

FAILURE OF ABC MERCHANT BANK LIMITED

1.0 INTRODUCTION

- 1.1 ABC Merchant Bank Limited was incorporated in 1982 as a private limited liability company to render merchant banking business. It commenced operations in 1984 at its Head Office, located at No. 11, Adeola Hopewell Street, Victoria Island, Lagos, and had four branches.
- 1.2 Right from inception, the bank experienced corporate governance challenges. The Board Members failed to discharge their fiduciary responsibilities. Rather than formulate policies that would drive the growth of the bank and provide strategic direction, they engaged in self-dealing practices. For example, at board meetings, they spent a lot of time arguing about interest charges on their non-performing credit facilities. Similarly, the bank experienced management instability as it had three Managing Directors (MDs) within a short span of time.
- 1.3 As a result of Board and Management ineptitude, the bank could not be nurtured to viability. Its growth was stunted; its meager capital fund was eroded largely by non-performing insider-related credits while the shareholders were unable to inject fresh capital as directed by the Regulatory Authorities. The bank was both illiquid and insolvent and could not be resuscitated by its shareholders. Consequently, its license was revoked by CBN on 16th January 1998 and put in liquidation by NDIC.

1.4 The rest of this case study is organized into six sections. Section 2 traces the bank's journey to failure while section 3 focuses on the early warning indicators of failure. Section 4 highlights the core reasons for failure while section 5 reviews regulatory intervention by CBN and NDIC. Section 6 provides some learning points while section 7 provides summary and conclusion.

2.0 JOURNEY TO FAILURE

- 2.1 The pioneer Managing Director (MD) who was one of the bank's founding members, was adjudged incompetent by the Board and removed from office. He challenged his removal by the Board in court but was unsuccessful. An expatriate MD engaged in replacement, started well, but left after a short stay, due to frustration caused by insider abuses by the Board Members. He was quickly succeeded by another, a Nigerian, during whose tenure the Board became divided, as some Board Members were not happy with his appointment.
- 2.2 An early symptom of the Board's ineptitude was its recourse to using depositors fund to finance the Head Office building project which adversely impacted on the bank's liquidity.
- 2.3 The Board Members used their privileged position to obtain credit facilities which they failed to service and became delinquent. Bank Examiners noted that 49% of the total risk asset was in the hands of insiders. The CBN removed from the Board and blacklisted five of the directors connected with non-performing credits. That action strained relationship amongst Board Members.

- 2.4 There was disharmony and mistrust amongst Board Members to the extent that they could not muster the will to confront the strategic issues critical to the bank's survival. Such issues include recapitalization, restoration of liquidity, recovery of non-performing risk assets and turning the bank around.
- 2.5 With regard to capitalization, the shareholders lacked the capacity to meet regulatory requirements. For example, in February 1991, the Federal Government increased the minimum paid-up capital of merchant banks from N12million to N40million. While the new capital threshold took immediate effect for new banking licence seekers, existing banks were given up to June 1992 to attain the new capital requirement. The Board Chairman claimed that he made deposits for shares to the tune of N27million to meet the N40million minimum capital requirement. According to him, the board refused to allot additional shares to him in view of the fact that he already held more than the 5% maximum allowed for each individual investor at that time. He alleged that several requests by him to have his money refunded, was not granted by the bank. The inability to refund the deposit for shares might be due to the bank's illiquidity. Subsequently, the bank was directed by CBN in 1993 to increase its share capital to N100million. The bank could only raise N53million over a period of three years. A major effort to inject N140million in March 1997 was aborted in July 1997. In the absence of fresh capital injection, the bank's paid-up capital as at 31st October 1994 is attached as Appendix 1.
- 2.6 The erosion of capital was largely attributed to the huge volume of non-performing credits. The Target Examination

Report on the bank as at 31st October 1994, revealed that adjusted capital was N150,202,796 (negative) while capital adequacy ratio was 24% negative as against the 8% prescribed minimum. As of that date, the bank was insolvent.

2.7 The Target Examination Report also revealed that N298,608,266 or 84% of total loans and advances had inherent defects, while insider-related accounts amounted to N117,089,961 or 32% of the total loans and advances. Subsequently, the bank's credit exposure to shareholders, directors and staff was put at 55% of total credit portfolio. The credit portfolio continued to deteriorate to the extent that as at 16th January 1998, when the bank was closed, classified credits stood at N631.30million (or 99.6%) out of a total credit of N633.98million.

2.8 The utilization of depositor's funds to finance the Head Office building project coupled with the quantum of non-performing credits put the bank's in liquidity crisis throughout its existence. The bank was a perpetual net borrower from the interbank market and could not honour its obligations when the interbank takings matured. As far back as 1992, the bank's account with CBN was substantially overdrawn. Indeed, the largest single creditor of the bank, which was not a depositor, was the CBN. As at 31st October, 1994, the bank's liquidity ratio was 28.81% (negative) compared with the prescribed minimum ratio of 30%. The bank was chronically illiquid.

