CENTRAL BANK OF NIGERIA

CODE OF CORPORATE GOVERNANCE FOR BANKS IN NIGERIA POST CONSOLIDATION

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1.0 Introduction

1.1 Financial scandals around the world and the recent collapse of major corporate institutions in the USA had brought to the fore, once again, the need for the practice of good corporate governance, which is a system of managing the affairs of corporations with a view to increasing shareholder value and meeting the expectations of the other stakeholders.

1.2 For the financial industry, the retention of public confidence through the enthronement of good corporate governance remains of utmost importance given the role of the industry in the mobilization of funds, the allocation of credit to the needy sectors of the economy, the payment and settlement system and the implementation of monetary policy.

1.3 In Nigeria, a survey, by the Securities and Exchange Commission (SEC) reported in a publication in April 2003, showed that corporate governance was at a rudimentary stage, as only about 40% of quoted companies, including banks, had recognized codes of corporate governance in place. Specifically for the financial sector, poor corporate governance was identified as one of the major factors in virtually all known instances of a financial institution’s distress in the country.

1.4 Yet, the on-going industry consolidation is likely to pose additional corporate governance challenges arising from integration of processes, IT and culture. Research had shown that two-thirds of mergers, world-wide, fail due to inability to integrate personnel and systems as well as due to irreconcilable differences in corporate culture and management, resulting in Board and Management squabbles. In addition, the emergence of mega banks in the post-consolidation era is bound to task the skills and competencies of Boards and Managements in improving shareholder values and balance same against other stakeholder interests in a competitive environment. A well-defined code of corporate governance practices should help organizations overcome such difficulties.
2.0 **WEAKNESSES IN CORPORATE GOVERNANCE OF BANKS IN NIGERIA**

2.1 Conflict of interests between Board and Management giving rise to Board squabbles.
2.2 Ineffective Board oversight functions.
2.3 Fraudulent and self-serving practices among members of the board, management and staff.
2.4 Overbearing influence of chairman or MD/CEO, especially in family-controlled banks.
2.5 Weak internal controls.
2.6 Non-compliance with laid-down internal controls and operation procedures.
2.7 Ignorance of and non-compliance with rules, laws and regulations guiding banking business.
2.8 Passive shareholders.
2.9 Poor risk management practices resulting in large quantum of non-performing credits including insider-related credits.
2.10 Abuses in lending, including lending in excess of single obligor limit.
2.11 Sit-tight Directors – even where such directors fail to make meaningful contributions to the growth and development of the bank.
2.12 Succumbing to pressure from other stakeholders e.g. shareholder’s appetite for high dividend and depositors quest for high interest on deposits.
2.13 Technical incompetence, poor leadership and administrative ability.
2.14 Inability to plan and respond to changing business circumstances.
2.15 Ineffective management information system.
3.0 CHALLENGES OF CORPORATE GOVERNANCE FOR BANKS POST CONSOLIDATION

3.1 Technical Incompetence of Board and Management: In view of the greatly enhanced resources of the consolidated entities, Board members may lack the requisite skills and competencies to effectively redefine, re-strategize, restructure, expand and/or refocus the enlarged entities in the areas of change of corporate identities, new business acquisitions, branch consolidation, expansion and product development.

3.2 Lack of Harmonious Relationships Among Directors: Boardroom squabbles could be an issue due to different business cultures and high ownership concentration especially in banks that were formerly family or “one-man” entities. The dominance of a “key man” could also emerge with the attendant problems.

3.3 Lack of Harmonious Relationship Between Management and Staff: Squabbles arising from knowledge gaps, harmonization of roles and salary structure could also manifest among staff and management of consolidating banks with the potential to create unhealthy competition and a counter-productive working environment.

3.4 Increased Levels of Risks: Currently, very few banks have a robust risk management system in place. With the huge amount of funds that will be available to them and the significantly increased legal lending limits, banks will be financing more long-term mega projects in the real sectors of the economy as opposed to the existing working capital/trade financing. Given the expected significant increase in the level of operations, the banks will be facing various kinds of risks which, if not well managed, will result in significant losses. The management of risks in a transparent and ethical way will thus present some issues bordering on corporate governance.

