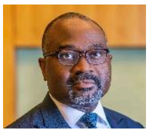
Key contacts



Chike Obianwu
Deputy Managing Partner,
Finance
chike.obianwu@templars-law.com

Zelda Akindele
Partner,
Finance
zelda.akindele@templars-law.com

Obianuju Ifebunandu
Managing Counsel,
Finance
obianuju.ifebunandu@templars-law.com

Victor Sameria
Senior Associate,
Finance
victor.sameria@templars-law.com

Client Alert

Central Bank of Nigeria (CBN) New Minimum Capital Requirements for Banks

Introduction

If the 2008 global financial crisis and subsequent failures of various banks around the world have taught us anything, it is that regulatory capital is pivotal in sustaining the resilience of banks and the overall stability of a country's financial system. The new minimum capital requirements introduced by the Central Bank of Nigeria (CBN) did not therefore entirely come as a surprise to the Nigerian market particularly given that the Governor of the CBN had indicated that this move was in view during the Bankers' Dinner in November 2023.

Twenty years after the minimum capital requirements for banks were last reviewed, the CBN through a circular dated 28 March 2024 has announced an upward review of the minimum capital requirements for commercial, merchant, and non-interest banks in Nigeria (the "**Recapitalisation Circular**") aimed at strengthening the Nigerian financial system and expressly noted as part of the Nigerian Government's objective to achieve a US$1 trillion economy in gross domestic product (GDP) terms by 2030.

This client alert highlights the significant changes made by the Recapitalisation Circular and the implications for the Nigerian banking sector.

Key Aspects of the Circular & Market Impact

- **Minimum Capital Requirements**

  Referred to as the Banking Sector Recapitalization Programme, the new minimum capital requirements are as follows:

Type of Bank	Authorization	Previous Minimum Capital	New Minimum Capital
Commercial Bank[1]	International	NGN50 billion	NGN500 billion
	National	NGN25 billion	NGN200 billion
	Regional	NGN10 billion	NGN50 billion
Merchant	National	NGN15 billion	NGN50 billion
Non-interest[2]	National	NGN10 billion	NGN20 billion
	Regional	NGN 5 billion	NGN10 billion

A key concern regarding the new capital requirements – which notably introduce a 900% increase for each of the international and national commercial bank categories – is whether the affected banks are positioned to attract the required capital within the 24 months deadline set by the CBN.

It is estimated that an aggregate of over N4 trillion in fresh capital injection is required to satisfy the new capital requirement and this would by no means be an easy feat. Based on the capital eligibility criteria set by the Recapitalisation Circular, no bank appears to meet the new minimum capital requirement. It is estimated, based on publicly available information, that the eight largest commercial banks in Nigeria will need at least N2.6 trillion in aggregate to meet the 500 billion capital mark whilst six merchant banks are estimated to require approximately N229 billion. Furthermore, at least 20 banks will need to raise more than 100% of their current capital base.

Prior to the Recapitalisation Circular, there were already reports that 17 of the current 24 banks in Nigeria might struggle to fulfil the CBN new capital requirements if increased by 15-fold from 25 billion. Issuance of the Recapitalisation Circular has not allayed such concerns, and the hard question of whether all banks can realistically achieve this target within the 24 months' timeline has to be addressed.

- **Eligible Capital**

The Capitalisation Circular mandates that the required minimum capital shall consist solely of paid-in share capital (i.e., paid-up capital and share premium) and that such other components of bank capital as (i) retained profits (ii) other reserves and (iii) even Additional Tier 1 (AT1) capital shall be disregarded for the purpose of meeting the new minimum capital requirements.

This approach to capital recognition is a deviation from the CBN's previous practice of setting minimum capital of banks by reference to shareholders funds (which comprises not just paid-up capital and share premium but also retained profits and other reserves). The approach also focuses on a narrower scope of regulatory capital

[1] CBN Scope, Conditions & Minimum Standards for Commercial Banks Regulation No. 01 2010 – https://www.cbn.gov.ng/OUT/2010/CIRCULARS/BSD/COMMERCIAL%20BANKING%20LICENSING%20REGULATIONS%20-%20FINAL%20RELEASED.PDF
[2] CBN Scope, Conditions & Minimum Standards for Specialized Institutions Regulations No. 3 2010 – https://www.cbn.gov.ng/OUT/2010/CIRCULARS/BSD/REVIEW%20OF%20GUIDELINES%20FOR%20SPECIALISED%20INSTITUTIONS%20-%20FINAL%20RELEASED.PDF

than the CBN Guidelines on Regulatory Capital and by extension the Basel III standards which recognise retained profits and other reserves, Additional Tier 1 Capital as well as Tier 2 forming part of capital.

In recognising only paid-up capital and share premium for the purpose of satisfying the new minimum capital for banks, the CBN appears to be signalling a preference for inward capital injection and a potential distrust of internal capital generation mechanisms which it has been suggested in certain quarters may either be vulnerable to artificial inflation through internal bookkeeping entries, or may not withstand regulatory scrutiny in the case of banks that may have previously received regulatory compliance waivers or forbearances. It has been suggested that the CBN's new approach may cause banks to in future rethink the accumulation of retained.

