

Review of the New Minimum Capital Requirements for Commercial, Merchant and Non-interest Banks in Nigeria

OALP M & A NEWSLETTER

INTRODUCTION

The second quarter of 2024 began with the directive by the Central Bank of Nigeria (the CBN) to all commercial, merchant and non-interest banks in Nigeria prescribing new minimum capital requirements for such banks. This directive was issued through Circular No. FPR/DIR/PUB/CIR002/009 to All Commercial, Merchant and Non-interest Banks; and Promoters of Proposed Banks dated 28 March 2024 titled Review of Minimum Capital Requirements for Commercial, Merchant and Non-Interest Banks in Nigeria (**the Circular**).

This directive increasing the minimum share capital of banks had been anticipated in many quarters following the speech by the CBN Governor, Mr. Olayemi Cardoso on 24 November 2023 at the 2023 Annual Bankers Dinner of the Chartered Institute of Bankers of Nigeria (CIBN).¹ This was also followed by the CBN Governor in a meeting, days before the directive was issued, urging Nigerian banks to expedite action on the recapitalisation of their capital base in order to strengthen the financial system.

In the Circular, the CBN enunciated that its objective for

the recapitalisation is to ensure banks have a robust capital base to absorb unexpected losses and capacity to contribute to the growth and development of the Nigerian economy. Further to this, the CBN launched the Banking Sector Recapitalization Programme 2024, which, according to the CBN, became necessary to further strengthen Nigerian banks against external and domestic shocks as well as enhance the stability of the financial system.

An increased capital base serves as a cushion to protect depositors and other stakeholders in case of adverse events or challenges in the financial sector. The capital base plays a crucial role in ensuring the stability and soundness of the banking system. It acts as a measure of a bank's financial strength and ability to withstand unexpected distress. Furthermore, it instils confidence in depositors, investors, and other stakeholders, fostering trust in the banking system. In this newsletter, we delve into a comparison of the previous position with the present, analyse the objectives behind the Circular, its potential impact on the banking landscape, and the recapitalisation options available to affected banks.

1. Full text of speech available at [FULL TEXT: CBN gov, Olayemi Cardoso's speech at CIBN dinner - Tribune Online \(tribuneonlineng.com\)](https://tribuneonline.com/olayemi-cardoso-s-speech-at-cibn-dinner) accessed on 4 December 2023



BANK RECAPITALISATION IN NIGERIA: A FAMILIAR TERRAIN

Significant reforms in the banking sector of Nigeria can be traced to interventions by the CBN at different points in the history of the sector in Nigeria. The CBN in December 2000 vide the Universal Banking Guidelines, authorised banks to engage in non-core banking financial activities, either directly as part of banking operations, or indirectly through designated subsidiaries. Other than the reversal of the universal banking model in 2010 pursuant to the CBN Regulation on the Scope of Banking Activities and Ancillary Matters by which all banks were directed to divest from noncore banking subsidiaries, other key interventions by the CBN which yielded tremendous impact on the sector have been bank recapitalisation directives affecting banks across different levels and tiers.

The 2005 recapitalisation drive began with a directive by the apex bank regulator in 2004 announcing an increase in the minimum share capital of banks from N2 billion to N25 billion, effective 31 December 2005, as part of a 13-point reform agenda. This directive which came with a regulatory option for mergers and acquisitions, true to its objective, facilitated a contraction in the number of banks in Nigeria from 89 to 25 – by about 72 percent. 19 banks emerged from M&As involving 70 banks and six banks remained as stand-alone banks. The remaining 13 banks failed.² Accordingly, the emerging banks jointly accounted for about 93.5 percent of the total market deposits, while the remaining 13 failed banks accounted for the rest (6.5%).³ 19 years after, following the forex illiquidity currently being experienced in Nigeria and the 1 trillion-dollar economy-goal of the incumbent political leadership, the CBN has directed all banks to hold a minimum share capital as prescribed in the Circular.

KEY HIGHLIGHTS FROM THE CBN'S BANK RECAPITALISATION DIRECTIVE

The CBN Circular introduced changes to the 2005 requirement of the minimum capital base of banks in Nigeria as well as other significant changes around the nature of capital required, as highlighted below:

● Increase in capital requirement

Type of Banks	Authorisation	Minimum Capital ⁴ (N 'Billion) (2024)	Minimum Capital (N 'Billion) (2005)
Commercial Banks	International	500	50
	National	200	25
	Regional	50	10
Merchant Banks	National	50	15
Non-interest Banks	National	20	-
	Regional	10	-

The foregoing is a significant increase from the previous minimum capital requirement for banks as seen from the table above. It is important to note that by virtue of section 3.1 of the CBN Guidelines on Regulatory Capital 2021, the previous capital requirement comprised Common Equity Tier 1 (CET1) and Additional Tier 1 Capital (AT1)⁵ net of the regulatory adjustments applied to those categories, in line with the Basel III standards.

2. Central Bank of Nigeria, "Bank Consolidation: 25 Banks Meet December 31st Deadline", Press Release, Governor's Office, Jan. 3 2006 cited in C Agu and ors "Mergers and Acquisitions: The Nigerian Banking Consolidation Program", *The International Journal of Banking and Finance* (2011, Vol 8 No 4) p 20 available at <https://pdfs.semanticscholar.org/e667/62357effba917da376e8c13d22d9e16d0721.pdf> accessed on 31 March 2024.

