Assessing the Banking Sector Recapitalization Programme 2024 by the Central Bank of Nigeria (CBN)

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INTRODUCTION

Safety and stability are very vital to the health of any banking system.

Indeed, one of the principal objects of the Central Bank of Nigeria ("CBN") as stated in the CBN Act 2007 is to promote a sound financial system in Nigeria. One of the ways in which the CBN performs this function is to exercise its powers under section 9 of the Banks and Other Financial Institutions Act 2020 ("BOFIA") to the effect that it can from, time to time and in the interest of financial system stability, determine the minimum paid-up share capital requirement of the respective banks under the various licence categories. Upon such determination, all existing banks shall be obligated to comply within any timeline prescribed to avoid having their licenses being revoked.

Pursuant to these powers, the CBN in a Circular dated 28th of March 2024 titled "REVIEW OF MINIMUM CAPITAL REQUIREMENTS FOR COMMERCIAL, MERCHANT AND NON-INTEREST BANKS IN NIGERIA" ("Recapitalisation Circular") announced an upward review of the regulatory minimum capital requirements for commercial, merchant and non-interest banks in Nigeria.

BACKGROUND INSIGHTS

The Basel Accords

Driven by the need to enhance the regulatory environment for banking sectors in various jurisdictions across the world, the Basel Committee on Banking Supervision ("**BCBS**")[1], developed a series of three sequential banking regulation agreements known as Basel I, II, and III) (the "**Basel Accords**").

The Basel Accords have been developed in furtherance of the BCBS' mandates of strengthening the regulation, supervision and practices of banks worldwide and enhancing the stability of financial systems.

Basel I was designed to improve banking stability through strong rules and supervision during a time of increasing bank failures and bankruptcy risks. Basel I weighed the capital that a bank holds to the credit risks that it faced.

Basel II is based on three pillars: minimum capital requirements (expanding on the provisions in Basel I), regulatory supervision, and market discipline and focused on strengthening the capital requirements of banks by establishing three goals: (i) making a bank's capital more risk-sensitive, (ii) promoting enhanced risk management tactics among larger banks, (iii) create a common means for evaluating banks from one country to another.

[1] A global committee of banking supervisory authorities constituted by the central bank governors of several countries.

Basel III is also based on three pillars being: (i) providing capital and liquidity adequacy minimum requirements (ii) outlining supervisory monitoring and review standards; and (iii) promote market discipline through prescribed public disclosures.

The inadequacy of Basel I and II was revealed by the global financial crisis of 2007 - 2009 which resulted in catastrophic losses and near collapse of the global financial system. The global financial crisis necessitated a thorough reevaluation of risk management practices. In response, **Basel III** was developed to prevent a reoccurrence of such crisis. The implementation of Basel III started globally in January 2013, although the transition window is open till 2028. It provides rules on liquidity, leverage, systemic risk factors and emphasizes the importance of strong liquidity and capital for financial stability.

Implementation in Nigeria

In Nigeria, implementation (initially planned for 2020), was delayed due to the outbreak of COVID-19. However, the CBN by its circular dated 21 September 2021 commenced the adoption of Basel III principles in November 2021 with the release of Basel III Reporting Guidelines/Templates[2] for implementation. ***The circular clearly provides that capital add-on will be introduced in a phased manner as part of the overall supervisory process to enhance better risk management practices and better align the capital of banks with their risk profiles.***

RECAPITALISATION CIRCULAR

Purpose

In the Recapitalisation Circular, the CBN requires commercial banks, merchant banks, and non-interest (Islamic) banks operating in Nigeria ("**Affected Banks**", each an "**Affected Bank**") to increase their minimum paid-up share capital (equity capital) to a threshold as specified below based. The new threshold is categorized by banking license and for the purpose of strengthening the sector against potential shocks and enhancing financial system stability. The CBN believes that by increasing capital requirements, banks will have a stronger capital base to absorb unexpected losses and have greater capacity to provide credit to support economic growth towards President Tinubu's target of the "***$1 trillion economy by 2030***".

[2] **Guidelines on Regulatory Capital;** Guidelines on Leverage Ratio; Guidelines on Liquidity Coverage Ratio; Guidelines on Liquidity Monitoring Tools; Guidelines on Large Exposures and Guidelines on Liquidity Risk Management and Internal Liquidity Adequacy Assessment Process

COMMERCIAL

INTERNATIONAL	NATIONAL	REGIONAL
Old Minimum Capital	**Old Minimum Capital**	**Old Minimum Capital**
N50,000,000,000	N25,000,000,000	N10,000,000,000
New Minimum Capital	**New Minimum Capital**	**New Minimum Capital**
N500,000,000,000	N200,000,000,000	N50,000,000,000

MERCHANT

NATIONAL
Old Minimum Capital
N15,000,000,000
New Minimum Capital
N50,000,000,000

NON-INTEREST

NATIONAL	REGIONAL
Old Minimum Capital	**Old Minimum Capital**
N10,000,000,000	N5,000,000,000
New Minimum Capital	**New Minimum Capital**
N20,000,000,000	N10,000,000,000

Minimum Capital Requirements, Capital Adequacy Ratio and Capital Buffers

The CBN **Guidelines on Regulatory Capital 2021** ("**RC Guidelines**") which adopts the Basel III's provision on composition of capital, provides that the total regulatory capital for banks is the sum of Common Equity Tier 1 (**CET1**)[3], Additional Tier 1 Capital (**AT1**)[4] and Tier 2 Capital (**T2**)[5], net of regulatory adjustments. Tier 1 capital is the sum of CET1 and AT1 capital, net of the regulatory adjustments applied to those categories.

