FAILURE OF PRIME MERCHANT BANK

1. Background Information

Prime Merchant Bank Limited (PMB) was incorporated on 17th August 1988 to undertake merchant banking business and was granted a banking licence on 5th October 1988. The principal promoter was Chief Ajibowu A. Owoade (a business man). At inception, no single shareholder was permitted to own more than 5% equity stake while the ownership structure must reflect two-third of the 19 states in existence then. However, subsequent liberalization of ownership removed those restrictions. The principal promoter took advantage of the liberalization policy to become the largest single shareholder of the bank.

For reasons to be discussed in the next section, corporate governance collapsed very early in the bank's existence. The principal promoter, who had neither proven track record of board leadership nor technical skill for bank management assumed an over-bearing role to the extent of conferring both board and executive management powers on himself. He assumed the position of Executive Vice-Chairman not provided for in the organization structure and without Central Bank of Nigeria (CBN) requisite approval. Thereafter, he engaged in various acts of insider abuse by dissipating the bank's resources for his personal benefits as highlighted in the next section. His unwholesome practices constitute the greatest factor that triggered the bank's failure.

The bank had only one branch in Kano. By 1993, it was declared distressed by the regulatory authorities. The failure of the shareholders and Board to implement remedial measures and directives of both the CBN and Nigeria Deposit Insurance Corporation (NDIC) led to further deterioration of the bank's condition and eventual failure.

The rest of this case study is organized into five sections. Section 2 presents an overview of the bank's performance while section 3 highlights the core reasons for failure. Section 4 covers regulatory intervention while section 5 deals with the failure resolution. Section 6 provides some learning points and conclusion.

2.0 Overview of Bank Performance

The CAMEL (Capital Adequacy, Asset Quality, Management, Earnings and Liquidity) parameters have been adopted to analyze the bank's performance in this study. The analysis that follows shows that the principal promoter willfully set the bank on a journey to failure.

2,1 Board and Management

The pioneer Board comprised of five (5) eminent Nigerians who had held high profile public offices in Nigeria. Ordinarily, the participation of such eminent personalities on a Board should elicit public confidence in the bank. But the conduct of the bank's affairs suggests that the presence of those eminent persons was just a facade as the principal promoter/Vice Chairman had his agenda to plunder and did plunder the bank.

At its first and second Board of Directors meetings held on December 8, 1988 and March 12, 1989 respectively, the Board approved Board Executive Committee (BEC) and Board Credit Committee (BCC) to facilitate effective Board oversight of the bank's affairs. The Board Chairman was appointed the Chairman of the BEC with the proviso that in his absence, a Non-Executive Director could chair the meetings of the Committee. The BCC had the Vice Chairman as its Chairman. But the Vice-Chairman under the pretext of a CBN advice, unilaterally changed the composition of all the Board Committees in order to be able to execute his pre-determined agenda. Furthermore, he made himself Chairman of the following Management Committees:

- Credit Committee
- Assets and Liabilities Committee (ALCO)
- Audit Committee
- Foreign Exchange Market (FEM) Committee
- Executive Management Committee

The quorum for each of these committees was: the Vice-Chairman and two other members. With such arrangement, no meeting of any of the committees could be held in the absence of the Vice Chairman thereby entrenching his stranglehold on the operations of the bank. Without seeking or obtaining requisite CBN approval, the Vice Chairman designated himself as Executive Vice Chairman (EVC) and became the de facto Chief Executive Officer. He arrogated to himself the powers of the Board and the functions of the Managing Director with key decisions taken by him while the Board was sidelined. The Board was not updated on the outcomes of the meetings of the various committees chaired by the Vice-Chairman, nor were actions taken presented to the Board for ratification. The stage was thus set for the Vice Chairman to operate as a Sole Administrator.