Having said this, it is critical to note that the Recapitalisation Circular expressly confirms that all the other categories of otherwise recognised regulatory capital referred to above will continue to qualify as part of the regulatory capital of banks in the computation and determination of the risk-based capital adequacy ratio (CAR) in line with the CBN's Guidelines on Regulatory Capital.

- **COMPLIANCE WITH EXISTING CAPITAL ADEQUACY RATIO (CAR) REQUIREMENTS**

Under the Recapitalisation Circular, Banks are still required to comply with the minimum capital adequacy ratio (CAR) requirement applicable to their license authorization and banks in breach will be required to inject fresh capital to regularize their position. To this extent, regulatory capital as otherwise previously defined and understood will continue to apply for CAR testing purposes.

CAR is a fundamental metric used in assessing a bank's financial health and resilience by testing a bank's capacity to meet liabilities and counteract credit and operational risks effectively. Under extant laws, international banks and Domestic Systemically Important Banks (D-SIBs) are mandated to maintain a CAR of 15%, while other banks, including national and regional ones, must uphold a CAR of 10%.

In view of the CBN's move to ensure that the banking sector is adequately positioned to absorb risks prevalent in its operations in the financial market, this is an important compliance requirement for banks to bear in mind, especially in the face of the new minimum share capital requirements.

- **TIMELINE & IMPLEMENTATION PLAN**

The CBN has set a timeline of 24 months from 1 of April 2024 and ending on 31 March 2026, and further mandated banks to each submit an Implementation Plan to the Director, Banking Supervision Department, of the CBN for executing compliance with the new minimum capital requirements by 30 April 2024. This Implementation Plan must indicate the bank's desired option(s) and various activities together with timelines for complying with the new minimum capital requirements.

In the forthcoming weeks, it will be imperative for the banks to engage in strategic planning and develop detailed action plans outlining their approach to comply with the newly established capital requirements. This process will involve a thorough assessment of their current capital positions, identification of potential shortfalls, and exploration of viable options which augment their capital base whilst complimenting their long-term strategic objectives. The goal will be to ensure that these financial institutions not only meet the regulatory requirement but also position themselves advantageously for sustainable growth and stability in the evolving banking landscape.

Options Available to Banks

The Recapitalisation Circular recognises three options for banks seeking to comply with the new minimum capital requirements. The options are the (i) injection of fresh capital through private placements, rights issue, and/or offer for subscription; (ii) mergers & acquisitions; and/or (iii) upgrade or downgrade of license authorization.

- **Injection of Fresh Capital Through Private Placement, Rights Issue And / or Offer for Subscription**

  Subject to the specific means of capital raise adopted by the banks, it appears inevitable that this option will create an avenue for public investors desirous of including bank stocks to their portfolio and more notably, stimulate the Nigerian equity capital markets.

  Alternatively, existing shareholders also stand a chance to be issued new shares as a matter of priority where a rights issue is adopted giving them the ability to increase their equity stake.

- **Mergers and Acquisitions**

  The banking industry has witnessed notable mergers and acquisitions over the two decades and whilst in recent times these have been prompted by the expansion drive of a handful of banks, the first wave of bank M&As came about as a result of the 2004 recapitalisation reforms.

  Whilst Nigerian banks are largely stronger this time around, we can still expect some M&A activity focused on meeting the new minimum capital requirement rules, likely in the national, regional and merchant bank categories.

  In this regard, the CBN has assured the public that in line with extant laws that depositors' accounts and funds will remain secure in the event of an M&A as the acquiring institution will assume responsibility for all liabilities and obligations, including the protection of depositors.

  In considering the M&A options, it is worth noting that compliance with the Banks and other Financial Institutions Act 2020 (BOFIA) and rules of the NGX and Securities and Exchange Commission (SEC) for listed banks will come to bear on transaction structuring and timelines. Under the circumstances, it is expected that the CBN will fully cooperate with the banks as necessary to ensure that M&A transactions resulting from the new capital requirements are seamless across the industry.

- **Changes to License Authorisation**

  Banks are also encouraged to explore the option of downgrading their license authorization in order to meet the new minimum capital requirements. Whilst the ability to upgrade has always been available to banks and presents an opportunity for banks within a lower licensing tier to increase their authorisation, the ability to downgrade provides a lifeline for banks that would otherwise struggle to meet the capital requirements but for whom M&A transactions may not be a preferred option. Such banks can now downgrade their authorisation and develop long term strategies for a sustainable capital base under a revised operational platform.

Conclusion

In the next 24 months, it will be interesting to see the various options adopted by the banks to meet the new capital requirements. One notable avenue of exploration will be the resurgence of activities such as public offers, rights issues and private placements within the equity capital markets (ECM) segment of the capital markets which has been largely quiet over the years.

We also expect to see some degree of M&A activity and possibly a couple of downgrades for banks that struggle to attract the required capital timeously.