3. *ibid.*

4. As seen in the Circular.

5. Common Equity Tier 1 capital (CET1) is the highest quality of regulatory capital for banks. It serves as a cushion to absorb any losses immediately when they occur. On the other hand, Additional Tier 1 capital (AT1) also provides a means of absorbing losses for banks on a going-concern basis. However, AT1 instruments do not meet all the criteria required for CET1 classification. For instance, certain types of debt instruments, like perpetual contingent convertible capital instruments, may be included in AT1 capital but not in CET1 capital.

● Exclusion of shareholders' fund from minimum capital requirement

Unlike the previous minimum capital requirement for banks which included shareholders' funds, the Circular categorically states that the minimum capital shall comprise paid-up capital (and share premium for existing banks) only. We note that this requirement is a stricter one as it eliminates retained earnings, a critical component of capital which banks historically had utilized for recapitalization. Similarly, Additional Tier 1 Capital (AT1 Capital) will be ineligible when calculating minimum paid-up capital. Historically, the CBN allowed banks to include AT1 Capital in the computation of a bank's regulatory capital. The Circular also added that notwithstanding the capital increase, banks must ensure to comply with the minimum capital adequacy ratio (CAR) according to the cadre of the license held and the relevant reserves shall continue to be recognised in the computation and determination of the risk-based CAR.

● Next Steps & Timeframe for Compliance

In compliance with the directive of the CBN, banks were expected to submit by 30 April 2024, an implementation plan which clearly indicates options the bank intends to explore in meeting the upgraded capital requirement. The weeks following the issuance of the CBN directive witnessed banks strategizing on various capital raising options and working towards putting together the implementation plan to meet the 30th April deadline stipulated by the CBN. The market witnessed a number of banks and their holding companies approaching their shareholders for shareholder approvals for proposed capital raising activities in compliance with the CBN directive.⁶

Banks have been directed by the CBN to recapitalize within a 24-month period, commencing from 1st of April 2024 and terminating on March 31, 2026, for existing banks and proposed banks for which capital deposit has been made and/or approval-in-principle has been granted. However, for new applications for banking license, the new rules shall apply from April 1, 2024.



RECAPITALISATION OPTIONS

The Circular set out recapitalisation options as follows:

- issuance of new common shares (by way of public offer, rights issues, or private placements);
- mergers and acquisitions (M&As); or
- upgrade/downgrade of their respective license category or authorisation.

The CBN has committed to issuing guidelines to prescribe the definition, options and approaches to meeting the new minimum capital requirement.

PROJECTIONS/RECOMMENDATIONS

Exciting times lie ahead of the Nigerian banking industry which have already been heralded by this recapitalisation directive. Interestingly, Mr. Bismarck Rewane in presenting his Economic Review and Investment Outlook had commented that *“top Nigerian banks are set for recapitalisation exercise in 2024, merger and acquisition is imminent (sic), recapitalisation will further strengthen the financial health and liquidity of Nigerian banks, and Nigerian banks will continue to be a major beneficiary of high yields from investment securities.”*⁷

The increase of the capital base for Nigerian banks, as mandated by the CBN, is a significant step towards strengthening the stability and resilience of the banking sector. This regulatory measure aims to align Nigerian banks with global best practices, enhance risk management capabilities, and safeguard depositors' funds. While the transition may pose initial challenges for banks, such as raising additional capital and adjusting business strategies, the long-term benefits outweigh the short-term hurdles. Optimizing the advantages of the increased capital base will also require adopting technology innovations and developing a culture of strong risk management.

6. The shareholders of Access Bank have approved USD1.5 billion capital raise and up to N365 billion through a rights issue. GT Holding Company's shareholders have also approved a USD750 Million capital raise. Zenith Bank Plc has also approved a capital raise. FCMB, Sterling Bank and Wema Bank are among the banks which have announced moves to raise capital. These are a few amongst others.

7. The CEO of Financial Derivatives Company Limited, Mr. Bismarck Rewane, in presenting his Economic Review and Investment Outlook for 2024, available at <https://www.icimigeria.org/opportunities-issues-that-will-shape-nigerias-capital-market-in-2024/> accessed on 31.03.2024

In furtherance of these new realities, affected banks are encouraged to:

- **focus** on proactive capital planning, investigating strategic alliances, and maximizing operational efficiencies to effectively navigate the current transition. Banks must focus on bolstering their capital reserves to create a strong financial base. This can be accomplished through attracting new investors, retaining profits, or pursuing partnerships;
- **implement** their capital raising strategies early. Given the delta between the previous minimum paid up capital requirements and the new minimum paid up capital requirements, a number of banks may need to: (x) approach the market a number of times to shore up their capital base; and (y) deploy a myriad of options to meet their capital goals;
- **ensure** strict adherence to the CBN's regulations and guidelines regarding capital adequacy, reporting, and corporate governance;
- **maintain** proper internal records and possibly conduct a financial and legal audit in readiness for mergers or acquisitions and to do so in a timely manner;
- **engage** professional advisers earlier on in order to have a smooth recapitalisation process; and
- **guard** against the incursion of illicit funds in the course of recapitalisation.

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