A major governance problem was lack of clear demarcation between Board and Management functions. As far back as 1992, CBN objected to the fusion of Board and Management functions and commented that “The arrangement by which the Vice-Chairman of the bank acting in the capacity of the Managing Director is unacceptable to us”. In an earlier communication to the bank, the CBN objected to the Vice-Chairman being Executive Vice-Chairman. In spite of CBN’s objection, the Vice-Chairman continued to act in the capacity of the Chief Executive of the bank. Even, the recommendation that the bank should operate Board Committees to effectively supervise the activities of the Management was not implemented. Similarly, the NDIC frowned at the unsavoury governance arrangement in its 1993 Bank Examination Report by stating that “During that period, the Vice-Chairman was actually the de-facto Chief Executive albeit without CBN consent. Consequently, the avenues for pooling together the collective wisdom of the Board on major decisions and proper guidance of the bank were made virtually non-functional. Major credit and operational decisions were taken in many cases solely by the Vice-Chairman and sometimes with the concurrence of the Chairman. Unfortunately, some of the decisions taken under the prevailing circumstance particularly regarding investment and credit disbursements largely exuberated PMB’s illiquidity, worsening losses, and the erosion of its capital which had characterized its operations”. Given its precarious condition, NDIC declared the bank distressed and recommended that Holding Action be imposed on it with a view to engendering self-restructuring by its shareholders and board. Furthermore, the Regulatory Authorities noted that membership of the Board was unstable between 1st December 1994 and 30th June 1996 as there were two Board changes with accompanying Management changes.

Expectedly, the atmosphere created was not conducive for Management stability. The pioneer Managing Director resigned after a short spell. His Deputy had resigned much earlier. For a period the bank had no substantive Managing Director. The Managing Director appointed in 1993 was stripped of the responsibilities of a Chief Executive Officer thereby rendering him a nominal Head of Management.

Under the foregoing scenario, the bank lacked strategic direction and focused leadership. Board meetings were infrequent. There were no policies to guide key operations of the bank. For example, the bank had no credit policy articulating its risk acceptance criteria. Virtually all (96.9%) of the credits granted were made to associated companies of the Vice-Chairman without rigorous credit appraisal or security. The credits became delinquent and were a major contributor to the bank's liquidity crisis. The Vice-Chairman was found to have engaged in a number of fraudulent activities.

A case in point was that without the authority or approval of the Board, the Vice Chairman pledged the credit balance of $5,893,441.00 in the bank's Autonomous Foreign Exchange Account with America Express Bank Ltd (AMEX) London as collateral for his foreign trading business through his company (Euromark Overseas Trading Inc). When Euromark suffered losses, the bank's foreign exchange balance with AMEX got encumbered. If that balance had been repatriated, it could have been utilized to ameliorate the bank's liquidity problems. NDIC in its 1993 Examination Report directed immediate repatriation of foreign exchange balance of $5.75million with AMEX, London but the directive was ignored. A similar directive from CBN was equally ignored by the Vice-Chairman.

It was also observed that certain liabilities of associated companies of the Vice-Chairman were manipulated to become the bank's obligations, such as lease finance transactions of associated companies. In fact, NDIC in its 1993 Examination Report recommended that the bank should completely disengage from wasteful and unprofitable investments in the associated companies of the Vice-Chairman. Given the bank's distressed condition and pursuant to NDIC's earlier recommendation, Holding Action was imposed on the bank in July 1994 which was intended to stem further deterioration of the bank's condition. Measures taken under the Holding Action included capital injection, strengthening of management, aggressive debt recovery, cost control and implementation of a turn-around plan.

Subsequent examination conducted by CBN as at 30th November 1994, revealed that the Shareholders/Board failed to implement the measures spelt out in the Holding Action imposed on the bank.

Consequently, the CBN Examiners made the following recommendations:

a. The Board should meet frequently in view of the imposition of Holding Action and to curb the excesses of the Vice-Chairman in order to successfully revive the bank.
b. An able and effective Managing Director should be employed in order to salvage the bank from its financial predicament.
c. The Board should put in place sound internal control policies to prevent frauds.
d. The Management should put in place a credible and independent Inspection and Audit Unit.
e. The Management should set up a well-staffed and well-equipped Debt Recovery Unit to boost recoveries.
f. The bank should quit shouldering the responsibilities of affiliated companies.

