CLARIFICATION ON CBN'S DEBT REDUCTION FOR BANKS

On the 6th April, the CBN Board of Directors approved some forbearance to the banks that are heavily indebted to the CBN in order to make them attractive to participate in the ongoing consolidation. The CBN Board resolved to write-off 80% of the debt provided the current owners meet a set of stringent conditions. Note that because of their heavy indebtedness to the CBN, other banks and investors were not willing to talk to the affected banks. It was therefore inevitable that these banks would be liquidated at the end of the consolidation exercise, and the Central Bank would have lost all the debt owed to it, PLUS many other consequences---- including loss of depositors money (estimated at N108 billion) and 7,429 jobs.

However, this masterstroke of a policy has been misunderstood in some quarters. Some of the commentators question the forbearance on the following grounds:

- It favours a particular geo-political zone or some banks more than others.
- That it would reward the current Owners and Management who mismanaged the Banks in the first instance. The argument is that the current owners and management should rather be punished for their misbehaviour.
- Why did the CBN allow the debt to accumulate in the first instance?

OUR RESPONSE:

1. All the debt to CBN was incurred before January 2004---- principally as a result of the clearing and settlement system in operation then, and the system has been modified since January 2004. The current CBN management is not responsible for the indebtedness. Under the current system with 7 Settlement Banks, it is not possible for any bank to have overdrawn position with the CBN in the future. So the situation is unlikely to reoccur in the future.

2. The 'debt forgiveness' does not stop the EFCC from prosecuting the Owners and Management of the affected banks under the 'Failed Banks Act'. Indeed, two of the cases, the Bank of the North and the Societe Generale Bank are already before the EFCC--- for investigation and prosecution.

3. The forbearance was not targeted at any particular bank ---- 13 banks are actually involved.

4. The forbearance is not a 'free lunch'. It is contingent on the owners/management of the banks meeting certain pre-conditions, including:
    - Recovery of non-performing insider/owner-related credits within two months
    - Injection of fresh capital to beef up the affected bank's recapitalization to the solvency status.
    - Balance of 20% of the debt to be converted to term loan of 7 years at 3% interest per annum including a moratorium of 2 years.

It is indeed possible that not every bank will apply or need the forbearance.

5. Recall that the CBN's exposure (credit) of N75 billion is already 'sunk'. These loans have also been provided for as loan losses in the CBN accounts, in accordance with the Prudential Guidelines. In other words, it does not cost the CBN or the taxpayers any new money to write-off part of the debt. If the CBN did not write-off part of the debt, the affected banks will die--- and the CBN will not be able to recover any of the debt. Under the current policy, at least part of the debt (20% or N15 billion) could be salvaged.

6. Our goal under the banking sector consolidation is to save the banking system from crisis; draw a thick line with the past; and lay a solid foundation for the future. We can spend years apportioning blames for the past mismanagement of the affected banks or why CBN involuntarily granted the overdrafts (before 2004). This is a useful debate on its own, but the challenge now is to make progress. It is precisely to redress the inadequacies and mismanagement of the past that the CBN introduced the 13-point agenda in July 2004 to restructure the system. If there were no problems with the industry and its management, the current reforms would have been unnecessary. Our primary goal now is to save the depositors and employment in the affected banks. If CBN did not act, surely the affected banks would die and be liquidated, and the consequences for the economy would be great. While the owners/Management could be prosecuted and sanctioned under the 'Failed Banks Act' and other laws, it is the economy as a whole, especially the poor depositors who would suffer the most.

Some of the consequences/costs for the economy if the CBN did not grant the debt reduction include:

a. All the affected banks would die and be liquidated as no bank or investor is willing to acquire such banks with heavy debt burden.

b. CBN would lose 100% of the debt owed it if the banks die and are liquidated; whereas under the current policy, it makes sense that 20% of the debt could still be salvaged since 80% is written-off.

c. NDIC would be required to pay out the insured deposit of N17 billion to the depositors.

d. Un-insured deposits of N91.1 billion would be lost by the depositors --- with all the untold hardships on families.

e. A systemic crisis could be triggered-off as part of the uninsured deposits are inter-bank placements---- with possible contagion effects on some healthy banks.

f. Jobs of staff totaling 7,429 in the affected banks could also be lost. This is in addition to the other service providers to the banks who would lose their jobs. Under the current policy, some jobs could be saved as some of the banks may be acquired by potential investors.

7. The policy is a win-win for the economy. The current owners will not just walk away with a new bank: they are required to bring new money into the banks--- at least 20% of the recapitalization requirement. All these are designed to make the affected banks more attractive to potential acquirers or investors, and hence avoid the consequences listed above.

8. Everywhere in the world, industry-wide restructuring of the banking system such as the one we have undertaken is a very expensive exercise. Currently, the least expensive in the world was the Malaysian restructuring which cost the country 4% of its GDP. For the ongoing banking sector revolution in Nigeria, the worst case scenario in terms of cost would still leave Nigeria with the world record of no more than 2% of GDP---- including the forbearance the CBN has recently granted to banks indebted to it. Under the ongoing restructuring, it is evident that some of the banks that were literally dead as at end of 2003 and mid 2004 could be resurrected---- which would be a win-win for the Nigerian economy. If in the end some banks still fail to make the consolidation exercise, the CBN Board and Management can at least feel proud that we did all that was possible to save them. The challenge now is for the owners/management of the affected banks to reciprocate the gestures of the CBN by implementing their own part of the bargain.