FAILURE OF MERCHANT BANK OF AFRICA LIMITED

1.0 Background Information

Merchant Bank of Africa (MBA) Nigeria Limited was incorporated on June 7, 1982 and having been granted the licence to operate as a merchant bank, commenced operations on June 20, 1983. At inception, fifty-five percent (55%) of the bank's equity capital was held by private Nigerians, forty percent (40%) by the Bank of America NT & SA as its foreign partner and five percent (5%) by the Federal Ministry of Finance Incorporated. Ten years later (in 1992), Bank of America fully divested from the bank and two years thereafter, the Federal Ministry of Finance Incorporated also fully divested.

MBA began with a 10-member Board made up of six Nigerians and four expatriates representing Bank of America. The pioneer Board Chairman remained in this position till September 15, 1995 when the regulatory authorities replaced the bank's Board with an Interim Management Team as part of the distress resolution measures to rescue the bank. Also, Bank of America provided the pioneer Managing Director/Chief Executive of the bank in person of Messrs K.J. Philipi but by 1988 the Board replaced him with Mr. B.O. Anyanwu.

At its peak, the bank operated with four branches located in Kano, Onitsha, Port Harcourt and Abuja. The bank also had some warped relationships with MBA Securities Limited and Parkview Property and Investment Company Limited both of which were initially portrayed as the bank's subsidiaries but indeed were claimed to be owned by some of the Nigerian shareholders of the bank. The two companies were found by bank examiners, to have been used as conduit pipes for a number of sharp practices within the bank.

2.0 REVIEW OF BANK PERFORMANCE

In our review of the bank's financial information we examine the financial facts as provided in the bank's audited accounts and available comparative figures as provided in bank examiners' reports. We synthesize the facts from both sources to provide a holistic report of what transpired in the course of the life of the bank. In this regard, we analyze the bank in terms of its size and its growth over time, volume of income generating activities with their inherent risks and profitability, owners' stake viz-a-viz the volume and cost of other people's funds employed in the business. Equally, we examined the bank's liquidity positions in the course of its existence.

2.1 Audited Financials

Using total assets as proxy for bank size, at commencement in 1983, MBA's total asset was N27.6million. In the first five years the assets grew at an average of 120% per annum, thus by the end 1987 the bank's total assets had grown to N607million. The next five years of the bank witnessed a much lower average annual growth of 22% in total assets. Hence by year end 1992 and 1996 (when the supervisory authorities replaced the bank's Board with an Interim Management Team), its total assets had grown to N3,028million (by the bank examiners' unaudited estimate). This represented an average annual growth of 22.4% for four years.

In terms of the components of the bank's total assets, as expected, the shares of loans and advances as well as cash and short term funds in the bank's total assets over this period were the highest. Apart from being the major components of the bank's total assets, the former harbours the credit risks while the latter indicates the bank's level of operational liquidity, both of which were key to its long term survival.

The bank's loans and advances grew from a meager N2million in 1983 to N154million in 1987, representing an average annual growth of 24% over the first five years of the bank's life. In the next five years from 1988 to 1992, the bank's loans and advances grew from N194million to N432million at an average annual growth of 28%. However, by 1996 when the regulatory authorities sent in an Interim Management Team, the bank's loans and advances had grown to over N2billion. A major problem with the bank's loan portfolio was the quality of these assets. For instance, in 1996 when the portfolio was N2billion the loan loss provision and interest in suspense summed up to over N1.2billion. These and other issues will be discussed in details when we examine the factors responsible for the bank's failure.

MBA started business with N6million share capital and maintained this position for the first five years of its existence. Over the same period, its shareholders' fund grew from N4.9million to N11.9million. Thereafter, the bank had a number of successive capital raise largely in compliance with the prevailing minimum capital requirement stipulated by CBN. At its peak in 1991, the bank's shareholders' fund was N66.6million. Thereafter, it began a progressive decline and by the time the bank was closed on January 16, 1998 the shareholders' fund was a deficit of N1,048 million.

In its first year operation, the bank's total deposit was N22.2 million and this grew at an annual average of 435% for the next four years which brought the total deposit to N466 million by 1987. This upward trend in the bank's total deposits sharply declined from 1988 when it grew by 24%. Worse still, the total deposits grew by 5% and 2% in 1989 and 1990 respectively, and suffered a negative growth of 3.4% in 1991. By 1992, total deposits resumed the upward trend as it grew by 41% and stood at N844 million. The bank examiners' estimate put it at N859 million in 1995 and N659 million in 1996, while the closing report (January 16, 1998) puts the bank's total deposit liabilities at N923 million.

In addition to the growth pattern of MBA's total deposit discussed above, it is noteworthy that interbank takings constituted the bulk of these deposit liabilities all through. It accounted for as high as 80% of the total deposits in 1990 and averaged 65% over the review period. This had serious adverse implications for the bank's cost of fund. Coupled with this was the implication that overall, the bank's deposit structure was also highly volatile.