Rather than take measures to salvage the bank, market information available to the Regulatory Authorities, showed that unethical practices and misuse of the bank's resources by the Vice-Chairman continued unabated. NDIC in June 1995 conducted a Target Examination to confirm the veracity of the alleged unethical practices. The Examiners confirmed that unethical practices were still being perpetuated by the Vice-Chairman. The CBN intervened and through its letter dated 7th July 1995 removed the Vice Chairman from the Board of the bank on account of his recklessness in conducting the affairs of the bank, failure to repatriate $5.75million and imprudent granting of credits to his associated companies.

As should be expected, while the Vice-Chairman was rampaging the bank, there was total collapse of internal control mechanism. The Internal Audit Unit had only one staff, a junior staff of the grade of Supervisor for that matter. Unarguably, a staff of that grade could not make any meaningful impact on the audit functions of the bank. Therefore, most aspects of the bank's operations could not be audited. A CBN Examination Report highlighted major lapses which included: (a) absence of audits and operations manuals, (b) non-response to audit queries and (c) operations procedures were based on directives from Heads of Departments.

Hence, the Unit was ineffective. The weak internal control system encouraged incidences of frauds. For example, the Head of Corporate Banking Department was found to have suppressed a debit entry of N29million due to be passed to a client's account.

Equally worrisome, was the parlous state of the bank's Management Information System. The accounting system was characterized by mis-representations and poor record-keeping. As a consequence, the bank's Audited Accounts for the year ended 31st December 1993 could not be concluded due to Management's inability to provide credible explanations or clarifications on the external auditors' observations. Therefore, the bank had no audited accounts since 1993, the last being the one for 1992. This is a graphic illustration of corporate governance failure as manifested in inability to account for stewardship. Statutory audit is a legal requirement. NDIC in its June 1996 Routine Examination Report recommended the appointment of new External Auditors to audit the accounts for 1993, 1994 and 1995 for publication as required by the provisions of BOFIA. The report also recommended (i) injection of N816million in order to restructure the bank for long-term viability and (ii) recovery of $2.6million fraudulently transferred by the Vice Chairman out of the bank's account with AMEX. The obvious inference from the fore-going narrative is that the bank had been set on a journey to failure.

2.2 Asset Quality

As earlier noted, the bank had no credit policy and guidelines for credit administration. Credit decisions revolved around the Vice-Chairman. Most of the facilities granted were to the Vice-Chairman and his associated companies. The credit portfolio stood at N839,775,464 as at 16th January 1998 out of which N813,534,290 (or 96.9%) were traceable to Chief Owoade and his associated companies.

The breakdown of exposure to these related parties is as follows:

Vice Chairman	-	N51,688.528
Great Heights Investments	-	N1,054,577
Bibson Motors Limited	-	N1,289,513
Militax Nigeria Limited	-	N3,845,325
Prime Securities Limited	-	N20,433,060
Prime Securities (Bi Credit)	-	N10,000,000
Pacom Limited	-	N21,027,578
FX Naira Position	-	N507,804,673
Idejo Site	-	N42,321,667
LMTS Balpha	-	N127,251,558
Prime Securities	-	N26,817,811
TOTAL:-		**N813,534,290**

Almost all the facilities were classified lost based on CBN Prudential Guidelines. Substantial recoveries could not be made because the facilities were unsecured. The bank had no collaterals to fall back upon to mitigate its losses. To compound the situation, debt recovery machinery was non-existent. In any case, there was no intention or effort to repay the insider-related credits. Otherwise, the insider-related exposure which stood at N577.5million as at 30th June 1995 according to NDIC's Target Examination Report would not have grown to N813.5million as at January 1998. It is also note-worthy that the insider-related debts violated the bank's statutory lending limit.