Under the Recapitalisation Circular, it is important to note that it clearly provides that the revised minimum capital requirement for existing banks, shall be paid up capital and share premium[6] and specifically excludes shareholders' funds (typically comprising of retained earnings, treasury shares) and AT1 capital. The exclusion of shareholders' funds for the purpose of calculating the new minimum capital requirement has been objected to in Nigeria by certain bankers citing that this approach fails to acknowledge the actual value that these earnings represent which goes against the conventional and legal treatment of a company's capital structure.[7]

Notwithstanding the proposed changes in the Recapitalisation Circular, the CBN requires that Affected Banks must continue to maintain capital adequacy ratio ("**CAR**") that applies to their respective license categorization as follows:

S/N	LICENCE CATEGORY	CAR
1	International banks and domestically systemically important banks (D-SIBs)	15% of risk-weighted assets.
2	National	10% of their risk-weighted assets
3	Regional	10% of their risk-weighted assets;

[3] CET1 capital consists of the sum of common shares issued by the bank, stock surplus (share premium) resulting from the issue of instruments included in CET1, retained earnings (only audited components), Small and Medium Enterprises Equity Investment scheme (SMEEIS) reserves and or any other scheme as may be stipulated from time to time by the CBN, statutory reserve, common shares issued by consolidated subsidiaries of the bank and held by third parties that meet the criteria for inclusion in CET 1 capital, and other reserves as may be determined by the CBN. The CET1 capital criteria must be met solely with common shares and the rare cases where banks need to issue non-voting common shares as part of CET1, they must be identical to voting common shares of the issuing bank in all respects except the absence of voting rights.

[4] Additional Tier 1 capital (AT1) consists of the sum of the following elements: (a) Instruments issued by the bank that meet the criteria for inclusion in AT1 capital and not included in CET1;(b) Stock surplus (share premium) resulting from the issue of instruments included in AT1 capital; (c) Instruments issued by consolidated subsidiaries of the bank and held by third parties that meet the criteria for inclusion in AT1 capital and are not included in CET1 capital.

[5] Tier 2 capital consists of the sum of the following elements; (a) Instruments issued by the bank that meet the criteria for inclusion in Tier 2 capital e.g bonds (and are not included in Tier 1 capital); (b) Stock surplus (share premium) resulting from the issue of instruments included in Tier 2 capital; (c) Instruments issued by consolidated subsidiaries of the bank and held by third parties that meet the criteria for inclusion in Tier 2 capital and are not included in Tier 1 capital (d) Regulatory adjustments applied in the calculation of Tier 2 capital.

[6] Whenever shares are issued at a price higher than the face value of such shares, the excess portion of the price is called a "share premium" and share premiums are required by law to be paid into a share premium account. See Section 145 of the Companies and Allied Matters Act No.3 2020

[7] Bankers oppose exclusion of retained earnings in CBN recapitalization terms – Nairametrics accessed at https://nairametrics.com/2024/03/29/recapitalization-bankers-oppose-cbns-exclusion-of-retained-earnings-in-calculating-minimum-capital/ on 29th March 2024

Capital Raise Options

The following options are provided in the Recapitalisation Circular to meet the new capital requirement.

a. Fresh capital: where an Affected Bank raises new capital by

i. ***Private Placement*** - the issue of securities by public company to select persons, not more than 50 subscribers[8].

ii. ***Rights Issue*** **–** where existing shareholders of an Affected Bank are granted pre-emptive rights[9] to purchase the newly issued shares in proportion to their existing shareholding in the shares of such Affected Bank.

iii. ***Offer for subscription*** – where members of the public are invited to subscribe for new unallotted shares in an Affected Bank at a fixed price.[10]

b. **Mergers and Acquisitions (M&A) –** where an Affected Bank can either merge with, acquire or allow itself to be acquired by another Affected Bank[11]

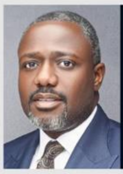
c. **Downgrade of License Category –** where an Affected Bank, sees that it is unable to or will be unable to meet the new capital requirement by the above stated options and within Compliance Timeline, a strategic option may be to consider a re-categorisation of its current license as means of meeting the new capital requirements. Using a national bank as an example, a strategic alternative to being under-capitalised is for such national bank to re-categorise as a regional bank, which has a lower capital threshold[12].

Accordingly, all existing banks are not later than **30 April 2024** required to submit to the CBN, an **implementation plan** indicating their chosen option and timelines for meeting the capital requirement. Existing banks are required to meet the new requirements by 31 March 2026. The new provisions will apply to any new applications for a banking license that is submitted after 01 April 2024 and all current banking license applications that have been granted approval in principle or for which capital deposits have been made also have till 31 March 2026 to comply with the new capital requirement.

CONCLUSION

In essence, the purpose of regulations on minimum capital is to ensure banks have adequate capital bases, while the buffer requirements aim to make such banks more resilient by requiring extra capital to be held for difficult periods. The higher the capital levels, the better a bank can withstand shocks.

[8] Rule 399 and 400, Securities and Exchange Rules, As Amended ("**SEC Rules**")
[9] Section 141 of the Companies and Allied Matters Act No.3 2020
[10] Rule 279, Securities and Exchange Rules, As Amended ("**SEC Rules**")
[11] See Section 710 – 712 of the Companies and Allied Matters Act No.3 2020
[12] As a regional bank, such national bank (now a regional bank) is still able to maintain physical offices within up to 12 States in not more than 2 geo-political zones and also in the Federal Capital Territory. See Paragraph 2(2) of the Central Bank of Nigeria Scope, Conditions & Minimum Standards for Commercial Banks Regulations No. 01, 2010



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