From a paltry gross earnings of N340,000 and a loss of N1.1 million in its first year of operation, these rose to N55 million and N7.5 million (profit after tax) respectively at the end of the fifth year in 1987. By 1988 gross earnings grew to N102 million while profit after tax rose to N16.5million. However, while gross earnings kept growing in the next five years up until 1992 when it attained a level of N527million, profit after tax practically stagnated and by 1992 the bank actually reported a loss position of N50million. Over the same period, interest expense had remained the single largest expenditure item. Statistics from the bank also show that on the whole, total expenses were an average of 80% of total income over the period of 1987 to 1991, which to a large extent, explained the bank's poor profitability.

3.0 JOURNEY TO FAILURE: Extracts from Bank Examiners' Report on MBA

In the course of its existence, the regulatory authorities (CBN and NDIC) severally and jointly carried out both (routine and non-routine) statutory examinations on the bank. The reports were exceedingly revealing in many respect. One was on prolonged inefficiencies in the system that bordered on incompetence of both the Board and Management of the bank as well as outright malpractices and frauds. As a matter of fact, the NDIC examination report on the bank declared the bank insolvent outright. The summary of the extracts from these reports is represented in this section of the report.

3.1 Ownership

In furtherance of its decision to withdraw from the bank, Bank of America divested 33% of its 40% shareholding in 1990 while the bonus shares of 848,400 allotted to it in respect of the remaining 7% shareholding was renounced. The divested and renounced shares were taken up by interested existing and new shareholders except the Federal Ministry of Finance Incorporated and Mr. S.A. Ajayi. With the total issued and fully paid shares being 28.28 million at this point in time (1992), Bank of America's total holding was 1,331,200 shares representing only 4% of MBA's total shares.

It is noteworthy that the financial transactions in respect of the divested shares were noted to involve a lot of fraudulent practices committed by both top management staff and some Board Members. For instance, it was observed that MBA Securities Ltd had unpaid balance of N5.3million being accrued interest on the facility granted to it by the bank to finance the purchase of the divested shares kept in constructive trust for the Nigerian shareholders of the bank. Also, there was no evidence to show that the Managing Director's holding company, paid for its shares. It was equally discovered that the Bank's Managing Director paid for his own shares with a loan from the MBA Securities Limited.

By January 1993, the ownership structure had changed significantly. This was due to the full divestment of Bank of America's remaining 7% share and the privatization of the 5% shares held by the Federal Ministry of Finance Incorporation on the directive of the Technical Committee on Privatization and Commercialization. Arising from this, membership of the Board was reduced from ten to six as at January 1993.

3.2 Board and Management

The Bank started with a 10-member board, but following the divestment of Bank of America, four of the board members resigned. The Board's performance was however, found to be less than desirable by the bank examiners (in 1992) because it was not able to achieve most of its strategic initiatives. Some of the failed initiatives included its inability to recruit needed expatriate staff (as Deputy Managing Director/Controller) to handle the bank's operations which was long identified as a problem area. Another was in respect of the failed attempt to conclude a strategic alliance with the then promoters of Cristal Commercial Bank in spite of providing financial assistance to the promoters to establish the bank.

The Board was also reported to have compromised the operational independence of the bank's subsidiaries – MBA Securities Ltd and Parkview Property and Investment Co. Ltd. In this regard, the Board supported the dual roles being played by the bank's top executives. For instance, the bank's General Manager (Corporate Banking) was also the chief executive for MBA Securities Ltd. This not only affected the quality of the loans booked by this key department but also facilitated the numerous insider abuse cases perpetrated by the directors at both the bank and the subsidiaries. A particular case in point was in respect of MBA shares bought by the holding company of the bank's Managing Director when Bank of America divested. MBA Securities Ltd handled the sale of these shares and examiners' report noted that there was no evidence that the MD's holding company paid for the shares claimed to have been bought. And on further probing by the examiners; MBA Securities Ltd was said to have granted a loan to the bank's Managing Director to pay for the shares.

In January 1993 examination report, the Board was indicted on many grounds. One was in respect of inadequate staffing at the top management level and failure to stem the incidence of high management staff turnover in the bank. This was compounded by the dissipation of the thin management staff it had by seconding some of them as technical management staff to City Savings and Investment Bank of Namibia, an equally ill-conceived offshore investment. Another was the shoddy implementation of the bank's computerization programme which adversely impacted on the accounting and internal control systems and operations.