Other acts of malfeasance by the Vice-Chairman included the transfer of Prime Securities Limited's debt on a lease transaction with LMTS to the bank. He had earlier diverted N48.5million meant to finance a lease transaction by one of his companies (Bison Motors Ltd) to LSTC. Thus a credit facility of N103.5million was manipulated by the Vice-Chairman into the bank's risk assets portfolio. This amount grew to N127,251,558 overtime with accumulated interest. The leases were never serviced and formed part of the charges for which the Vice Chairman was tried before the Failed Banks Tribunal.

2.3 Capital Adequacy

The bank had an authorized capital and paid-up capital of N46million as at the date of closure. But its capital had long been eroded by loan losses. NDIC's Routine Examination Report as at 30th June 2006 computed a negative shareholders fund of N812,284,693 which it recommended as the minimum capital injection to be made by shareholders. But the capital injection never materialized before the bank's closure. Given that delinquent related-party indebtedness amounted to N814million, repayment of those facilities could have addressed the bank's capital deficiency. That did not happen because the Vice-Chairman and his associated companies were not interested in the bank's survival as a going concern.

2.4 Liquidity

The bank's deposit base was highly short-tenored and most of it had 90 days maturity. Therefore, it could not support the bank's operations. The deposit base for 1991 – 1996 according to various Examination reports is as shown below:

Year	Deposit Base (=N= Million)
1991	300
1992	510
1993	231
1994	172
1995	121
1996	117

Above tabulation shows continuous decline of deposit base after 1992. Viewed against the backdrop of a delinquent credit portfolio, severe liquidity crisis was inevitable. For example delinquent insider-related credits amounted to N577.5million in 1995 vis-à-vis a deposit base of N121million.

2.5 Income and Expenditure

The bank's ability to generate profit was severely constrained by the reckless mismanagement of its resources by the Vice-Chairman. A case in point was the encumbrance he created on the bank's funds with AMEX and subsequent transfer of $2.6million for his own benefit. The losses suffered by the bank especially in 1994 and 1995 were inevitable due to sustained increases in provisioning for loan losses. A summary of the bank's Income and Expenditure Profile from 1991 to 1995 as extracted from various Bank Examination reports is presented below:

Year	Income (N'm) IN	Expenses (N'm)	Net Income NI	NI/IN
1991	106	90	16	15.1
1992	173	162	11	6.4
1993	345	326	19	5.5
1994	53	316	(230)	(490.2)
1995	34	695	(661)	(1994.1)

Source: Various Examination Reports

The above tabulation shows that net income (Income less Expenses) fluctuated between N16million in 1991, N11million in 1992 and N19million in 1993, it actually showed a declining trend when related to income generated. The bank suffered significant losses in 1994 and 1995. The failure of the shareholders to inject fresh capital or attract new investors showed that failure was inevitable.

3.0 Core Reasons For Failure

The preceding overview of the bank's performance based on CAMEL parameters has shed light on the reasons for the bank's failure. The core reasons for failure are summarized below:

3.1 The Board was not only passive but abdicated its responsibilities to the Vice-Chairman. The impunity with which he jettisoned the Committees set up by the Board raised suspicion as to whether the other Directors had beneficial interest in the bank. If they were real investors, they would not readily surrender the oversight of the bank to the whims and caprices of the Vice-Chairman who lacked both technical competence and leadership trajectory. The Board's abdication of its responsibilities denied the bank of strategic direction and focused leadership. Hence, policies to guide business conduct were not formulated.

3.2 There was no clear demarcation between Board and Management functions after the Vice-Chairman assumed the role of Executive Vice-Chairman (EVC). The fusion of Board and Executive powers in the EVC provided opportunities for monumental acts of insider abuse as all decisions revolved around the EVC who had a pre-determined agenda to plunder the bank. He made himself the Chairman of various Management Committees that could not meet in his absence. The arrangement violated good corporate governance principles with embedded checks and balances. The bank experienced Management instability attributable to the over-bearing role of the EVC. In summary, the total collapse of corporate governance contributed to the bank's failure.

