CENTRAL BANK OF NIGERIA

CODE OF CORPORATE GOVERNANCE FOR BANKS IN NIGERIA POST CONSOLIDATION

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PART I: NEED FOR A NEW CODE OF CORPORATE GOVERNANCE

1.0 Introduction

1.1 Financial scandals around the world and the recent collapse of major corporate institutions in the USA and Europe have brought to the fore, once again, the need for the practice of good corporate governance, which is a system by which corporations are governed and controlled with a view to increasing shareholder value and meeting the expectations of the other stakeholders.

1.2 For the financial industry, the retention of public confidence through the enthronement of good corporate governance remains of utmost importance given the role of the industry in the mobilization of funds, the allocation of credit to the needy sectors of the economy, the payment and settlement system and the implementation of monetary policy.

1.3 In Nigeria, a survey, by the Securities and Exchange Commission (SEC) reported in a publication in April 2003, showed that corporate governance was at a rudimentary stage, as only about 40% of quoted companies, including banks, had recognized codes of corporate governance in place. Specifically for the financial sector, poor corporate governance was identified as one of the major factors in virtually all known instances of a financial institution's distress in the country.

1.4 Yet, the on-going industry consolidation is likely to pose additional corporate governance challenges arising from integration of processes, IT and culture. Research had shown that two-thirds of mergers, world-wide, fail due to inability to integrate personnel and systems as well as due to irreconcilable differences in corporate culture and management, resulting in Board and Management squabbles. In addition, the emergence of mega banks in the post-consolidation era is bound to task the skills and competencies of Boards and Managements in improving shareholder values and balance same against other stakeholder interests in a competitive environment. A well-defined code of corporate

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governance practices should help organizations overcome such difficulties.

1.5 Since 2003 when the Nigerian Securities and Exchange Commission released a Code of Best Practices on Corporate Governance for public quoted companies, the relevant banks had been expected to comply with its provisions. This was in addition to a Code of Corporate Governance for Banks and Other Financial Institutions approved earlier in the same year by the Bankers' Committee.

1.6 The consolidation of the banking industry, however, necessitated a review of the existing code for the Nigerian Banks. This new code therefore was developed to compliment the earlier ones and enhance their effectiveness for the Nigeria n banking industry.

1.7 Compliance with the provisions of this Code is mandatory.

2.0 **Weaknesses in Corporate Governance of Banks in Nigeria**

2.1 Disagreements between Board and Management giving rise to Board squabbles.

2.2 Ineffective Board oversight functions.

2.3 Fraudulent and self-serving practices among members of the board, management and staff.

2.4 Overbearing influence of chairman or MD/CEO, especially in family-controlled banks.

2.5 Weak internal controls.

2.6 Non-compliance with laid-down internal controls and operation procedures.

2.7 Ignorance of and non-compliance with rules, laws and regulations guiding banking business.

2.8 Passive shareholders.

2.9 Poor risk management practices resulting in large quantum of non-performing credits including insider-related credits.

2.10 Abuses in lending, including lending in excess of single obligor limit.

2.11 Sit-tight Directors – even where such directors fail to make meaningful contributions to the growth and development of the bank.

2.12 Succumbing to pressure from other stakeholders e.g. shareholder's appetite for high dividend and depositors quest for high interest on deposits.

2.13 Technical incompetence, poor leadership and administrative ability.

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2.14 Inability to plan and respond to changing business circumstances.

2.15 Ineffective management information system.

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3.0 Challenges of Corporate Governance for Banks Post Consolidation

3.1 Technical Incompetence of Board and Management: In view of the greatly enhanced resources of the consolidated entities, Board members may lack the requisite skills and competencies to effectively redefine, re-strategize, restructure, expand and/or refocus the enlarged entities in the areas of change of corporate identities, new business acquisitions, branch consolidation, expansion and product development.

3.2 Relationships among Directors: Boardroom squabbles could be an issue due to different business cultures and high ownership concentration especially in banks that were formerly family or "one-man" entities. The dominance of a "key man" could also emerge with the attendant problems.

3.3 Relationship between Management and Staff: Squabbles arising from knowledge gaps, harmonization of roles and salary structure could also manifest among staff and management of consolidating banks with the potential to create unhealthy competition and a counter-productive working environment.

3.4 Increased Levels of Risks: Currently, very few banks have a robust risk management system in place. With the huge amount of funds that will be available to them and the significantly increased legal lending limits, banks will be financing more long-term mega projects in the real sectors of the economy as opposed to the existing working capital/trade financing. Given the expected significant increase in the level of operations, the banks will be facing various kinds of risks which, if not well managed, will result in significant losses. The management of risks in a transparent and ethical way will thus present some issues bordering on corporate governance.

