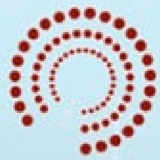


Review of Minimum Requirements for Commercial, Merchant and Non-Interest Banks by the Central Bank of Nigeria: A Revitalization of the Nigerian Economy?

www.odujinrinadefulu.com

Introduction

The Central Bank of Nigeria (CBN) through a circular dated March 28, 2024 (the Circular), announced an upward review of the minimum capital requirements for commercial, merchant and non-interest banks in Nigeria. The revolutionary financial reform by the CBN was hinged on the need to navigate the current turbulent macroeconomic conditions and enhance the resilience, solvency and capacity of banks to contribute to the growth and development of the Nigerian Economy. Prior to the release of the Circular, the Governor of the CBN, Mr. Olayemi Cardoso, in his keynote address delivered at the 58th Chartered Institute of Bankers' Dinner on November 24, 2023, had indicated that the CBN was gearing up for the attainment of the economic agenda of the Federal Government of Nigeria to achieve a Gross Domestic Product (GDP) of US$1 trillion by 2030[1] for the capital adequacy of the Nigerian banking industry. Consequently, all banks are mandated to meet the minimum capital requirement within twenty-four (24) months commencing from April 1, 2024, and terminating on March 31, 2026.

The implementation of the Circular is expected to transform the Nigerian banking industry and tremendously impact the national economy through increased liquidity in the banking sector, attraction of foreign direct and portfolio investments resulting in currency stability, and increased commercial activities across the country, among others. In this newsletter, we provide an overview of the Circular and its potential impact on stakeholders, including investors and market participants in Nigeria.

Overview of the Circular

By way of background, the last bank recapitalisation was in 2005 when the CBN in July 6 2004, under the leadership of the former CBN Governor, Professor Charles Soludo, issued a circular which increased the minimum capital requirement for commercial banks from N2Billion to N25Billion, with effect from December 31, 2005. Thus, this new Circular herald the twelfth phase of bank recapitalisation in Nigeria since 1952 by which banks are required to increase their minimum capital to a specified amount according to their license category and authorization within the time frame stipulated by the CBN.

Minimum Capital Requirements and Composition of Eligible Capital.

Pursuant to the provisions of the Circular, the minimum capital requirements for commercial banks with international banking authorisation, national banking authorisation and regional banking authorisation have been increased from N50billion[2] to N500billion, N25billion[3] to N200billion and N10billion to N50billion, respectively. Further, the new minimum capital base for merchant banks with national banking authorisation is N50 billion, whilst non-interest banks[4] with national and regional banking authorisations are required to have a minimum capital requirement of N20billion and

[1]Keynote Address by Mr. Olayemi Cardoso, Governor Central Bank of Nigeria delivered at the Chartered Institute of Bankers Nigeria 58th Annual Dinner and Grand Finale of the Institute's 60th Anniversary held on November 24, 2023. Page 13.

[2]Section 7 of the CBN Scope, Conditions & Minimum Standards for Commercial Banks Regulations No. 01. 2010.

[3]Section 6 of the CBN Scope, Conditions & Minimum Standards for Commercial Banks Regulations No. 01. 2010.

[4]A Non-Interest Bank is a type of bank in which depositors of money with the bank are not rewarded on the basis of a predetermined rate of interest and a borrower of such fund is not subjected to the payment of a specific rate of interest no matter the outcome arising from the use of money lent, profit or loss.

N10billion, respectively.

The Circular bifurcates the composition of eligible capital viz: eligible capital for existing and proposed banks. For existing banks, paid-up capital and share premium only will be considered by the CBN for the purpose of meeting the regulatory requirement above. Likewise, additional Tier 1 capital[5] and Shareholders' Fund[6] are expressly excluded from the composition of eligible capital. Whilst the underlying factor responsible for the eligible capital restrictions for existing banks is indecipherable from the Circular, the most probable rationale behind the eligible capital restrictions is the nature of paid-up capital and share premium in that both intrinsically translates into injection of fresh capital into the banking sector, which is the ultimate regulatory objective of the CBN.

In the same vein, paid up capital is the eligible capital for proposed banks and this applies to all new applications for banking license submitted after April 1, 2024. However, all applications for banking license for which capital deposit had been made and/or approval in principle (AIP) had been granted by the CBN are required to make up the difference between the capital deposited with the CBN and the new capital requirement not later than March 31, 2026.

