

assets, including the NDIC Act 2006, which gives extensive powers to the NDIC as bank liquidator.(4) However, the functions of the CBN and NDIC sometimes overlap, particularly regarding oversight and powers to require information via periodic examinations.(5)

Under Sections 2 and 42 of the CBN Act, the CBN is responsible for promoting a sound financial system, acting directly or in collaboration with the Nigerian banks. To that extent, the CBN is statutorily empowered to lend moneys to any Nigerian bank facing liquidity problems on the terms and interest rates that it deems fit (Section 42(2)).

Under the Banks and Other Financial Institution Act, on the other hand, the CBN can supervise and regulate the activities of Nigerian banks and financial institutions (Section 61(1)), as well as ordering routine or special examinations of those banks to assess their financial health (Sections 61(2)(3)). The Banks and Other Financial Institutions Act further gives control and management powers to the CBN with respect to failing banks (Sections 30 to 38, particularly Sections 35 and 36).(6) The CBN has argued that these sections justify its recent intervention in the banking system.

In addition to the CBN's powers, the NDIC can, at the request of a failing bank, assist in the restructuring of that bank by providing a (convertible) loan or giving a guarantee for a loan taken out by such institution, or by accepting an accommodation bill with short life span (usually 90 days).(7)

Use of criminal prosecution as a tool to manage bank insolvency

Another phenomenon that has become more prominent after recent CBN intervention has been the regulatory bank's use of criminal prosecution as a tool to manage bank insolvency, in particular for those in which the government has intervened.

Several specific laws have provided banking regulators such as the CBN, the NDIC and the Economic and Financial Crimes Commission (EFCC)(8) with the freedom to use criminal recourse against banks' directors/officers and customers. They are the Banks and Other Financial Institutions Act, the Failed Banks (Recovery of Debts) and Financial Malpractices in Banks Act, the EFCC (Establishment) Act 2004, the Money Laundering (Prohibition) Act 2004, the Investments and Securities Act 2007 and the Criminal Code. However, the applicability of these laws has been disputed by some of those charged with offences under them.

All but the Investments and Securities Act can be defined as penal statutes. However, following the Supreme Court decision in *FRN v Ifegwu*,(9) it may be argued - as has been attempted in certain ongoing criminal cases against directors affected by the intervention - that charges cannot be brought under a statute such as the Investments and Securities Act as it is not a penal statute *per se*.

The acts create a wide range of offences, including offences relating to:

- financial malpractice, false information and retention of proceeds of criminal conduct;(10)
- failure to keep proper accounts or to make proper monthly or quarterly returns;(11)
- reckless lending (ie, granting credit without (adequate) security or against the security of the bank's shares without the CBN's prior written approval;(12)
- involvement or dealings in the active trading of the bank's shares on the exchange or outside the exchange through the grant of credit facilities;(13) and
- conspiracy by fraudulent means to manipulate the bank's market price.(14)

The offences are said to be aimed at serving as a strong deterrent against insider dealing by managers and directors relating to depositors' funds.

As the criminal enforcement agency, the EFCC has general responsibility for prosecuting all such offences with the leave of the attorney general. However, it appears to have become a mere debt recovery agency, as many accused prefer to pay up on toxic assets rather than face prosecution. Therefore, it has been argued that the mere threat of criminal prosecution has proved a more effective tool for managing bank insolvency. In addition, the EFCC Act offers, either concurrently or alternatively to imprisonment, the confiscation and forfeiture of the personal assets of those convicted. It has been argued that these powers provide a safety net for the recovery of allegedly mismanaged or diverted funds so that the risk posed by the automatic (but limited) indemnity under Section 20 of the NDIC Act 2006 is eliminated. Again, the constitutionality of these expropriatory provisions has been challenged. In *Nwaigwe v EFCC* the Court of Appeal held Section 29 of the EFCC Act, which allows for the *ex parte* forfeiture of assets, to be unconstitutional. Other cases are also challenging the validity of Section 28 of the EFCC Act, which allows for a temporary attachment of assets order.

Notwithstanding these challenges, it would appear that the recourse against directors and managers offered by these provisions is a more efficient way of managing bank insolvency, particularly compared to the general remedies under the Companies and Allied Matters Act. The general company law remedies available against directors of insolvent banks are not being used properly in practice.(15) Accordingly, the government, through its financial crimes investigative and prosecuting arm, the EFCC, has increasingly ordered the investigation of bank chiefs' assets,(16) as well as those belonging to executive directors and managers.

The EFCC Act empowers the EFCC to investigate the assets and properties of the person arrested; where the EFCC believes that the suspect's assets are the proceeds of financial crime and are in danger of disappearing, the EFCC can attach, seize or order the temporary forfeiture such assets or properties on arrest the suspect's arrest. In addition, the EFCC can obtain *ex parte* interim orders of attachment, seizure or forfeiture of such assets pending determination of the charges - such orders can become permanent on conviction.(17)

The remedies and the discretion allowed to the agency are not limited to recourse against alleged fraudulent banking officers, but are also available against debtor customers. Remedies are also available against debtors even before a bank is declared financially distressed by the CBN, as Sections 15(2) and 16 of the Failed Banks (Recovery of Debts) and Financial Malpractices in Banks Act penalizes individual or corporate customers which in any way provide misleading information to a bank in the course of applying for a loan, and subsequently default on repayment of such loan. Other offences, such as conspiracy by fraudulent means to manipulate a bank's share market price and the capital market offences created under the Investments and Securities Act, give the regulator additional options in regard to debtor customers, particularly capital market operators which are alleged to have conspired with bank officers to obtain loans or to be involved in money laundering.