3.5 Ineffective Integration of Entities: Banks that would have completed the process of merging might continue to operate independently rather than as a single entity. For example, an investment bank's merger with a retail bank in which the MD of the investment bank continues to manage his arm of the business and the MD of the retail bank does the same and the

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operating results of the two entities are then consolidated for reporting purposes.

3.6 Poor Integration and Development of Information Technology Systems, Accounting Systems and Records: Banks with different IT systems (banking application, database platform, operating systems, human resource applications, hardware, server configuration, and network and telecommunication infrastructure) as well as different accounting systems and records will have to fuse and this could pose problems if not well managed. There will also be increased use of technology to power the consolidated business and this too will have to be well managed to ensure efficient operations and quality service delivery.

3.7 Inadequate Management Capacity: Directors and Managers will be running a much larger organization and controlling a significantly higher level of resources. Adequate management capacity is needed to efficiently and profitably run a larger organization.

3.8 Resurgence of High Level Malpractices: To boost income as a result of intense competition and lack of enough viable projects, malpractices may resurface post consolidation. Such sharp practices could include round-tripping of forex, excessive customer charges, falsification of records etc. , and adoption of unethical methods to poach customers.

3.9 Insider-Related Lending: If consolidation should fail to achieve transparency through diversification in bank ownership, the pervasive influence of family and related party affiliations may continue, resulting in huge levels of insider-abuses and connected lendings.

3.10 Rendition of False Returns: Similarly, rendition of false returns to the regulatory authorities and concealment of information from Examiners to prevent timely detection of unhealthy situations in the banks may continue as a result of lack of transparency and pressure to boost income.

3.11 Continued Concealment: Continued concealment of material issues discovered by banks during their pre-merger due-diligence will also compromise good corporate governance.

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3.12 Ineffective Board/Statutory Audit Committee: The audit committee, which comprises both directors and shareholders who are not board directors, may be composed of people who are not knowledgeable in accounting and financial matters thus rendering the committee less effective.

3.13 Inadequate Operational and Financial Controls: There might be absence of such controls to cater for the increased size and complexity of operations.

3.14 Absence of a Robust Risk Management System: The huge amount of funds that would be available to banks post consolidation would significantly increase their legal lending limits and make them engage in financing long term mega projects. The management of the attendant risks in a transparent and ethical manner would require, as part of sound practices, the institutionalization of a robust risk management system.

3.15 Disposal of Surplus Assets: After consolidation, some branches of banks that are closely located may be sold to insiders at below market price. Other surplus assets may also be similarly sold. Fixed assets may also be sold indiscriminately and the profit from the sale used to boost profits with the intention of covering operational losses and inefficiencies.

3.16 Transparency and Adequate Disclosure of Information: These are key attributes of good corporate governance which the merged banks must cultivate with new zeal in order to provide stakeholders with the necessary information to judge whether their interests are being taken care of. Currently there are many deficiencies in the information disclosed, particularly in the area of risk management strategies, risk concentration, performance measures etc. These shortcomings will need to be addressed.

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PART II: CODE OF BEST PRACTICES ON CORPORATE GOVERNANCE

4.0 Principles and Practices that Promote Good Corporate Governance

4.1 The establishment of strategic objectives and a set of corporate values, clear lines of responsibility and accountability.

4.2 Installation of a committed and focused Board of Directors which will exercise its oversight functions with a high degree of independence from management and individual shareholders .

4.3 A proactive and committed management team.

4.4 There should be adequate procedures to reasonably manage inevitable disagreements between the Board, Management and staff of the bank.

4.5 The Board should meet regularly at a minimum of four (4) regular meetings in a financial year. There should also be adequate advance notice for all Board meetings as specified in the Memorandum and Article of Association.

4.6 The Board should have full and effective oversight on the bank and monitor its executive management.

4.7 There is a well-defined and acceptable division of responsibilities among various cadres within the structure of the organisation.

4.8 There is balance of power and authority so that no individual or coalition of individuals has unfettered powers of decision making.

4.9 The Articles of Association should clearly specify those matters that are exclusively the rights of the Board to approve apart from those for notification.

4.10 The number of non-executive directors should exceed that of executive directors.

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4.11 All Directors should be knowledgeable in business and financial matters and also possess the requisite experience.

4.12 There should be a definite management succession plan.

4.13 Shareholders need to be responsive, responsible and enlightened.

4.14 Culture of compliance with rules and regulations.

4.15 Effective and efficient Audit Committee of the Board.

4.16 External and internal auditors of high integrity, independence and competence.

4.17 Internal monitoring and enforcement of a well articulated code of conduct/ethics for Directors, Management and staff.