3.3 There was total lack of risk management as manifested in concentration of credits in associated companies of the Vice Chairman which accounted for about 97% of the credit portfolio. Worse still, the credits were not subjected to established cannons of lending nor were they collaterised to protect the bank. Virtually all the credits became delinquent and the attendant provisioning made the bank to sustain huge losses, which eroded its modest capital funds.

The refusal or unwillingness to repay credits to the Vice-Chairman and his associated companies was a major contributor to the bank's failure because their quantum was sufficient to redress the bank's capital deficiency.

3.4 The fraudulent activities of the Vice-Chairman put the bank in a precarious condition. Without the Board's approval, he pledged the bank Autonomous Foreign Exchange Account with AMEX as collateral for his overseas trading company (Euromark Overseas Trading Inc). The account got encumbered and was not available to support the bank' operations. The Vice-Chairman later transferred $2.6million out of the account balance for his personal use. The directives of both CBN and NDIC that the fund be repatriated to shore up the bank's operations was ignored. Furthermore, lease obligations of two associated companies totaling N103.5million were manipulated into the bank's credit portfolio at the instance of the Vice-

Chairman. These fraudulent practices further exacerbated the bank's precarious condition.

3.5 The bank suffered severe liquidity crisis mainly due to the concentration of credits in associated companies of the Vice-Chairman and conversion of its Autonomous Foreign Exchange Account balance with AMEX by the Vice-Chairman. Consequently, the bank could not meet its matured obligations which induced erosion of public confidence. The declining trend of deposit base after 1992 was a clear evidence of loss of public confidence. If the funds held with AMEX had been repatriated, it could have been deployed to moderate the bank's liquidity crisis.

3.6 The deliberate sabotage of internal control mechanism was fully exploited by the Vice-Chairman and some other Management staff to both misappropriate and misapply the bank's resources. It is inconceivable that the Internal Audit function of a bank was assigned to one junior staff. If the bank had an effective internal control system with proper segregation of duties and dual control, the unilateral pledge of the bank's foreign exchange balance by the Vice-Chairman or the suppression of N29million debit into a client's account by a management staff could have been prevented.

The absence of an effective internal control system provided a fertile ground for the numerous fraudulent activities perpetrated to the bank's detriment.

4, Regulatory Intervention

As noted under the overview of the bank's performance, various bank examinations conducted by both CBN and NDIC revealed gross mismanagement, failure of corporate governance and a failing bank scenario. As a result, NDIC, in 1993 declared the bank distressed and recommended imposition of Holding Action on the bank with a view to halting further deterioration of its condition. However, the Holding Action was not imposed by CBN until July 1994. The shareholders and board failed to implement the measures specified by the Holding Action while the Vice-Chairman continued to engage in unethical practices detrimental to the bank's survival. Consequently, the CBN removed the Vice-Chairman from the board in July 1995.

In September 1995, the CBN assumed control of the bank and appointed an Interim Management Board (IMB) to superintend over its affairs. The mandate of the IMB comprised debt recovery and cost control. But given the circumstances under which unsecured credits were granted to the removed Vice-Chairman and his associated companies, little or no progress could be made on debt recovery. It was imperative that pressure needed to be put on the erstwhile Vice-Chairman in order to recover the debts owed by his associated companies. Accordingly, the IMB documented all his unethical and fraudulent activities and submitted same to NDIC for consideration. NDIC reviewed the submissions of the IMB and referred same to the Failed Banks Inquiry Unit of the Nigeria Police for further investigation.

Upon conclusion of Police investigation, the Vice Chairman and two others were arraigned before the Failed Bank Tribunal, Zone 1, Enugu in 1996 for charges which included stealing, unlawful advance of credit facilities contrary to the rules and regulations of the Prime Merchant Bank Limited and granting of credit facilities to the Vice Chairman and associated companies in contravention of section 18(3) of BOFIA, 1991 (as amended). At the end of the trial, the Vice Chairman was found guilty on most of the counts and was committed to prison sentence and fined. The conviction was accompanied with forfeiture of assets both personal and corporate in order to recover the debts owed the bank by him and his associated companies.