As a result, the EFCC states that it had recovered over N45 billion (£180 million) from bank debtors by the end of 2009.

However, the use of criminal prosecution has its downside. Criticism has been levelled at the selective use of this tool against some bank directors by the government, casting doubt on how genuine the government's motives are. In addition, the burden is on the government to prove alleged offences beyond reasonable doubt. The risk of this high burden of proof, if the

government fails to obtain convictions or loses them on appeal, is that criminal prosecution as an option for managing insolvency would lose its impact. It has also been argued that some of the offences created are not proper offences that may be committed by bank directors or officers personally, but rather are corporate offences susceptible to being committed only by banks themselves. On the other hand, the infractions described under the Investments and Securities Act 2007 are viewed not as penal offences, but rather as regulatory penalties.

As part of the other measures to manage banking insolvency, and in line with Section 39 of the NDIC Act, which allows both the CBN and the NDIC to license what the provision describes as 'bridge banks', the government has recently developed a legal framework which creates the asset management company to acquire the toxic assets found in the balance sheets of financially troubled banks.

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Endnotes

(1) According to Eurasia Group, a New York-based research company. A statement credited to Bank of America Corp before the Nigerian Saturday Tribune of August 29 2009 stated that part of the bad debt being held by the banks is the result of at least N1 trillion of margin loans assessed to have been used to buy shares in the Nigerian capital market.

(2) From August to October 2009 CBN Governor Alhaji Sanusi Lamido removed from office the managing directors or executive directors of Afribank Plc, Union Bank Plc, Finbank Plc, Bank PHB Plc, Oceanic Intl Bank Plc, Intercontinental Bank Plc, Spring Bank Plc and Equitorial Trust Bank Plc. This has led to a series of civil cases brought by the removed directors challenging the grounds for the exercise of the CBN governor's powers, particularly as they were not given the opportunity to react to the report on which the governor based his decision.

(3) The legality - or rather, constitutionality - of the unilateral exercise of bail-out power was also challenged in some quarters of the Nigerian Parliament, where it was argued that the process was flawed to the extent that it did not defer to Parliament's powers to appropriate expenditure for all ministries, departments and agencies of the federal government. The CBN governor has since clarified that the bail-out sum was a legitimate convertible loan which differs from the periodic loan that the CBN gives to Nigerian banks to meet their commercial obligations only in terms of the longer maturity period. However, the broader issue is the question of who regulates the regulator - more so when the general consensus is that the banking industry is over-regulated, with too many statutory watchdogs, including the CBN, the NDIC and the EFCC (Nigerian Bar Association Section on Business Law session on "Regulating the Business Environment", Abuja, Nigeria).

(4) Sections 40 to 44, Part IX of the NDIC Act 2006. However, the enabling act also gives certain supervisory, examination and intervention powers to the NDIC which are to be exercised collaboratively with the CBN. The act imposes a duty for the NDIC to forward its special examiner's report to the CBN as well as to provide for joint examination by the two bodies to prevent duplication of costs and regulation and regulatory conflicts.

(5) Please see Part VI, Sections 27 to 31 of the NDIC Act 2006.

(6) Under Section 38 of the NDIC Act, the NDIC has a joint mandate with the CBN to take over management of failing banks, direct changes to be made on the board of the failing bank or arrange mergers and acquisitions between different banks.

(7) Section 37 of the NDIC Act

(8) These state authorities and bodies have adopted a collaborative and concerted approach to tackle efficiently the insolvency issues raised by the huge debt portfolio of banks and the fall-out problems arising in terms of management of the banks and the protection of depositors' interests, the protection of the financial system and the recovery of assets that have been fraudulently misappropriated.

(9) (2003) 15 NWLR Pt 842, 113 at 214 paragraph D.

(10) Sections 14 to 18 of the EFCC Act 2004.

(11) Sections 24 and 50 of the Banks and Other Financial Institutions Act.

(12) Sections 20(1)(b) and 20(2)(a)(ii) of the Banks and Other Financial Institutions Act and Sections 15(1)(a) and 16(1)(a) of the Failed Banks (Recovery of Debts) and Financial Malpractices in Banks Act.

(13) See Sections 105 to 106 of the Investments and Securities Act 2007.

(14) Section 422 of the Criminal Code.

(15) For example, see Section 279 of the Companies and Allied Matters Act on fiduciary duties of directors on breach of fiduciary duties, and Sections 504 to 508 (particularly Section 506) on fraudulent trading. The Business Recovery and Insolvency Practitioners of Nigeria has also been pushing for reform of the act's insolvency provisions and the enactment of a more comprehensive Insolvency Act.

(16) See article by Davidson Iriekpen, February 9 2009, *This Day Online*.

(17) See Sections 26, 28, 29, 30 and 31 of the EFCC Act 2004.

Comment or question for author

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