

FAILURE OF CENTURY MERCHANT BANK LIMITED

1.0 INTRODUCTION

- 1.1. Century Merchant Bank Limited commenced operations in 1988 at its registered Head Office situated at 11 Burma Road, Apapa, Lagos. It was a private limited liability company.
- 1.2. The bank was engulfed in crisis early in its life as well as too much litigation which hampered its growth and damaged its reputation. The bank therefore, experienced illiquidity and capital erosion which were attributable to insider dealings and management ineptitude.
- 1.3. The bank failed to publish its accounts as and when due. For example, at the time the bank's licence was revoked in January, 1998, its last audited financial statement, was as at 31st December, 1993, which was yet to be approved by the Board of Directors, an indication that all was not well with the bank.
- 1.4. One of the largest contributory factors to the demise of the bank was the quality of its risk assets. The classified loans deteriorated from 35% of its total risk assets at the beginning of its operations to 100% at the closing of the bank.
- 1.5. Despite the intervention of the Central Bank of Nigeria (CBN) by imposing Holding Actions on the bank, as a result of the special examination conducted as at 30th September, 1993, the bank still could not pull through its deteriorating distress condition, which led the CBN to take control of the activities, assets and liabilities of the bank, from 15th September, 1995 to 16th January, 1998.
- 1.6. The liquidation of Century Merchant Bank Limited along with 25 others on January 16th, 1998, was therefore, a

development which many stakeholders accepted as necessary, to avoid contagious effect among the other banks operating in the system.

- 1.7. The rest of this case study is organized into six sections. Section 2 presents an overview of the bank's performance while Section 3 focuses on the early warning indicators of failure. Section 4 highlights the core reasons for failure while 5 reviews regulatory intervention by CBN and NDIC. Section 6 identifies some of the lessons learnt while Section 7 provides a short summary and conclusion.

2.0 OVERVIEW OF BANK PERFORMANCE

- 2.1. The conduct of the bank's affairs was characterized by board and management instability, lack of focus, insider dealings, inadequate capitalization, capital erosion due to provisioning for non-performing assets and willful violation of banking laws and regulations. These weaknesses resulted in illiquidity and insolvency.
- 2.2. The bank commenced operations with a seven-member board. The Examination report on the bank as at 31st July 1991, noted that there were some changes in the composition of the board. Its membership increased from seven to eight, as a result of the appointment of an Executive Director. Also, another Director was appointed in replacement of one who never attended any board meeting from inception. The failure of the Director to attend a single board meeting would suggest that he had no beneficial interest in the bank.
- 2.3. Other issues raised in the examination report bordered on overlapping of functions and conflicts that arose as a result of

the organizational structure in place at that point in time, as well as non-compliance with regulations and the provisions of the Bank's and Other Financial Institutions Act (BOFIA) 1991.

- 2.4. Of particular concern, was the observation by Bank Examiners that a Director alone approved virtually all the credits whose values were not in excess of 50% of the bank's net worth, while those in excess of 50% of net worth were expected to be referred to the Board Executive Committee for approval. A focused and well-informed board should know that such a nebulous approval threshold would be difficult to monitor. A bank's net worth is not static and could change in tandem with asset quality and operating results. In practical terms, the net worth would first be determined before taking a decision on each credit proposition. In the circumstance, objectivity in determining the bank's net worth is imperative.
- 2.5. It was also, observed that the bank had management relationships with two companies, namely, Century Warehouse Limited (CWL) and Century Securities Limited (CSL), the ownership of which was opaque and for which CBN's approval was not obtained.
- 2.6. The CBN/NDIC Special Examination of the bank as at 30th September, 1993 revealed that the board and management failed to provide the required leadership role and direction to the bank. As a result, the shareholders fund had been completely eroded and was negative to the tune of N544, 566,789 while the bank had overdrawn its position with the CBN and in nearly all the commercial banks with which it maintained current accounts, to the tune of N117million. The Special Examination report adjudged the bank to be technically insolvent.