The examiners' report of June 1996 noted that the Board conducted the affairs of the bank in such ways that compromised the interest of MBA and furthered the exploitation by members of the Board and some other shareholders. For instance, there were enough documentary evidence showing that MBA Securities Ltd and Parkview Investment Company were floated and incorporated by the bank and with the bank's funds they operated like subsidiaries of the bank only for ownership of these companies to be claimed by some of the Board Members and shareholders. MBA Securities Ltd voluntarily severed its relationship with the bank in December 1994.

The Board also invested the bank's fund in some untenable projects even when the bank's condition had visibly deteriorated, (the BEC Development Company, Eastern Wrought Iron Company and the N35.2 million investment in the Namibia Banking Corporation embarked upon even when the CBN had imposed Holding Actions on the bank were cases in point). Finally, prior to the supervisory intervention the Management had been factionalized with noticeable in-fighting and lack of cooperation.

Other significant malpractices committed by the defunct Board included some fraudulent real estate transactions between the bank and Parkview Investment Company and the investment of 98% of the bank's Staff Pension

Scheme fund in the bank and in MBA Securities Ltd. Coupled with these malpractices listed above were other issues relating to the fundamental deficiencies in the bank's accounting system and internal controls noted in earlier examination reports which were further aggravated. All these have adversely affected reconciliation and generated significant differences in General and subsidiary ledger balances running into millions of Naira and rendering the bank's internally generated financial information grossly inaccurate and unreliable.

3.3 Accounting System and Internal Control

The examiners' appraisal of the bank's accounting system and internal controls revealed some fundamental weaknesses relating to accounts reconciliation, defective record-keeping and communication gap between departments/units on operational information. For instance, there were cases of vouchers raised by one department on some transactions not brought to the notice of other relevant departments to raise complementary entries that would ensure that there were no differences in related account balances. In the same vein, there were reported cases of huge and long-standing un-reconciled inter-branch and correspondent banks' transactions. In fact, the examiners noted that the bank's current account with the CBN had over 65 outstanding reconciliation items. The bank was also reported as not having any register for its Guarantees and Liabilities on Acceptances, thus the amounts standing in the bank's books as off-balance sheet engagements could not be verified.

In all, these lapses were found to have provided veritable ground for perpetrating frauds and other sharp practices. For instance, because the bank had no separate registers for tracking its foreign exchange (forex) transactions in autonomous and interbank markets, a reported case of negative open position of US$2,329,743 could not be resolved. Furthermore, due to these lapses, the bank was able to conceal a portion of its deposit liabilities especially in respect of a special Corporate Banking Fund set up by the bank to finance the issuance of Bankers' Acceptances. Understatement of deposit liability was a ploy to reduce deposit insurance premium due to NDIC. A key point on this issue of the noted lapses above is that they were direct consequences of inadequately staffing the accounts, operations and internal control departments and these appeared to have been deliberately perpetrated.

The examiners' report of January 1993 noted that the accounting system remained partly computerized (General ledger computerized while the subsidiary ledgers were manually operated). This situation led to a lot of differences in the account balances between transaction originating departments and Account department. The Internal Control Unit was inadequately staffed and along with the accounting system problem noted above, it was inevitable that the bank's records and returns to CBN and NDIC seriously lacked integrity.

The examination report of February 1995 reiterated the fact that the accounting system remained partially computerized with all the shortcomings as identified in earlier examiners' reports. Prominent problem in this regard was reconciliation. For example, there were many long outstanding (over three years) un-reconciled balances with some local banks which totaled N93.3million; there was accumulated un-retired cash advances granted to staff for official assignments. Similarly, there were outright omission of ADB/ESL facility of N386.8million from the General ledger and a misclassification of another such facility worth N48million.

3.4 Liquidity and Funds Management

The examiners' report of January 1992 puts the bank's total deposit liability at N742.7million and was reported to have been dwindling in the last two years. Noted defects in the profile of the deposits were its very short maturity as well as the fact that the bulk was from placements from other banks. About 75% of these deposits had maturity of less than three months while over 82% had maturity of less than six months and over 62% were placements from other banks. Thus the bank's funds were short tenured and highly volatile with its excessive reliance on interbank and other short term funds. Viewed against the maturity profile of the bank's loans and advances, where it was noted that the overdraft facility with the shortest duration of one year was the least, it was clear that the bank had serious maturity mismatch and liquidity problems. In fact, the bank was reported to have been close to liquidity failure in 1989 when public sector deposits were withdrawn from the licensed banks. It was one of the ten banks bailed out with NDIC accommodation facility in 1989 but failed to learn the appropriate lesson by diversifying its deposit base. Over-reliance on volatile interbank funds made it prone to intractable liquidity crisis. Finally, the bank's liquidity ratio which appeared to have improved on paper was a product of fraudulent manipulations of returns rendered to the regulatory authorities by the bank such as understating its assets.