4.18 Regular management reporting and monitoring system.

5.0 Code of Corporate Governance Practices for Banks Post Consolidation

5.1 Equity Ownership

5.1.1 **Preamble:** The current practice of free, non-restrictive equity holding has led to serious abuses by individuals and their family members as well as governments in the management of banks. However, to encourage a private sector-led economy, holdings by individuals and corporate bodies in banks should be more than that of governments. It is also recognised that individuals who form part of management of banks in which they also have equity ownership have a compelling business interest to run them well. Such arrangements should be encouraged.

5.1.2 Government direct and indirect equity holding in any bank shall be limited to 10% by end of 2007.

5.1.3 An equity holding of above 10% by any investor is subject to CBN's prior approval.

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5.2 Organizational Structure

5.2.0 Executive Duality

5.2.1 The responsibilities of the head of the Board, that is the Chairman, should be clearly separated from that of the head of Management, i.e. MD/CEO, such that no one individual/related party has unfettered powers of decision making by occupying the two positions at the same time.

5.2.2 No one person should combine the post of Chairman/Chief Executive Officer of any bank. For the avoidance of doubt, also no executive vice-chairman is recognised in the structure.

5.2.3 No two members of the same extended family[1] should occupy the position of Chairman and that of Chief Executive Officer or Executive Director of a bank at the same time.

5.3 Quality of Board Membership

5.3.1 Institutions should be headed by an effective Board composed of qualified individuals that are conversant with its oversight functions.

5.3.2 Existing CBN guidelines on appointment to the board of financial institutions should continue to be observed. Only people of proven integrity and who are knowledgeable in business and financial matters should be on the Board.

5.3.3 Regular training and education of board members on issues pertaining to their oversight functions should be institutionalized and budgeted for annually by banks.

[1] The term 'extended family' here refers to the members of a nuclear family comprising the husband, wife and their siblings plus (+) parents and brothers/sisters of both the husband and the wife.

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5.3.4 The Board should have the latitude to hire independent consultants to advise it on certain issues and the cost borne by the banks.

5.3.5 The number of non-executive directors should be more than that of executive directors subject to a maximum board size of 20 directors.

5.3.6 At least two (2) non-executive board members should be independent directors (who do not represent any particular shareholder interest and hold no special business interest with the bank) appointed by the bank on merit .

5.3.7 A committee of non-executive directors should determine the remuneration of executive directors.

5.3.8 There should be strict adherence to the existing Code of Conduct for bank directors, failing which the regulatory authorities would impose appropriate sanctions including removal of the erring director from the board.

5.3.9 Non-executive directors' remuneration should be limited to sitting allowances, directors' fees and reimbursable travel and hotel expenses.

5.3.10 In order to ensure both continuity and injection of fresh ideas, non-executive directors should not remain on the board of a bank continuously for more than 3 terms of 4 years each, i.e. 12 years.

5.3.11 Banks should have clear succession plans for their top executives.

5.3.12 There should be, as a minimum, the following board committees – Risk Management Committee, Audit Committee, and the Credit Committee.

5.3.13 The practice of the Board Chairman serving simultaneously as chairman/member of any of the board committees is against the concept of independence and

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sound corporate governance practice, and should be discontinued.

5.4 Board Performance Appraisal

5.4.1 Preamble: While adherence to corporate governance principles is recognised as necessary for successful performance of Boards, it is often not a sufficient condition. Hence, the need for Board performance reviews or appraisals as a new concept to ensure successful or exceptional performance.

5.4.2 Each Board should identify and adopt, in the light of the company's future strategy, its critical success factors or key strategic objectives.

5.4.3 Boards should determine the skills, knowledge and experience that members require to achieve those objectives.

5.4.4 A Board should work effectively as a team towards those strategic objectives.

5.4.5 There should be annual Board and Directors' review/appraisal covering all aspects of the Board's structure and composition, responsibilities, processes and relationships, as well as individual members' competencies and respective roles in the Board's performance.

5.4.6 The review should be carried out by an outside consultant.

5.4.7 The review report is to be presented at the AGM and a copy sent to the CBN.

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5.5 Quality of Management

5.5.1 Appointments to top management positions should be based on merit rather than some other considerations.

5.5.2 Existing guidelines on appointments to top management of banks should continue to be observed.

5.5.3 Track record of appointees should be an additional eligibility requirement. Such records should cover both integrity ('fit and proper' as revealed by the CBN 'blackbook', CRMS etc) and past performance (visible achievements in previous place(s) of work).

5.6 Reporting Relationship

5.6.1 Officers should be held accountable for duties and responsibilities attached to their respective offices.

5.6.2 The structure of any bank should reflect clearly defined and acceptable lines of responsibility and hierarchy.

6.0 Industry Transparency, Due Process, Data Integrity and Disclosure Requirements

6.1.1 The above are core attributes of sound corporate governance practices that are essential to installing stakeholder confidence.

6.1.2 Where board directors and companies/entities/persons related to them are engaged as service providers or suppliers to the bank, full disclosure of such interests should be made to the CBN.