- 2.7. The precarious condition adversely affected the bank's relationship with its correspondent banks. The situation was further compounded by the bank's inability to properly reconcile its accounts with the correspondent banks which resulted in huge differences in its account balances, periodically. For example, while the bank claimed to have a credit balance of N2, 204,579 with Afribank, Afribank's statement showed an overdrawn balance of N3, 713,024.40 as at the same date. Non-reconciliation of accounts casts doubt on the reliability of a bank's financial statements.
- 2.8. Given the bank's precarious condition, Holding Actions were imposed on it by CBN in November 1993, to safeguard its assets in the interest of its depositors and creditors. The requirements of the Holding Actions include: injection of fresh capital, change or strengthening of management, restriction on lending, intensification of debt recovery efforts, perfection of collateral documents, strengthening of internal control system and reconciliation of accounts.
- 2.9. It was against the imperative of repositioning the bank that the Managing Director, resigned his appointment on 31st October 1993, while the appointment of another Director as acting Managing Director was terminated by the Board barely six months after, with effect from 31st March 1994. The Board at its meeting of 30th March 1994, confirmed the appointment of new acting Managing Director, to fill the leadership vacuum that existed.
- 2.10. Meanwhile, the bank was experiencing a serious liquidity problem that required urgent action to save it from total collapse. The CBN conducted a Target Examination of the bank as at 31st October, 1994. The Examination report

revealed that in an effort to turn around the bank, the Board entered into an agreement with BOTKET NIGERIA LIMITED, a private investment firm. The group was headed by Chief Lai Balogun, an Architect and Community Leader, supported by Messrs Gab Fatona, Yemi Ojeahere, experienced bankers, Chief J.G.O. Adegbite, a University Administrator, Dr. Promise Abuwa, a Medical Consultant and Alhaji D. M. Haliru, an Accountant. Based on the agreement, Botket Nigeria Limited proposed an injection of N250million as equity and liquidity support for the bank.

2.11. Following this, a new nine-member Board of Directors was constituted, six members to be provided by the new investors and three by the existing shareholders. The new investors acquired 75% of the new equity capital, while the existing shareholders retained 25%. The liquidity position of the bank was precarious during the period and, as a result, it could not meet its financial obligations to its depositors, as and when due. The bank also overdrew its current account with the Central Bank of Nigeria to the tune of N182.1million and showed a negative position of N150.53million for interbank transactions, as at the date of the Target Examination.

2.12. In the bank's Routine Examination Report as at 30th June 1995, it was revealed that the Board of the bank became unstable, between 1993 and 1995. The Managing Director and the Company Secretary resigned their appointments on 31st October, 1993 and 22nd September 1994, respectively. The earlier indictment of the Board members for lack of interest and commitment to the affairs of the bank by the CBN was not redressed.

- 2.13. The total director-related facilities grew to N464million, or 36% of the bank's total credit portfolio of N1.3billion. Attempts made by the two institutional investors to turn around the fortunes of the bank failed. One of the investors was to inject N250million, take over the management of the bank and turn it to a commercial bank. The bank's distress led to the spate of legal actions against it by its depositors, including the correspondent banks. There were 18 pieces of litigations against the bank in the Head Office, while three court judgments had already been obtained against the bank in Lagos, during the examination period.
- 2.14. The indication that the bank was under siege, was that cases of harassment by angry depositors, including physical assault, on the bank's management were experienced.
- 2.15. Within this examination period, 42 staff left the bank through resignation or termination of appointments, including the experienced top management staff. As a result, after the exit of the 42 staff, the most senior staff next to the Acting Managing Director was just a manager. In effect, the bank's management had collapsed. How can such a bank be saved from collapse?
- 2.16. The deregulation of interest rates in 1992 further compounded the bank's problem, as it resorted to interbank borrowing to fund its operations, at distress rates of interest, ranging between 100% to 200%. The total interbank takings of N284million that matured, remained unredeemed, after several roll-overs. The bank's account with the CBN was substantially overdrawn.
- 2.17. The quality of the risk assets of the bank continued to deteriorate to the extent that 98% of the total asset was

classified as non-performing. The appraisal of the bank's N1, 303,140,212 credit portfolio revealed that N1, 278,823,719 or 98% was defective, as at that date. The capital adequacy ratio declined from minus 56% to minus 164% as at June 1995. The bank therefore, remained technically insolvent. For the bank to attain the prescribed minimum capital adequacy ratio of 8%, the shareholders needed to inject fresh funds amounting to N1, 493,187,350.