3.5 Income and Expenditure

The examiners' report of January 1992 revealed that interest received from loans and advances was the bank's major income source accounting for about 70% of total income. This was followed by income from leasing activities which was 17% of total. Other income sources like foreign exchange transactions, fees and commissions made marginal contributions to total income. Two important observations noted were the serious decline in forex transactions income and the fact that though fee income grew in absolute terms but that was due to some arbitrariness in the charges imposed on customers most of which later generated controversies on the affected accounts. Overall, the bank's total income maintained its trend of marginal increase as was in the preceding years.

Total expenditure also trended upwards like the total income. Interest expense was the major component accounting for 69% of total, followed by staff and other overhead costs. The bank was noted to have deliberately underprovided for its loan losses thereby overstating its income from loans and advances. It was also observed that there had been a systematic decline in the percentage of interest margin and interest income to total income over some years back. On the whole, the bank's over-dependence on expensive interbank takings and lack of control of overheads were responsible for the observed profit erosion.

The examination report of January 1993 showed that the bank's profit reduced within one year by about 50% from N30.7million to N15.6million. This was because over the same period expenditure grew (by 128.4%) faster than income (109.8%). Interest expense which was the major expenditure item grew by 163% in one year. Due to the bank's high dependence on interbank funds (at 62% of its total deposits) its ratio of interest expense to interest income was as high as 93.6%, net interbank indebtedness was N463 million and average interbank cost of funds was 118% for the year under review. Against the backdrop of under-provisioning for loan losses, the profit reported was not real.

The examiners' report of June 1996 revealed that the bank's loss-making which started in 1992 when it reported a loss of N50million increased to N843 million in 1993 and came down to N600 million and N696 million in 1994 and 1995 respectively. It however, turned out that the reduction in the bank's loss positions for those two years were as a result of fraudulent and deliberate under-charging for the loan loss provision. For instance, total loan loss provision charged to the profit and loss account for 1993 was N751 million but this was reduced to N539million and N389 million for 1994 and 1995 respectively even when the bank's credit portfolio suffered worse deterioration. Lastly, the bank's capacity to generate income had seriously diminished and worse still, its expenses particularly, interest expense was rising. For instance, in 1991, interest expense was N183 million and was 70% of total income.

By 1995 it has increased to N498 million and was 84% of the bank's total income. The major reason for this anomaly was the bank's heavy dependence on expensive interbank takings to fund its operations.

3.6 Credit Administration and Assets Quality

The problem of poor quality assets was very pronounced. This was attributed to saddling the General Manager in charge of corporate banking with the responsibility of being the chief executive of the bank's subsidiary MBA Securities Ltd simultaneously. This resulted in inadequate attention being paid to the bulk of the bank's loan portfolio. Invariably, the bank resorted to loan repackaging, rescheduling and rolling over with intent to portray such facilities as performing in violation of CBN Prudential Guidelines. In particular was the portion of these delinquent loans that were ADB/ESL facilities that had crystallized and the Naira equivalent debited into the bank's CBN account. In addition, to this problem was the issue of insider abuse. Many of the bank's directors and shareholders as well as their related interests were heavily indebted to the bank and the facilities were non-performing. This situation seriously compromised the Board's oversight function on loans. To further worsen this was the issue of concentrated lending especially in respect of the ADB,ESL loans guaranteed by the bank. Most of these facilities were also classified with the attendant liquidity problem created for the bank when on crystallization, the CBN debited the bank.

On the whole, as an indication of the depth of inherent deficiency in the loan portfolio undisclosed by the bank, the examiners noted that about 37.7% of the total loan portfolio haboured various defects and therefore recommended that the bank should increase its provision for loan losses to N173.6 million as against the N79.3 million set aside by the bank.

In examiners' report as at January 1993, the bank's total credit was N862.6 million out of which N454.8 million (53%) was deficient and required loan provision of N238.8million. Interest in suspense was N63.5million while the bank's loan loss provision was N145million as against the examiners' figure thus showing a shortfall of N93.8 million.

The report strongly noted deep-rooted lapses in the bank's credit approval and documentation process. Loan monitoring was left for operations department which had little information on the facilities. Non-performing insiders' credit amounting to N55.9 million (or 12.3% of classified debts) was another problem with the loan portfolio. Finally, the bank's outstanding guarantees were grossly deliberately understated as N74.6 million as against N324.2 million in the bank's books.

An important remark that can be inferred from the tone of the report's conclusion was that the severity of the bank's problem was underplayed.

Even though Holding Action was imposed on the bank's lending activities by CBN in 1993, the credit portfolio continued to grow. The Bank Examiners report of October 1994 put the bank's total loans and advances at N1.305 billion out of which N1.06 billion or 81.3% was non-performing. Interest in suspense was N127 million, bank provision was N476.8 million as against examiners' recommendation of N778.9 million. Insiders' credit was N79.5million out of which N70.9 million or 89% was non-performing. A major chunk of the deficient loans was the ADB/ESL facilities for which the sum of $114million was past due, the beneficiaries defaulted and the bank was debited by the CBN accordingly.

