

Banking and Investments

11 November, 2010

Reversal of Universal Banking - CBN Regulation on the Scope of Banking Activities, 2010

Introduction

The *Guidelines for the Practice of Universal Banking in Nigeria* issued by the CBN on 22 December 2000 (**Universal Banking Guidelines**), introduced a new specie of banks; outside the contemplation of the Banks and Other Financial Institutions Act, 2004 (**BOFIA**) that is, the Universal Bank. This Guideline gave impetus to the incursions by the banks into diverse non-banking businesses. However, the reforms in the Nigerian financial sector brought to the fore, concerns over the risks to which depositor's funds were exposed due to the activities of some of the banks.

To address the above concern and thereby ensure (x) that depositors' funds are adequately ring-fenced, and (y) that banks focus on core-banking business (which falls within CBN's regulatory radar), the CBN undertook a review of the Universal Banking Model. This review also involved a comparative analysis of structures (such as Holding Company structures) used in other financial markets to adequately segregate business, function and risks, where diverse financial services are undertaken through separate entities within a financial supermarket. In addition, comments were received from key industry stakeholders and this served as input towards the finalization of the exposure draft document which was circulated by the CBN in March 2010.

Repeal of Universal Banking

Sequel to the exposure draft, the CBN published the *Circular on the Review of the Universal Banking Model* dated 7 September, 2010 with reference number BSD/DIR/GEN/UBM/03/025. The circular outlined the intentions of the CBN to repeal the Universal Banking regime and enjoined the banks to submit their Compliance Plans to the CBN.

The BOFIA circumscribed bank types to wit - *Commercial Banks, Merchant Banks, Community Banks, Specialized Banks.*

There is doubt as to the legal basis of the subsidiary legislation which introduced Universal Banks in light of the decision of the Supreme Court in **Osadebey v A.G. Bendel State [1991] 1 NWLR (Part 169) 525 S.C**, where the court held that that any part of a subsidiary legislation that exceeds the scope of the parent legislation is a nullity.

Consequently, on 8 November, 2010, the CBN repealed the Universal Banking Guidelines via the *Regulation on The Scope Of Banking Activities & Ancillary Matters, No. 3, 2010 (the 2010 Regulation)*, which principally abolished the Universal Banking Model amongst others. Note, that whilst the 2010 Regulation is dated 4 November 2010, its Commencement Date is 15 November, 2010.

Highlights of the 2010 Regulation

The 2010 Regulation comprises of about 11 (eleven) sections and in the main, deals with the following broad issues:

- *Reverses the Universal Banking Guidelines* – whilst the 2010 Regulation takes effect almost immediately, this does not invalidate any acts done pursuant to the Universal Banking Guidelines, between the Commencement Date and the Effective Date (14 May 2012).
- *Reinstates the narrow definition of banking as contemplated under BOFIA* – Section 66 of BOFIA circumscribes the permitted activities for banks though the Governor of the CBN may, by Order published in the Gazette, designate certain other business as banking business.
- *Prohibits banks from establishing, maintaining or permitting to exist, any Related Enterprise* – Related Enterprise is defined in the 2010 Regulation to mean any (x) Associate, (y) Subsidiary or (z) Enterprise which a bank controls, possesses common directorship or equity interest in. However, banks may, with the permission of the CBN, maintain a foreign banking institution as a Related Enterprise. Other exceptions include (x) permitted investments under Section 21(1) and 22(1)(c) of BOFIA; (b) approved companies jointly owned by two or more banks for certain developmental purposes; and (c) Custodians licensed as such under the Pension Reform Act, 2004.
- *Requires banks to dispose of all real estate interest acquired for purposes other than for use as business premises.*
- *Prohibits banks from funding or otherwise investing in political activities or the like.*
- *Banks are required to divest themselves of interests in Related Enterprises except as permitted by the 2010 Regulation* - To ensure the integrity of this process, the divestiture should be on an arm's length basis and should take into consideration, the interests of stakeholders such as depositors and shareholders.

However, whilst the Circular stated that the CBN was issuing a Regulation/Guideline on Scope of Banking Business to amongst others, (x) repeal the Universal Banking Model; (y) require banks to divest from all non-banking business; (z) define the permitted banking activities; and (xx) set transition timelines for restructuring, no such Regulation was issued alongside the circular.

- *Requires banks currently operating under a Universal Banking Licence, to submit a Compliance Plan* – This Compliance Plan should be approved by the board of the bank and submitted to the CBN within 90 days of the Commencement Date of the 2010 Regulation. The Plan is required to detail amongst others, the type of banking licence such bank proposes to operate and how the bank intends to situate itself within the provisions of the 2010 Regulation. Where it considers the Compliance Plan satisfactory, the CBN shall grant the bank an approval-in-principle. This entitles the bank to commence restructuring of its operations, in line with the new regime.

Failure to submit a Compliance Plan or obtain an approval-in-principle within the stipulated timeframe, would entitle the CBN to vary the licence conditions of the bank, in order to bring it in conformity with the current licensing regime.

- *Requires banks to apply to the CBN not later than 60 days prior to the Effective Date, for a licence to operate as one of the bank types permitted under BOFIA* – These are limited to Commercial Banks, Merchant Banks and Specialised Banks (non-interest banks, microfinance banks, development banks and mortgage banks. Subject to relevant rules, regulations, and guidelines on licensing, authorisation, operation and conduct of business that the CBN may issue periodically, the Commercial Banks referred to above may carry on banking business on a regional, national or international basis. For example, Wema Bank Plc, recently applied to CBN seeking a banking licence, to operate as a regional bank with the regulatory capital requirement of N10 billion.
- *Application for a licence* – This may be made further to an approval-in-principle by the CBN, or pursuant to a variation of the existing Universal Banking Licence held by a bank as a result of its failure to obtain an approval-in-principle or submit a Compliance Plan within the stipulated timeline. A successful applicant shall submit its Universal Banking Licence in exchange for one of the permitted banking models.
- Where a bank fails to obtain a banking license by the Effective Date, such a bank shall cease to carry on banking business in Nigeria and consequently, shall deliver its Universal Banking Licence to the CBN.

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Without doubt, there is need for the banks to realign themselves in the wake of the changes in the Nigerian banking and financial services sector. A restructuring of this scale may also give rise to investor concerns especially in light of the fact that the banks would have to hive-off some of their assets and operations.

However, the need to ring-fence depositor's funds from risky investments should be paramount and despite the delimitation of the scope of banking business, banks can take advantage of diverse financial structures within which banks can effectively conduct their operations. One of such notable structures is the Holding Company structure, of which there are several variants as practiced in the U.S.A, Canada, Republic of Korea etc.

In adopting a suitable structure, some of the issues worthy of consideration include:

- The ability to capture synergies across complementary financial services business lines;
- Possible tax advantages;
- Cost efficiency;
- Utilization of a foreign banking subsidiary or associate etc;
- Protection of investors and other stakeholders.

In addition, in view of the timelines set for restructuring bank operations and the dire consequences of failure to do so, there is the need for the banks to act expeditiously.

Conclusion

Clearly, the 2010 Regulation represents a positive step by the CBN to sanitise the banking sector, with the ultimate aim of ensuring financial stability. It is envisaged that with the release of the 2010 Regulations, the Nigerian banking system will witness a flurry of restructuring and reorganisations, which will indeed reduce the risks to which the banks were hitherto exposed as a result of their operations and restore investor confidence.

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