2.18. In the face of the existing problem of under capitalization of the bank, the CBN raised the minimum paid-up capital requirement for both merchant and commercial banks to a uniform level of N500 million in 1997, which further compounded its problem. Given its insolvency and chronic illiquidity, liquidation became the ultimate resolution option. Consequently, the bank's licence was revoked on 16th January 1998.

3.0 EARLY WARNING INDICATORS

- i. Insider Abuse in the Bank:** As at 16th January, 1998, the outstanding loans to five Directors and their related interests was N272, 072,261, or 32% of the total risk assets. The owners and Directors engaged in self-serving activities, by granting to themselves huge facilities that became non-performing.
- ii. Litigation:** The bank was involved in a series of litigations in the course of its operations. This affected its financial fortunes and gave it a bad image. There was a particular meeting when a list of 22 court cases filed

against the bank by depositors (mostly banks) was reported.

- iii. **Lack of Accountability:** The bank failed to publish its accounts as and when due, as required by Banks and Other Financial Institutions Act (BOFIA) 1991, as amended. As at 16th January 1998, when its license was revoked, the last approved financial statement was as at 31st December 1993. A bank without published financial statements cannot secure patronage from blue-chip companies.
- iv. **Quality of Risk Assets:** The quality of risk assets was poor. There were material breaches of section 20 of the BOFIA, 1991 as amended, through lending in excess of 50% of the unimpaired share capital (that is single obligor limit) to related companies and others. This appeared to have been the largest single contributory factor to the demise of the bank. The non-performing assets of the bank deteriorated from about 35% of the total risk assets in 1993 to about 98% at the bank's closure in January 1998.
- v. **Persistent Illiquidity:** The Special Examination Report as at 30th September, 1993, revealed that the bank could not honour its obligations to depositors, as accumulated call money was due, but remained unpaid and the bank had overdrawn its current account with a number of other banks. This signified a serious illiquidity challenge to the bank.
- vi. **Contravention of Regulations:** Frequent contravention of regulatory directives and guidelines contributed to the gradual demise of the bank. For example, the bank failed

to comply with the requirements of several foreign exchange circulars as highlighted in the report of the routine examination on foreign exchange operations as at 30th April 1996.

4.0 CORE REASONS FOR FAILURE

There were several factors that contributed to the failure of the bank. The core factors are considered below:

- i. **Management of Risk Assets:** It appeared that the largest single contributory factor to the demise of the bank was the poor quality of its risk assets. This was due to the self-serving disposition of the Board, poor credit appraisal and supervision by the management. Significant amounts of loans were granted to related companies, in excess of the statutory requirements, as provided in section 20 of BOFIA 1991. A total sum of N237, 794,300, was classified as Director-related credits as at 30th September 1993. Furthermore, credit approval was concentrated in the person of the Managing Director, without adequate Board supervision or review.
- ii. **Run on the Bank:** As revealed by the Special Examination Report as at 30th September, 1993, the bank could not honour its obligations to depositors and on overdue call money to other banks. This caused a major run on the bank and a series of litigations between the bank and its correspondent banks, to which the bank had outstanding obligations.

- iii. **Existence of Multiple Litigations:** The bank was involved in too many litigations. It was in fact reported that there was a particular year that the bank had about 22 law suits in the courts. These cases were between the bank and its depositors and correspondent banks which cost the bank a lot, in terms of time, funds and reputation.
- iv. **Attitude of the Board:** The lukewarm attitude of the Board members as observed in a consultant's report in 1993, affected adversely the management culture of the bank. There was lack of effective supervision on the part of the bank management and the Board, which were pronounced by indiscriminate lending and poor investment judgment that affected the bank's operation and resulted in the very high distress position of the bank.
- v. **Prolonged Loss-making:** The Profit and Loss Analysis for the years ended December 1994 and the six months ended June, 1995, showed a consistent decline in the operating results of the bank since 1992. For example, from a Profit After Tax position of N15.4million in 1991, the bank recorded substantial and rising losses of N232.9million, N503.6million and N638.5million in 1992, 1993 and 1994 respectively.
- vi. **Insider Abuse:** The owners and Directors of the bank abused their privileged positions and breached their fiduciary duties by engaging in self-serving activities, including the granting of un-secured credit facilities to owners and Directors and their related companies, in excess of the banks statutory lending limits, in violation

of the provisions of BOFIA 1991, as amended. Furthermore, the management of the bank granted interest waivers on non-performing insider credits, without obtaining the CBN's approval, as required by BOFIA.