The examiners' report of February 1995 revealed that there had been serious deterioration in the credit review processes and records. The bank was found to have practically abandoned this function since the holding action was placed on lending in 1993. Total credit portfolio stood at N1,092 million as against N1,139 million recorded in the previous examination in January 1994; a marginal decrease of N46.9million or 4.3%. In addition, there were ADB/ASL facilities totaling N386.8million out of which N217.2 million had crystallized. Director-related loans had reduced by 5.1% to N54.2million due mainly to recoveries. However, virtually 100% of the total loan portfolio was delinquent as N844.98 or 88.6% were classified as lost and N108.8 million ot 11.4% was doubtful. Thus the examiners' provision N1,094.6 million as against the bank's figure of N507.9million an increase of N586.7 million. In addition, other known losses such as trapped placements with other banks and uncollected interests, amounted to N208.9 million.

The special examination report of June 1995 revealed that the bank's loan portfolio had grown to N2,099 million out of which N2,016 million (or 96%) was adjudged non-performing with required loan loss provision of N1,953 million as against the bank's provision of N539 million. Further review of the report shows that N868 million (or 41%) of the total credits was in respect of ADB/ESL facilities that have crystallized, N417 million (or 20%) was on overdrafts while term loans were N490 million (or 23%).

The major problems with the credits portfolio were poor loan administration, excessive exposure to ADB/ESL facilities and credit concentration. For instance, cases of missing credit files and incorrect loan balances on customers' file were very prevalent and in fact in some instances led to litigation. On concentration, the total exposure to ten companies was put at N913 million (or 43%) of total credit portfolio. In addition to these problems were the ADB/ESL facilities that crystallized. It was also noted that the bank did not give due regard to securing the facilities despite the appraising officers' recommendation with the resultant hardcore credits being unsecured.

Based on the financial information on the bank as at the time of the examination, its' risk-weighted capital adequacy ratio was negative 46.5% as against the stipulated minimum ratio of 8%. As a result, the bank required the sum of N1,360 million in fresh capital to meet the mandatory minimum capital requirement.

The last routine examination report conducted in 1996 showed that the bank's total credits had marginally reduced from N2,099 million in June 1995 to N2,016 million, out of which N2,003 million or 99% was classified. In addition, other known losses were N432 million and equally attracted full provision. Thus the bank's required provision was N2,403 million as against the existing loan loss provision of N1,577 million. In terms of facility type, Overdrafts accounted for N885 million (or 44%), term loans were N585 million (or 29%) while BAs and CPs were N200 million (or about 10%) of the portfolio.

Furthermore, the bank had N717 million (or 40%) of its credit portfolio exposed to a group of related companies while director-related loans amounted to N103 million or 5% of the bank's total loans and advances.

The widespread improper record-keeping in the bank noted above had, among other problems, generated a lot of fictitious assets in the bank's loan portfolio, which even in some cases, had resulted into dispute between the bank and some customers over their loan balances. The bank was also reported to have abandoned the quarterly credit review stipulated in the Prudential Guidelines issued by CBN. Expectedly, the focus of the Interim Management Board was debt recovery and in its first nine months up to June

1996, it had recovered the sum of N224 million representing 11% of the total loan portfolio.

3.7 Capital Adequacy and Solvency

The NDIC routine examination report of 1992 demonstrated the insolvency of the bank and was the first formal report to pronounce the bank as being technically insolvent. The bank's adjusted capital was put at negative N10 million and a negative risk-weighted asset ratio of 1.07%. On the basis of this, the bank was adjudged technically insolvent having negative net-worth as at January 1992. The examiners' specifically indicated that at least N85 million would have to be injected by the shareholders for the bank to meet the minimum capital requirement for the level of its operations.

The examiners' report of October 1994 revealed that on both the adjusted capital and risk-weighted capital ratios, the bank's scores were still negative. The bank's risk-weighted capital ratio worsened from the negative 1.07% in the 1992 report to negative 20% as against the 8% stipulated and implying that the bank on the whole required N354.4 million in fresh capital injection to meet the minimum prudential stipulations on these ratios. The obvious conclusion is that the bank had sunk deeper into insolvency.

The examiners' report of February 1995 noted that the bank's continuing operational losses from 1991 together with huge bad debts and the attendant loan loss provision resulted in negative shareholders' fund of N544.8 million with adjusted capital ratio of negative 1:1.07 and a risk-weighted capital ratio of negative 28.1% as against the stipulated minimum of 8%. Thus, the bank's required fresh capital injection to the tune of N584.8 million for the bank's share capital to be restored to the then required minimum paid up capital of N40 million.