2.9 The management had advised the board in 1993, to dispose its head office building to generate liquidity for its operations but the advice was not heeded immediately. However, in 1995, the head office annex building was sold while the main

building was disposed in October 1996. By then the bank had no hope of survival.

- 2.10 Given the overwhelming financial crisis in which the bank was engulfed, the board could not discharge its duty of accountability to shareholders. As at January 1998, when the bank's licence was revoked, the last audited accounts were as at March 31st, 1994. This is a glaring evidence of financial distress.
- 2.11 In summary, inept management by both the Board and Management coupled with insider dealings manifested in a huge portfolio of non-performing credits, erosion of capital by provisions for non-performing credits, illiquidity and accumulated losses. The inability of the shareholders to inject fresh capital, made the bank's journey to failure a fait accompli.

3.0 **EARLY INDICATORS OF FAILURE**

- 3.1 The early warning indicators of the collapse of the bank included, the following, among others:-
 - i. **Bad Credits:** As a result of the erosion of the bank's capital, a target examination was conducted on the bank as at 31st October 1994. The focus of the examination included capital adequacy and recapitalization, assets quality, insider credits, liquidity and funds management. The findings of the examination confirmed the common but universal statement that bad loans cause bank failure.
 - ii. **Insider Abuse:** The directors and the shareholders of the bank also had loans that were non-performing for a

long time which eventually led to their removal from the board and blacklisting.

- iii. **Perpetual Net-taker of Funds:** The bank was a net taker of funds from the system for quite a long time, due to its weak liquidity position. All the interbank takings expired and the bank came under severe pressure to repay its outstanding obligations.
- iv. **Non-Publication of Financial Statements:** As at January 16th 1998, when the bank's licence was revoked, the last audited accounts were as at March 31st 1994, an indication that all was not well with the bank.
- v. The bank was under severe pressure from its depositors, as their demand for withdrawals far exceeding available funds. There was no working capital to support normal banking operations. As far back as October, 1992, the bank's account with the CBN was substantially overdrawn, precipitating a crisis situation.
- vi. **Mistrust among Directors:** The relationship among the Directors deteriorated after the blacklisting and removal of five of them from the Board, due to non-performing, Director-related credits.

4.0 CORE REASONS FOR FAILURE

4.1 The distress in the financial system during the period emanated from a number of exogenous and endogenous factors. The exogenous factors included adverse economic conditions, inhibitive policy environment, political instability, impact of deregulation and poor and inadequate supervision and regulation. The endogenous factors included

under capitalization, manpower problems, poor management, fraud etc. Several factors contributed to the failure of ABC Merchant Bank Limited. The principal or core factors included the following:

- i. **Capital Inadequacy:** The bank's effort to increase its paid up capital from N40million to N100million, as required by the CBN as at 31st March, 1995, was not successful. The lower a bank's capital, the higher the probability of its failure. One of the critical functions of a bank's capital is to absorb losses. Where the capital of a bank is eroded by losses arising from frauds/forges, and large amounts of non-performing credits, it becomes insolvent. This was the case with ABC Merchant Bank Ltd., with 49% of its total risk assets in the hands of insiders.
- ii. **Inept Management and Board:** The Central Bank of Nigeria removed from the Board and blacklisted five of the Directors connected with some non-performing credits. This caused the deterioration of the relationship among the Board, culminating in poor communication and frequent diversion to non-productive issues during meetings and gross mistrust among the Directors. Under this climate, the bank could not achieve fruitful results in key policy areas, as delay in addressing strategic issues became the order of the day.
- iii. **Poor Assets Quality:** Most of the credits granted were poor and many were therefore not performing, as at January 16, 1998. From the closing report of the bank, the classified credits stood at N631.30million, out of a

total loan portfolio of N633.98million, amounting to 99.6%.

- iv. **Insider Abuse:** It was established that over 55% of the loans and advances were granted to shareholders, staff and directors of the bank. For example, as at 31st October, 1994, the insider-related accounts amounted to N117,089,961 or 32.9% of the total loans and advances. All the credit facilities were fully classified. The owners and Directors abused their privileged positions and breached their fiduciary duties by engaging in self-serving activities. These included, granting of unsecured credit facilities to the owners, Directors and related companies which, in some cases, were in excess of the bank's statutory lending limit, in violation of the provisions of the BOFIA 1991, as amended, as well as the granting of interest waivers on non-performing insider credits, without obtaining the CBN's approval, as required by law.
- v. **Poor Liquidity Management:** The use of depositors' funds by the bank to finance its building projects resulted in serious liquidity challenges for the bank. As at March 1994, the liquidity ratio of the bank fell to an all time low of mines 28.81%, compared with the prescribed ratio of 30%.
- vi. **Weak Corporate Governance:** The Board of ABC Merchant Bank was engulfed in frequent crises and exhibited a high level of mistrust among the members and with the Management, right from its early years. This became pronounced after the removal of and blacklisting of five Directors. The crisis persisted and

led to frequent changes of the Managing Directors, which made the Board ineffective, until the regulatory intervention in 1998 to close the institution.