3.5 Ineffective Integration of Entities: Banks that would have completed the process of merging might continue to operate independently rather than as a single entity. For example, an investment bank’s merger with a retail bank in which the MD of the investment bank continues to manage his arm of the business and the MD of the retail bank does the same and the operating results of the two entities are then consolidated for reporting purposes.
3.6 **Poor Integration and Development of Information Technology Systems, Accounting Systems and Records:** Banks with different IT systems (banking application, database platform, operating systems, human resource applications, hardware, server configuration, and network and telecommunication infrastructure) as well as different accounting systems and records will have to fuse and this could pose problems if not well managed. There will also be increased use of technology to power the consolidated business and this too will have to be well managed to ensure efficient operations and quality service delivery.

3.7 **Inadequate Management Capacity:** Directors and Managers will be running a much larger organization and controlling a significantly higher level of resources. Adequate management capacity is needed to efficiently and profitably run a larger organization.

3.8 **Resurgence of High Level Malpractices:** To boost income as a result of intense competition and lack of enough viable projects, malpractices may resurface post consolidation. Such sharp practices could include round-tripping of forex, excessive customer charges, falsification of records etc., and adoption of unethical methods to poach customers.

3.9 **Insider-Related Lending:** If consolidation should fail to achieve transparency through diversification in bank ownership, the pervasive influence of family and related party affiliations may continue, resulting in huge levels of insider-abuses and connected lendings.

3.10 **Rendition of False Returns:** Similarly, rendition of false returns to the regulatory authorities and concealment of information from Examiners to prevent timely detection of unhealthy situations in the banks may continue as a result of lack of transparency and pressure to boost income.

3.11 **Continued Concealment:** Continued concealment of material issues discovered by banks during their pre-merger due-diligence will also compromise good corporate governance.

3.12 **Ineffective Board/Statutory Audit Committee:** The audit committee, which comprises both directors and shareholders who are not board directors, may be composed of people who are not
knowledgeable in accounting and financial matters thus rendering the committee less effective.

3.13 **Inadequate Operational and Financial Controls:** There might be absence of such controls to cater for the increased size and complexity of operations.

3.14 **Absence of a Robust Risk Management System:** The huge amount of funds that would be available to banks post consolidation would significantly increase their legal lending limits and make them engage in financing long term mega projects. The management of the attendant risks in a transparent and ethical manner would require, as part of sound practices, the institutionalization of a robust risk management system.

3.15 **Disposal of Surplus Assets:** After consolidation, some branches of banks that are closely located may be sold to insiders at below market price. Other surplus assets may also be similarly sold. Fixed assets may also be sold indiscriminately and the profit from the sale used to boost profits with the intention of covering operational losses and inefficiencies.

3.16 **Transparency and Adequate Disclosure of Information:** These are key attributes of good corporate governance which the merged banks must cultivate with new zeal in order to provide stakeholders with the necessary information to judge whether their interests are being taken care of. Currently there are many deficiencies in the information disclosed, particularly in the area of risk management strategies, risk concentration, performance measures etc. These shortcomings will need to be addressed.
4.0 PRINCIPLES AND PRACTICES THAT PROMOTE GOOD CORPORATE GOVERNANCE

4.1 The establishment of strategic objectives and a set of corporate values, clear lines of responsibility and accountability.

4.2 Installation of a committed and focused Board of Directors who will exercise a high degree of independence in its oversight responsibilities.

4.3 A proactive and committed management team.

4.4 There should be no conflict of interest between the Board, Directors, Management, staff and the bank.

4.5 The Board should meet regularly – minimum of four (4) times in a financial year.

4.6 The Board should retain full and effective control of the bank and monitor executive management.

4.7 There is a well-defined and acceptable division of responsibilities.

4.8 There is balance of power and authority so that no individual or coalition of individuals has unfettered powers of decision making.

4.9 The Articles of Association should clearly specify those matters that are exclusively the rights of the Board to approve apart from those for notification.