The June 1996 routine examination revealed that the bank's paid up capital of N77.6 million had been fully eaten up by huge operating losses and provisions for non-performing credits. The bank had a negative shareholders' fund of N695 million. Its adjusted capital was negative N1,522 million and a risk-weighted asset ratio of negative 105.7% (as against stipulated minimum of 8%). The bank required a total of N1,637 million in fresh capital to enable it meet the statutory minimum solvency benchmarks. It was therefore deeply insolvent.

3.8 The Closing Report

The bank was closed on January 16, 1998 following the revocation of its banking license by the CBN. As at the time of closure, the bank's net worth was a deficit of N1,048 million. Total deposit liabilities amounted to N718 million, net loans and advances was N246 million (risk assets was N1,748 million while provision and interest in suspense was N1,996 million). Insiders' credit was N122.6 million.

The closing report corroborated the issue of widespread inadequacy of documentation in credit files as noted in virtually all the examiners' report. It noted that most files had no evidence (such as application and sanction letters) to show that any advance was granted and that these lapses were prejudicial to proving the indebtedness of the loan defaulters. Also, there was apparent jettison of credit guidelines especially in respect of government funded/guaranteed loan schedules such as ADB ESL. Credit proposals appeared not to have been subjected to the laid-down stringent appraisal and approval procedures. When the facilities subsequently crystallized and the CBN debited MBA's current account, it was a major factor that precipitated the bank's distress and its eventual collapse.

Lastly, a major observation of the closing report was in respect of the imprudence with which the Board made some foreign investment in Namibian Banking Corporation at a time when MBA was already in distress. Apart from the N35.2 million investments, an additional sum of N26.6million was spent on MBA's representatives' attendance at meetings in Namibia. Worse still was the fact that the imprudent investment was later fraudulently converted by some former directors.

4.0 Factors Responsible for MBA's Failure

The preceding review of the financial and non-financial information on the activities of Merchant Bank of Africa has shed a lot of light on the critical factors that led to the bank's ultimate failure. While each factor would still be elaborated upon, we sum up the factors in terms of total collapse of corporate governance in the bank. Manifest weaknesses in the bank's corporate governance structure include technical incompetence and poor leadership on the part of the Board resulting in poor discharge of its oversight functions, fraudulent and self-serving practices among members of the Board and Management, ineffective management information system and weak internal controls, poor risk management practices resulting in large quantum of non-performing credits. However, ahead of this manifestation of the collapse of corporate governance in the bank was the divestment by the Bank of America. This development paves way for other ugly manifestations.

a. Divestment of Bank of America

The first and probably the primary factor that induced most other factors was un-mindful implementation of the indigenization policy of the Federal Government, which prompted the divestment of the bank's core investor – Bank of America. This core investor provided the bank with sound technical representation on the Board, which in turn drove the excellent performance of the Board in terms of upholding good corporate governance practices and execution of its oversight function on the bank's management. Secondly, operational excellence was also driven in the bank by the Bank of America. For example, shortly after the exit of this core investor, technical partner, the NDIC examiners' report of 1992 which was the first to declare the bank as being technically insolvent, noted the Board's inability to recruit two competent expatriate staff to strengthen operations as Deputy Managing Director and Controller of Operations. The need for that recruitment was because of the vacuum created with the exit of the team of expatriates including the Managing Director following the Bank of America's divestment.

b. Fraudulent and Self-serving Practices among Members of the Board.

The exit of representatives of Bank of America from the Board, created opportunities for the remaining Board Members to engage in all manners of self-dealing. In order to veil their self-dealing, all the Board Members transferred their shareholdings to various holding companies, such that the

Board was therefore composed of proxies, representing each member's holding company. Among the noted cases of self-dealing that the Board Members engaged in was the issue of ownership of MBA Securities Limited and Parkview Investment Company. Bank examiners' report of June 1996 claimed to have come across substantial evidence to show that the two companies mentioned above were incorporated and owned by the bank and with the funds of the bank, but along the line the Board Members claimed to own the two companies. A more shocking case of self-dealing was in respect of the bank's investment in the Namibian Banking Corporation at a time when MBA was already in distress and which was later fraudulently converted by some former directors.

The above facts clearly illustrate some form of what is termed as the 'agency problem' in corporate finance theory. Agency problem refers to the difficulty faced and cost borne by a principal in ensuring that contractual relationship with an agent is carried out in the best interest of the principal. While there is no doubt that the contractual relationship between a bank and its employees is principal-agent, in strict legal terms, the relationship between the Board and owners of a business (i.e. the shareholders) is trusteeship. But in the more generic sense it fits into an agency contractual relationship, hence the agency problem framework may be employed to analyze and understand the behavior of the bank's board.