5.0 REGULATORY INTERVENTION

- 5.1 It is the responsibility of the regulatory/supervisory agencies to husband the financial services sector to ensure its safety, soundness and stability. In this regard Holding Action was imposed on the bank to halt further deterioration of its financial condition. The Holding Action required the bank to inject fresh capital, strengthen management, focus on debt recovery and adopt cost-control measures. But the shareholders and board failed to faithfully implement the Holding Action requirements.
- 5.2 As already noted, the CBN removed five of the directors from the board on account of the non-performing credits availed to them. Those directors were also arraigned before the Failed Banks Tribunal with a view to recover the debts owed by them.
- 5.3 Meanwhile, the bank's condition contributed to deteriorate until it was beyond resuscitation. It is noteworthy, that the Federal Government's policy at that time was that public funds should not be used to bail out banks. To compound the situation, the CBN at that point in time required the approval of the President before revoking a banking licence. The requisite approval was not easily obtainable.
- 5.4 It was in January 1998 that approval was granted to revoke the licences of 26 banks including ABC Merchant Bank

Limited. Pursuant to that approval, CBN revoked the licences of 26 banks on 16th January 1998.

- 5.5 In keeping with the provisions of BOFIA, NDIC was appointed Provisional Liquidator of the 26 banks. Thereafter, NDIC obtained formal approval as Liquidator from the Federal High Court as well as winding-up order to liquidate the banks.
- 5.6 According to 2012 NDIC Annual Report and Statement of Accounts, the bank's total deposits at closure amounted to N224.182million out of which N169.774million (or 75.73%) had been paid as at 31st December 2012. The performance with debt recovery was very low as only N77.74million (13.75%) out of total credits of N565.37million had been recovered. The dismal, result on debt recovery attested to the reckless manner in which the credits were created.

6.0 **LESSONS LEARNT**

- 6.1 As expressed by the erstwhile Chairman of the Board of Directors of ABC Merchant Bank, the regulators should always ensure that the members of the Board of a bank, given their responsibility for overseeing the bank, should be adequately trained and properly educated on the principles of good corporate governance and the necessary skills to guide their banks. He asserted that some of the Board members were ignorant of their duties and expectations. Hence, the regulators should insist on the appointment of suitably qualified candidates as members of the Boards of banks.

- 6.2 The adoption of universal banking in 2000, was a response to the clamour for a level playing field with the commercial banks, as canvassed by the merchant banks in Nigeria. While that helped to stabilize the situation, a number of structural and regulatory defects in the system ensured that the policy was not the silver bullet some had envisaged it to be.
- 6.3 Financial system supervision and control have to be much more proactive, which requires strict enforcement of the rules and regulations by the regulators. This led to the adoption of risk-based supervision and consolidated supervision, much later.
- 6.4 Indiscipline was encouraged by weak banking laws, which failed to provide adequate punishment and enforcement for insider abuses.
- 6.5 Learning from the banking failures at the time, the CBN/NDIC had to establish an Early Warning System as well as an effective failure resolution structure, the Contingency Planning Framework, for the Prevention and Management of Banking Crisis.
- 6.6 The mandatory withdrawal of public sector deposits from the banks to the CBN in 1989 had unintended consequences for weak banks like ABC Merchant Bank Limited with precarious liquidity. Policy makers should avoid the adoption of shock therapy in macro-economic management.
- 6.7 The liberalization and excessive licensing of banks between 1986 and 1991 engendered stiff competition within the banking industry, with deleterious effects on the weaker banking institutions in the system.

7.0 **CONCLUSION AND SUMMARY**

- 7.1 The causes of bank failure are numerous. This case study attempts to identify some of the factors that led to the failure of ABC Merchant Bank Limited and the revocation of its operating license, on January 16, 1998. These included weak corporate governance, poor assets quality, late/non-publication of Annual Financial Statements, inadequate capital and insider abuses.
- 7.2 ABC Merchant Bank Limited was liquidated along with 25 other banks that exhibited very grave distress conditions. The bank could not escape the axe of the regulators, despite several earlier attempts made by the regulators to preserve its going concern status, as the warning signs were too evident.
- 7.3 With the benefit of hind sight, it seems that if an earlier, more timely, decision had been taken by the CBN, it would have reduced the burden on the depositors at the time of the bank's final closure.
- 7.4 The liquidation of the 26 banks, including, ABC Merchant Bank Ltd, in January, 1998, was therefore a development which many people believed had not only become inevitable, but necessary, to save the nation's banking system from collapse and redeem its severely dented image.

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