Notwithstanding the provisions of the Circular explicated above, all banks are enjoined to comply with the minimum capital adequacy ratio requirement applicable to their license authorisation, breach of which attracts mandatory injection of fresh capital for regularization.

Submission of Implementation Plan

To ensure swift implementation of the Circular, the CBN mandates all banks to submit an implementation plan indicating the preferred option(s) for compliance with the Circular to the Director, Banking Supervision Department of the CBN on or before April 30, 2024. The Circular prescribes three (3) options for all banks to meet the minimum capital requirements viz: (a) injection of fresh equity capital through private placements, rights issue and/or offer for subscription; (b) mergers and acquisitions; and/or (c) upgrade or downgrade of license authorization. Hence, all banks are required to specify their chosen option (s) from the foregoing in the implementation plan to be submitted to the CBN within the stipulated timeline.

In our view, the express specification of the composition of eligible capital and options available to banks to comply with regulatory requirements signifies the strategic approach of the CBN to strengthen the banking sector, stabilize exchange rate, control inflation and create an enabling environment for businesses and individuals to thrive.

Potential Impact of the Circular

As at date, none of the banks have paid-up capital above the proposed minimum. Therefore, Nigerian banks need circa NGN4.7trillion to meet the new regulatory minimum because most tier 1 and tier 2 banks require twice their current eligible capital or more to comply with the Circular[7]. Nevertheless, stakeholders in the Nigerian banking sector believe that the regulatory minimum set by the CBN is neither an

---

[5] *Additional Tier 1 (AT1) Capital is composed of instruments that are not common equity.*

[6] *A Shareholder Fund is the fund available to stakeholders after all liabilities have been met in the event of a company's liquidation. It is the capital amount legitimately belonging to its stakeholders. It helps to examine the financial soundness of a company.*

[7] *The CBN Reviews Capital Requirement for Banks: Our Perspective - Nigeria's First Credit Rating Company (agusto.com)*

attempt by the regulator to inflict hardship on businesses in Nigeria nor asphyxiate investors in the banking sector. Rather, the giant step by the CBN is considered an inevitable regulatory rescue mission to strengthen the Nigerian banking sector and by extension, stabilize the country's financial system.

Opportunities for key sectors in Nigeria.

a. Increased Liquidity in the Nigerian banking sector

Liquidity is the lifeblood of the banking sector all over the world. Therefore, it is highly essential for banks to ensure that funds are available to meet demands from investors and customers. As stated in the preceding paragraphs, the restriction of eligible capital to paid-up capital and share premium is targeted at the injection of fresh capital into the Nigerian banking industry. Thus, where fresh capital is raised by banks in order to meet the regulatory minimum capital, it will result in increased liquidity in the banking sector which in turn leads to access to credit for small and medium-sized businesses, corporates, development of large infrastructure projects and ultimately boosts the Nigerian economy.

b. Potential to Curb Domestic Currency Devaluation

The unit currency of Nigeria, Naira,[8] experienced a significant devaluation in June 2023 caused by the unification of the multiple foreign exchange rates into the Investors and Exporters window by the CBN[9], allowing market forces to determine the exchange rate. This policy has led to increased inflationary pressures, increased import prices of goods needed by Nigerians, and low purchasing power for Nigerians' savings held in Naira, among others. Given the estimated capital required for banks to meet up with the minimum capital requirements, it is anticipated that the capital necessity will attract foreign portfolios and direct investment in the banking sector. Accordingly, with the increased supply of foreign currency in the country, the value of Naira will stabilize and thus, lower the current inflation, and improve purchasing power and cost of production in Nigeria.

c. Increased Business Activities

The new minimum capital requirements imposed on banks by the CBN is expected to increase business activities in Nigeria within the next twenty-four (24) months and beyond. Within the statutory timeline, where banks issue new capital they will need to expand their businesses to deliver value to investors. Furthermore, to meet the minimum capital requirement, we expect an increase in commercial activities such as bond issuance, initial public offering, private placements, right issue, mergers and acquisitions and exogenous debt financings which will involve different professionals, including solicitors, regulators and investment bankers. Post recapitalisation, we anticipate increased lending by banks to individuals and businesses as well as development of projects and other economic activities to improve the national economy.