5.0 Failure Resolution

After assumption of control by CBN, effort to attract new investors to invest in the bank was unsuccessful. Against the backdrop of Federal Government policy that public funds should not be used to bail out banks, the final option available was liquidation. Accordingly, the bank's licence was revoked on 16th January 1998 along with those of 25 other banks by the CBN. Sequel to revocation of licence, NDIC was appointed liquidator in accordance with the provisions of BOFIA by the Federal High Court. The liquidator also obtained a winding-up order from the Federal High Court to wind up Prime Merchant Bank.

Pursuant to Liquidation, NDIC prepared Statement of Assets and Liabilities, Deposit register, Debtors' register and Schedule of Fixed Assets for realization. Deposit pay-out was the selected resolution option. A summary of the liquidator's activities as at 31st December 2012 is provided below:

Total loans as at closure	-	N838.11million
Cumulative recoveries to date	-	N49.30million
Disposal if fixed assets & Chattels	-	N7.67million
Total deposit at closure	-	N204.73million
Total deposit payment	-	N40.70million

6.0 Lessons Learnt and Conclusion

In retrospect, Prime Merchant Bank provides a classic example of how not to run a bank. The review of its performance from cradle to grave in this study shows that the bank provides some learning points some of which are listed below:

6.1 The passive disposition of the Board suggests that apart from the Vice-Chairman, the other Directors in spite of their pedigree had no beneficial interest in the bank. The abdication of a Board's oversight responsibility to a member with dubious motive is detrimental to the well-being of a financial institution. The scenario enabled the Vice-Chairman to exercise almost unlimited powers to plunder the bank. The lesson here is that governance should be a collective responsibility of the Board supported by a system of checks and balances and devolution of authority across different strata of the organization.

6.2 Given the technical and specialized nature of banking operations, it requires a professional and competent Management. The bank had no professional Management for better part of its existence and was left to the whims and caprices of a charlatan who was more interested in misappropriating the bank's resources. The lesson here is a bank's survival requires a professional and competent management accountable to a board with strategic focus.

6.3 Unethical practices require prompt corrective action by the Regulatory Authorities. The Vice-Chairman's fraudulent practices were observed and documented in various Bank Examination Reports as early as 1992/93. He flagrantly refused to implement regulators' directives targeted at halting the bank's deteriorating condition but was not removed until July 1995 by CBN after he had inflicted maximum damage on the bank. The lesson here is that regulators should take prompt corrective action to curb abusive or fraudulent practices by any director or manager.

6.4 Assumption of control of an insolvent bank by regulatory authorities without the power to inject capital where new investors are not available cannot ensure successful restructuring or turn-around of the bank. The Federal Government policy of not using public funds to bail out banks then was a hindrance to effective bank resolution. The learning point is that regulators should have the discretion to choose from a wide range of resolution options.

6.5 Risk Management is critical to a bank's viability. The concentration of the bank's credit portfolio to the tune of 97% in associated companies was a potential threat to viability and subsequent default by those affiliates spelt doom for the bank. The learning point is that a bank's risk should be adequately diversified.

6.6 Internal Control should be embedded in a bank's governance structure. In the case of Prime Merchant Bank, internal control was deliberately undermined thereby creating avenue for brazen misappropriation of resources and fraudulent practices. The learning point is that a bank can only neglect internal control at its own peril.

In conclusion, the abdication of the bank's responsibilities to a member who lacked technical competence and had no track-record of purposeful leadership of a highly leveraged financial institution was a recipe for chaos. The situation was compounded by the brazen misapplication of the bank’s resources and fraudulent practices by the Vice-Chairman who constituted himself into a Sole Administrator and chose not to be accountable to the Board. He ensured that the credit portfolio was concentrated on his associated companies without the intention of repaying the credit facilities. He also engaged in misapplication and conversion of the bank’s resources. His unethical and fraudulent practices caused the bank’s illiquidity and insolvency and eventual failure.