Two major features of this contractual relationship ensure that agency problem exits. One is the inevitability of information asymmetry. Bank Board would always have strategic and operational information about the present activities and future direction of the bank over and above the quantum of such information that would be at the disposal of the owners (i.e. the shareholders). Second, the contracting parties' interests do not necessarily coincide and in particular, the possibility that an agent can employ either 'effort' or 'sabotage' in the pursuit of his interests means that there is need for monitoring and enforcements by the principal.

In MBA's case, the Board took advantage of the information asymmetry to establish MBA Securities Ltd and Parkview Investments Company seemingly, as subsidiaries of the bank and with the resources of the bank.

But because the Board could not be properly monitored to ensure that it acted in the bank's best interest, the Board employed 'sabotage' to defraud the bank of these and other investments such as was done in the Namibian Banking Corporation.

c. Ineffective Management Information System

The examiners' reports were replete with adverse comments on the short-comings of the bank's management information system. The bank's computerization programme was shoddily implemented with no experienced staff employed to drive the programme. The accounting system was partially computerized and was noted to be inadequate in both design and scope; hence proper records of assets and liabilities could not be maintained. This undermined the tracking of loan assets, deposit takings, income and expenditure recognition and precipitated huge reconciliation problems for the bank. Likewise, the internal control system was grossly deficient and under-staffed. Necessary control measures such as account reconciliation and segregation of duties were not given the deserved attention and resources.

d. Poor Risk Management Practices

Poor administration and management of the bank's risk assets was the single most devastating factor that brought down the bank. For instance, in its twilight days as revealed in the special examination report of June 1995, the bank's loan portfolio was N2,099 million out of which N2,016 million (or 96%) was adjudged non-performing. The sum of N868 million (or41%) out of the total credit was in respect of ADB/ESL facilities and had fully crystallized necessitating the CBN to debit the bank's current account and further compounding the bank's operational liquidity problem and ultimately its solvency. The bank's non-adherence to credit guidelines, loan concentration and jettisoning of credit review processes were the major problems that culminated in the huge non-performing credits. Coupled with the deficiencies noted above in the bank's information system, it was a matter of time for the problem to completely grind the bank to a halt.

e. **Sloppiness of External Monitoring/Supervision** In addition to these internal factors discussed above, there was also the failure of the external mechanism for ensuring corporate governance and arresting deviant situations. One was the external auditor's apparent complicity especially with respect to under-provision for non-performing credits. The auditing firm of the Company at that time cannot claim ignorance of the deficiencies in the internal workings of the bank neither did it make the bank to adequately provide for visible deterioration in the bank's credit portfolio. The external auditors compromised by giving the bank a clean bill of health in spite of their knowledge of these short-comings. Second, it also appeared that there was regulatory lethargy. The bank was first pronounced technical insolvent in the January 1992 NDIC examination report. Then the bank needed about N85 million in fresh capital injection to come out of insolvency. Two year later in 1994, the required fresh capital injection had increased to N354 million. A year thereafter, the bank had sunk deeper into insolvency and required N585 million in fresh capital, and by June 1995 which was shortly before the regulatory authorities decided to intervene to rescue the bank, the required additional capital was N1,360 million to meet the mandatory minimum capital requirement. Apart from the imposition of holding actions which itself had little or no effect on arresting insolvency, there was no decisive regulatory intervention in the bank to prevent further slide into deeper insolvency. Such delay could only have increased the tax payer's cost of resolution to the resultant insolvency. The delay was attributed to the inadequate resolution powers conferred on CBN and NDIC. For example, the Federal Government policy then was that public funds could not be utilized to bail out banks. Any intervention in MBA without capital injection was an exercise in futility.

5.0 Failure Resolution

After the bank was adjudged to be technically insolvent, CBN imposed Holding Action in 1993. The major objective of Holding Action was to engender self-restructuring by the Shareholders and the Board. Measures to be taken typically include capital injection, change or strengthening of

Management, aggressive debt recovery, cost/staff rationalization, submission of Turn-around Plan and rendition of monthly returns on key performance indicators. However, the Shareholders and Board failed to implement the Holding Action imposed by CBN. Expectedly, the bank's precarious condition continued to deteriorate which led to the assumption of control effected by CBN in September 1995. An Interim Management Board (IMB) was appointed to replace the Board and Management that were removed.

The mandate of the IMB was mainly debt recovery and cost rationalization. The IMB superintended over the bank until the revocation of its banking licence in January 1998. In the absence of capital injection, the impact of the IMB on reversing the deteriorating condition of the bank was minimal. With the revocation of the bank's licence, NDIC was appointed the bank's liquidator. The liquidator also obtained a court order to wind up the bank. Depositor reimbursement was adopted as the final resolution option.