5.0 REGULATORY INTERVENTIONS

The intervention measures taken by the regulatory authorities during the period, tended to weaken, rather than strengthen, the performance of the bank. A bank that was adjudged to be both illiquid and insolvent required massive injection of funds and a turn-around management. In keeping with the Federal Government's policy at that time, public funds should not be used to bail out banks. Under such circumstance, the following measures at the discretion of the regulatory authorities were adopted:

- Following the CBN/NDIC Special Examination as at 30th September, 1993 and the findings on the precarious condition of the bank, holding actions were imposed on it in November, 1993 by the Central Bank of Nigeria. In the same year, consultants were also appointed by the regulators to critically examine the bank, independently.
- Sequel to the inability of the shareholders and board of directors of the bank to implement the requirements of the holding actions, the CBN on 15th September 1995 assumed control of the activities, assets and liabilities of the bank. An

Interim Management Board (IMB) was constituted to superintend over the affairs of the bank.

- The IMB oversaw the affairs of the bank until 16th January, 1998, when the Central Bank of Nigeria finally revoked the licences of 26 distressed banks in Nigeria, including Century Merchant Bank Ltd and appointed NDIC as the provisional liquidator of the banks. Hence, the closing activities of the bank started with effect from January 16, 1998 at its Head Office and branches.

- The liquidation process had been on since then. According to NDIC 2012 Annual Report and Statement of Accounts, as at 31st December, 2012, N46.432million (8.10%) out of total deposits of N573.287million as at 16th January 1998 had been paid. Similarly, only N31.66 million (or 3.91%) out of total loans and advances of N809.81million as at the date of closure had been recovered. The abysmally low rates of depositor reimbursement and debt recovery, are eloquent testimonies to the reckless mismanagement of the bank.

6.0 LESSONS LEARNT

6.1 The persistence of bank failure in the country therefore became a matter of grave concern to the entire nation, particularly the practitioners and the academia. The situation provided some learning points to the regulators and policy makers, management of the banks and other stakeholders.

- 6.2 In the case of Century Merchant Bank Limited, the CBN allowed the bank to persistently overdraw its account, an action which normally should be frowned at by the regulators. To curb the practice, a new system whereby healthy banks that met specified requirements were appointed as clearing banks, was introduced.
- 6.3 The regulators have learnt that the imposition of holding actions on the bank in November 1993 and some other distressed banks did not help such banks to come out of their distressed condition.
- 6.4 The introduction of a uniform capital requirement for the commercial and merchant banks did not in fact create a level playing field for them, as the merchant banks continued to be subjected to a number of restrictions, such as in deposit taking and membership of the clearing house. This measure, therefore, did not assist the merchant banks, as many of them became distressed and were eventually liquidated as were some of their commercial counterparts, on 16th January, 1998. This reality contributed to the adoption of the universal banking model in year 2000.

7.0 SUMMARY AND CONCLUSION

- 7.1 Century Merchant Bank Limited, which commenced operations in 1988, had its license revoked in January 1998, indicating that the bank operated for a period of just 10years. The bank, right from its inception was flawed, with mismanagement and a lot of insider abuses.

- 7.2 Regulatory interventions in the bank, such as the imposition of holding actions, and assumption of control by CBN and NDIC during its ten years of operation could not assist the bank to survive as a going concern, beyond 1998.
- 7.3 Given the Board's lack of commitment, managerial incompetence and inability to recapitalize the bank, its failure was predictable. Hence, the doors of the bank were closed for business with effect from 16th January, 1998 and it was eventually liquidated by the Nigeria Deposit Insurance Corporation (NDIC).

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