Challenges

a. Increased Interest Rates on Loans

One of the notable highlights of the Circular is the restriction of eligible capital for recapitalisation to paid-up capital and share premium only. By implication, the new dispensation indicates the exclusion of other previously acceptable components of banks' capital such as retained

[8]*Section 15 of the Central Bank of Nigeria Act, 2007.*

[9]*Central Bank of Nigeria Press Release: Operational Changes to the Foreign Exchange Market dated June 14, 2023.*

earnings, addition tier 1 capital and other reserves from the composition of paid-up capital. This will significantly reduce the pool of funds that can be counted towards meeting the minimum capital threshold and thus result in capital raising through issuing new shares and attracting investors, which can be slow and expensive for banks. Ultimately, this may result in difficulty in recapitalisation for some banks and the pressure to meet the new capital requirements could lead to increased interest rates on loans to boost profitability.

b. Reduction in Competition in the Banking Sector

The implementation of the Circular could potentially reduce competition in the banking sector wherein smaller banks who struggle to meet the capital requirements will by implication be required to merge with larger banks, which reduces the overall number of banks in the market. With less competition in the banking sector, banks may raise interest rates on loans without the traditional fear of losing customers easily, making borrowing more expensive for businesses and individuals. Also, borrowers might have fewer options for loans and other financial products with fewer banks competing in the market.

c. Heightened Unemployment Rate

As stated in the preceding paragraphs, the Circular prescribes three (3) options for banks to comply with the Circular within the stipulated timeline. In the event that some banks are unable to meet the new requirements, they may opt for mergers and acquisitions or downgrade of license authorization. Where some banks opt for either of the foregoing, loss of jobs in the banking sector will be inevitable thereby heightening unemployment rate in Nigeria.

Conclusion

It is our view that the upward review of the minimum capital requirements of banks is within the regulatory purview of the CBN pursuant to Section 9 and 63(2)(a) of the Banks and Other Financial Institutions Act, 2020. In addition, the revolutionary move mirrors regulatory practices all over the world. Also, from our review of the Circular, the overarching objective of the Circular is to strengthen the financial ecosystem to revitalize the economy, which is highly commendable. Thus, the new policy holds promise for the banking sector and the national economy provided it is effectively implemented.

Furthermore, the possible challenges associated with the implementation of the Circular are not insurmountable. We recommend a phased recapitalisation approach to reduce pressure on banks to resort to drastic measures such as interest rate hikes as to meet the stipulated timeline for recapitalisation. The risk of reduced competition in the banking sector may also be mitigated by the relaxation licensing requirements for new banks to increase competition and transparency in loan pricing, giving customers the opportunity to select the best interest rates and thus enhance competition. Heightened unemployment rate may be unavoidable. However, with increased liquidity in the banking sector comes business expansion and development of new projects which typically results in creation of job opportunities for Nigerians.

Ultimately, to achieve the regulatory objective of the new policy, collaboration between stakeholders in the banking industry is pivotal. Also, banks must carefully evaluate their current financial standing, leverage their individual

opportunities and strengths in selecting the most suitable recapitalisation option for them as indicated in the Circular. With the foregoing, we are optimistic for a more resilient banking system that can withstand future shocks and support the GDP target of US$1 trillion by 2030.

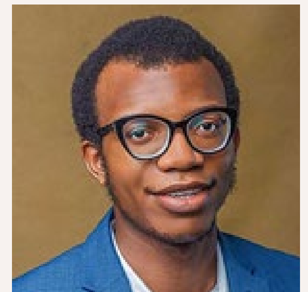
Authors

Damilola Adetunji
Partner

E: damilola.adetunji@odujinr-inadefulu.com
T: +234 1 271 4961-2

Olubukola Opebiyi
Senior Associate

E: olubukola.opebiyi@odujinr-inadefulu.com
T: +234 1 271 4961-2



Chigozie Chukwuma
Associate

E: chigozie.chukwuma@odujinri-nadefulu.com
T: +234 1 271 4961-2

Contact Address

Lagos Office
1st Floor, Church House 29 Marina, Lagos, Nigeria.
T: +234 127149612,
+234 708 6450 720

Abuja Office
3rd Floor, WAEC Complex
10, Zambezi Crescent Maitama
Abuja, Nigeria
T: +234 805 090 2150

Port Harcourt Office
16A, Manilla Pepple Street, D'Line, Port Harcourt, Rivers State, Nigeria
T: +234 70 869 53468