The performance of the liquidator as at 31st December 2012 is summarized below:

Total Deposit as at closure	-	N712.398 million
Payment to depositors	-	N431.909 million
Total Credit Portfolio at closure	-	N2,048.81 million
Cummulative debt recovery	-	N235.09 million
Disposal of Fixed Assets and Chattels	-	N305.78 million

In order to ensure that wrongdoing did not go unpunished, the liquidator documented the numerous unwholesome practices by the Board and Management and submitted same to the Failed Banks Inquiry Unit of the Nigeria Police for further investigation. Upon conclusion of Police investigation the erstwhile Managing Director of MBA was prosecuted before the Failed Bank Tribunal.

6.0. Lessons from the Failure of MBA

With the benefit of hindsight a number of lessons could be drawn from the above review of the critical factors that eventually led to the collapse of MBA. In the main, it can be summed up as the collapse of corporate governance in the bank but in some specific terms, the following lessons are instructive.

i. Information from the bank's financial statements suggests that the deluge of malpractices in the bank began with the orchestrated exit of Bank of America under the guise of implementing the indigenization policy. The withdrawal of representatives of Bank of America from the MBA's Board and top Management positions was a development that negatively affected the bank in two respects. One was the loss of advocates of good corporate governance practices on the board of the bank and secondly, the loss of experienced top management staff. The lesson here for our policy-makers is that our domestic economic policy should not inhibit foreign investment from core investors with potentials for providing technical support and best practices for our banking system which, in relative terms, is still in its infancy. Holding on to the technical partnership with seasoned banking institutions such as the Bank of America with track record of sound corporate governance practices and experienced staff would probably have forestalled some of the malpractices that eventually led to the failure of MBA. We however, acknowledge the fact that both our broad economic policies and banking policies have of recent reflected this thinking in view of the recent amendments to related legislations.

ii. A second lesson point from the failure of MBA is with respect to the effectiveness and responsiveness of the frame-work for addressing corporate governance failures whenever it happens in our banking system. There appears to be considerable lethargy in this frame-work and this was responsible for the aggravation of the ultimate loss that the public purse was subjected to by the time the curtain was drawn on MBA, To facilitate early intervention in troubled banks, the CBN and NDIC, in 2001 initiated a Contingency Planning Framework for Distress Resolution while some sections of BOFIA were amended to enhance CBN's intervention powers. In the same vein, the connivance or helplessness of external auditors would also be lessened if additional disclosure requirements can be stipulated that would compel greater transparency and reduce information asymmetry and associated moral hazards.

iii. A third lesson relates to government policy which prohibited the use of public funds to bail out banks. The policy constituted a hindrance to bank resolution. The revival of a technically insolvent bank should be subjected to established principles of corporate restructuring which inevitably would involve capital injection into an insolvent bank by the regulatory authorities in cases where the existing shareholders lack the financial capacity or new investors are not readily available. The intervention by CBN in 2009 could not have been possible if that policy was still applicable.

iv. A fourth lesson relates to automatic debit of banks by CBN with regard to foreign currency denominated credits provided by international financial institutions for on-lending to local entrepreneurs. The tripartite agreements under which CBN debited banks for crystallized facilities aggravated the liquidity problems of MBA and other banks whose current accounts with CBN had no funds to meet the matured obligations. The arrangement also unwittingly made some banks not to apply established credit appraisal criteria for beneficiaries of such foreign credit facilities. Eventually, CBN had to stop debiting the accounts of banks in liquidity crisis.

v. Another lesson from MBA's case was that any bank whose Board and Management willfully engage in fraudulent practices is bound to fail. The fraudulent disposition of the Board and Management of MBA was a major contributor to its failure. Probity, accountability and transparency in the management of resources are critical to a bank's viability and survival.

7.0 Summary and Conclusion

We have examined the available facts on the operations and factors responsible for the collapse of Merchant Bank of Africa. Specifically, we have reviewed the operational practices of the bank, the operating policy environment, the role of the bank's board in relation to the performance of its oversight functions, the external auditors and the roles of the supervisory/regulatory agencies. Our findings revealed that the bank's journey to extinction began with major blow to its enviable Board composition which had great potentials for sound corporate governance practices when the representative of the core investor (Bank of America) with solid banking experience had to divest on ground of a domestic policy of indigenization.

The collapse of corporate governance that ensued manifested in many aspects of the bank's life. The bank suffered lack of quality top management staff to handle key areas of operations. Its accounting system was partly and badly computerized thereby compromising internal controls system and reconciliations. Credit administration and reviews were shoddy especially, with the externally funded schemes like ADB/ESL credit facilities. The performance of the external auditing firm was less than desirable and the decisive regulatory intervention appeared to have come when the bank's level of insolvency had become terminal.

However, since a lot of reviews and enhancements have been brought to bear on the guiding legislations for banking as well as on the responsiveness of supervisory/regulatory authorities, there appears to be a reduced likelihood that the factors that led to the bank's collapse can ravage any of the existing banks with as much impunity and devastation as was the case with MBA.