4.10 The number of non-executive directors should exceed that of executive directors.

4.11 All Directors should be knowledgeable in business and financial matters and also possess the requisite experience.

4.12 There should be a definite management succession plan.

4.13 There should be responsive, responsible and enlightened shareholders.

4.14 Culture of compliance with rules and regulations.
4.15 Effective and efficient Audit Committee of the Board.

4.16 External and internal auditors of high integrity, independence and competence.

4.17 Internal monitoring and enforcement of a well articulated code of conduct/ethics for Directors, Management and staff.

4.18 Regular management reporting and monitoring system.

4.19 Regulators of high integrity and competence.
5.0 CODE OF CORPORATE GOVERNENCE FOR BANKS POST CONSOLIDATION

5.1 Equity Ownership

5.1.1 Preamble: The current practice of free, non-restrictive equity holding has led to serious abuses by individuals and their family members as well as governments in the management of banks. However, to encourage a private sector-led economy, holdings by individuals and corporate bodies in banks should be more than that of governments. It is also recognised that individuals who form part of management of banks in which they also have equity ownership have a compelling business interest to run them well. Such arrangements should be encouraged.

5.1.2 Government direct and indirect equity holding in any bank shall be limited to 10%.

5.1.3 An equity holding of above 5% by any investor is subject to CBN’s prior approval.

Notes: Since the observance of corporate governance provisions are generally voluntary, the above provisions on holding limits, by virtue of their importance, are mandatory for the purpose of supervision and enforcement.
5.2 Organizational Structure

5.2.0 Executive Duality

5.2.1 The responsibilities of the head of the Board, that is the Chairman, should be clearly separated from that of the head of Management, i.e. MD/CEO, such that no one individual/related party has unfettered powers of decision making by occupying the two positions at the same time.

5.2.2 No one person should combine the post of Chairman/Chief Executive Officer of any bank. For the avoidance of doubt, also no executive vice-chairman is recognised in the structure.

5.2.3 No two members of the same extended family should be on the board of a bank at the same time.

Notes: The observance of the above is mandatory.

5.3 Quality of Board Membership

5.3.1 Institutions should be headed by an effective Board composed of qualified individuals that are conversant with their oversight functions and who can lead and control the institution.

5.3.2 Existing CBN guidelines on appointment to the board of financial institutions should continue to be observed. Only people of proven integrity and who are knowledgeable in business and financial matters should be on the Board. Directors should be able to read and interpret financial statements.

5.3.3 Regular training and education of board members on issues pertaining to their oversight functions should be institutionalized and budgeted for annually by banks.

5.3.4 The Board should have the latitude to hire independent consultants to advise it on certain issues and the cost borne by the banks.
5.3.5 The number of non-executive directors should be more than that of executive directors subject to a maximum board size of 20 directors.

5.3.6 At least two (2) non-executive board members should be independent directors who, though appointed by the bank, should be accountable to the shareholders and the CBN.

5.3.7 A committee of non-executive directors should determine the remuneration of executive directors and report same to the shareholders at AGMs for ratification.

5.3.8 There should be strict adherence to the Code of Conduct for bank directors, failing which the regulatory authorities would impose appropriate sanctions including removal of he erring director from the board.

5.3.9 Non-executive directors’ remuneration should be limited to sitting allowances, directors’ fees and reimbursable travel and hotel expenses to be determined by the shareholders at AGM.

5.3.10 The tenor for directors should be defined. In order to ensure continuity/injection of fresh ideas, it is recommended that no director should remain on the board of a bank continuously for more than 3 terms of 4 years each, i.e. 12 years.

5.3.11 There should be, as a minimum, the following board committees – Risk Management Committee, Finance and General Purpose Committee, Audit Committee, and the Credit Committee.

5.3.12 The practice of the Board Chairman serving simultaneously as chairman/member of any of the board committees is against the concept of independence and sound corporate governance practice, and should be discontinued.
5.4 Board Performance Appraisal

5.4.1 Preamble: While adherence to corporate governance principles is recognised as necessary for successful performance of Boards, it is often not a sufficient condition. Hence, the need for Board performance reviews or appraisals as a new concept to ensure successful or exceptional performance.

5.4.2 Each Board should identify and adopt, in the light of the company’s future strategy, its critical success factors or key strategic objectives.