6.1.3 Chief Executive Officers and Chief Finance Officers of banks should continue to certify in each statutory return submitted to the CBN that they (the signing officers) have reviewed the reports, and that based on their knowledge:

- The report does not contain any untrue statement of a material fact.
- The financial statements and other financial information in the report, fairly represent, in all material respects the financial condition and results of operations of the bank as of, and for the periods presented in the report.

6.1.4 False rendition to CBN shall attract very stiff sanction of fine plus suspension of the CEO for six months in the first instance and removal and blacklisting in the second. In addition, the erring staff would be referred to the relevant professional body for disciplinary action.

6.1.5 There should be due process in all the procedures of banks.

6.1.6 All insider credit applications pertaining to directors and top management staff (i.e. AGM and above) and parties related to them, irrespective of size, should be sent for consideration/approval to the Board Credit Committee.

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6.1.7 The Board Credit Committee should have neither the Chairman of the Board nor the MD as its chairman.

6.1.8 Any director whose facility or that of his/her related interests remains non-performing for more than one year should cease to be on the board of the bank and could be blacklisted from sitting on the board of any other bank.

6.1.9 The Board Credit Committee should be composed of members knowledgeable in credit analysis.

6.1.10 The practice/use of Anticipatory Approvals by Board Committees should be limited strictly to emergency cases only and ratified within one month at the next committee meeting.

6.1.11 Banks' Chief Compliance Officers (CCO) should, in addition to monitoring compliance with money laundering requirements, monitor the implementation of the corporate governance code.

6.1.12 Banks should also establish 'whistle blowing' procedures that encourage(including by assurance of confidentiality) all stakeholders (staff, customers, suppliers, applicants etc) to report any unethical activity/breach of the corporate governance code using, among others, a special email or hotline to both the bank and the CBN.

6.1.13 The CCO shall make monthly returns to the CBN on all whistle blowing reports and corporate governance related breaches.

6.1.14 The CCO together with the CEO of each bank should certify each year to the CBN that they are not (apart from 6.1.14) aware of any other violation of the Corporate Governance Code.

6.1.15 The corporate governance compliance status report should be included in the audited financial statements.

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7.0 Risk Management

7.1.1 The Board/Board Risk Management Committee should establish policies on risk oversight and management.

7.1.2 Banks should put in place a risk management framework including a risk management unit that should be headed by a Senior Executive, in line with the directive of the Board Risk Management Committee.

7.1.3 The internal control system should be documented and designed to achieve efficiency and effectiveness of operations; reliability of financial reporting, and compliance with applicable laws and regulations at all levels of the bank.

7.1.4 External auditors should render reports to the CBN on banks' risk management practices, internal controls and level of compliance with regulatory directives.

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8.0 Role of Auditors

8.1.0 Internal Auditors

8.1.1 Internal auditors should be largely independent, highly competent and people of integrity.

8.1.2 The Head of Internal Audit should not be below the rank of AGM and should be a member of a relevant professional body.

8.1.3 He should report directly to the Board Audit Committee but forward a copy of the report to the MD/CEO of the bank. Quarterly reports of audit must be made to the Audit Committee, and made available to examiners on field visits.

8.1.4 Members of the Board Audit Committee should be non-executive directors and ordinary shareholders appointed at AGM and some of them should be knowledgeable in internal control processes. One of such appointed ordinary shareholders should serve as the Chairman of the Committee.

8.1.5 The Audit Committee will be responsible for the review of the integrity of the bank's financial reporting and oversee the independence and objectivity of the external auditors.

8.1.6 The Committee should have access to external auditors to seek for explanations and additional information without management presence.

8.1.7 Internal Audit Unit should be adequately staffed.

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8.2.0 External Auditors

8.2.1 External auditors should maintain arms-length relationship with the banks they audit.

8.2.2 Appointment of External Auditors will continue to be approved by the CBN.

8.2.3 The tenure of the auditors in a given bank shall be for a maximum period of ten years after which the audit firm shall not be reappointed in the bank until after a period of another ten years.

8.2.4 A bank's external auditors should not provide the following services to their clients:

1. Bookkeeping or other services related to the accounting records or financial statements of the audit client;
2. Appraisal or valuation services, fairness opinion or contribution-in-kind reports;
3. Actuarial services;
4. Internal audit outsourcing services;
5. Management or human resource functions including broker or dealer, investment banking services and legal or expert services unrelated to the audit contract.

8.2.5 Quality assurance auditing should be engaged whenever the CBN suspects a cover-up by auditors, and where proved, erring firms would be blacklisted from being auditors of banks and other financial institutions for a length of time to be determined by the CBN.

8.2.6 An audit firm would not provide audit services to a bank if one of bank's top officials (Directors, CFO, and CAO etc) was employed by the firm and worked on the bank's audit during the previous year.

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