5.4.3 Boards should determine the skills, knowledge and experience that members require to achieve those objectives.

5.4.4 A Board should work effectively as a team towards those strategic objectives.

5.4.5 There should be annual Board and Directors’ review/appraisal covering all aspects of the Board’s structure and composition, responsibilities, processes and relationships, as well as individual members’ competencies and respective roles in the Board’s performance.

5.4.6 The review should be carried out by an outside consultant whose appointment and termination are to be approved by the shareholders at an AGM.

5.4.7 The review report is to be presented to the shareholders and a copy sent to the CBN.

5.5 Quality of Management

5.5.1 Appointments to top management positions should be based on merit rather than some other considerations.

5.5.2 Existing guidelines on appointments to top management of banks should continue to be observed.
5.5.3 Track record of appointees should be an additional eligibility requirement. Such records should cover both integrity (‘fit and proper’ as revealed by the CBN ‘blackbook’, CRMS etc) and past performance (visible achievements in previous place(s) of work).

5.6 Reporting Relationship

5.6.1 Officers should be held accountable for duties and responsibilities attached to their respective offices.

5.6.2 The structure of any bank should reflect clearly defined and acceptable lines of responsibility and hierarchy.
6. Industry Transparency, Due Process, Data Integrity and Disclosure Requirements

6.1.1 These are core attributes of sound corporate governance practices that are essential to installing stakeholder confidence.

6.1.2 There should be full-disclosure of interests by all insiders i.e. directors and related parties.

6.1.3 Board directors and companies/entities/persons related to them should not be service providers or suppliers to the bank.

6.1.4 False rendition to CBN shall attract very stiff sanction, e.g. fine plus suspension of the CEO for six months in the first instance and removal and blacklisting in the second.

6.1.5 There should be due process in all the procedures of banks.

6.1.6 All insider credit applications, irrespective of size, should be sent for consideration/approval to the Board Credit Committee, which should have neither the Chairman of the Board nor the MD as a member/chairman.

6.1.7 Any director whose facility or that of his/her related interests remains non-performing for more than one year should cease to be on the board of the bank and could be blacklisted from sitting on the board of any other bank.

6.1.8 The Board Credit Committee should be composed of members knowledgeable in credit analysis.

6.1.9 The practice/use of Anticipatory Approvals by Board Committees should be limited strictly to emergency cases only.
7.0 **RISK MANAGEMENT**

7.1.1 Banks should put in place a risk management framework including a risk management unit that should be headed by a Senior Executive, in line with the directive of the Board Risk Management Committee.

7.1.2 External auditors should render half-yearly reports to the CBN on banks’ risk management practices, internal controls and level of compliance with regulatory directives.
8.0 Role of Auditors

8.1.0 Internal Auditors

8.1.1 Internal auditors should be largely independent, highly competent and people of integrity.

8.1.2 The Head of Internal Audit should not be below the rank of GM and should be a member of a relevant professional body.

8.1.3 He should report directly to the Board Audit Committee but forward a copy of the report directly to the MD/CEO of the bank as well as to the Banking Supervision Department of the CBN.

8.1.4 Members of the Board Audit Committee should be non-executive directors and ordinary shareholders appointed at the AGM, and should be knowledgeable in internal control processes. One of such appointed ordinary shareholders should serve as the Chairman of the Committee.

8.1.5 Internal Audit Unit should be adequately staffed.

8.2.0 External Auditors

8.2.1 External auditors should maintain arms-length relationship with the banks they audit.

8.2.2 Appointment of External Auditors will continue to be approved by the CBN.

8.2.3 The tenure of the auditors in a given bank shall be for a term of five years in the first instance and is renewable for another term of five years subject to CBN’s approval. Furthermore, such audit firm shall not be reappointed in the bank until after a period of ten years.
8.2.4 A bank’s external auditors should not provide bookkeeping or internal auditing services or any non-audit services to the same bank in order to safeguard their independence.

8.2.5 Two auditing firms should be appointed for each bank as joint auditors.

8.2.6 Quality assurance auditing should be engaged whenever the CBN suspects a cover-up by auditors, and where proved, erring firms would be blacklisted from being auditors of banks and other financial institutions for a length of time to be determined by the CBN.