CASE STUDY OF PAN AFRICAN BANK LIMITED

I. INTRODUCTION

Banking crises which typically result in the failure of banks are a common global phenomenon. Caprio and Klingebiel (2000) shows that between the late 1970s and 1999, there were at least 113 systemic banking crises in 93 countries and 50 non-systemic crises in 44 countries. Banking crises also featured prominently in the global economic recession of 2008 – 2009; while the on-going problems of the euro zone include significant bank distress in each of the affected countries.

Nigeria has not been immune to this global trend. In fact, the trend in bank failures in Nigeria can be traced back to over 60 years ago. In particular, as many as 21 of the 25 indigenous banks established in Nigeria during the 1952 – 58 period failed. Between the mid – 1980s and 1990s, the financial conditions of many Nigerian banks worsened significantly. As a result, the number of these banks that were classified as distressed increased from 8 to 52. This compelled the authorities to take decisive corrective action as a means of restoring public confidence in the financial system. More specifically, the Central Bank of Nigeria (CBN) revoked the licenses of 4 banks in 1994, 1 bank in 1995, took over the Management of 18 distressed banks during 1995 – 1996, and announced the revocation of the banking licenses of 26 banks with effect from 16 January, 1998.

The general bank recapitalization policy of 2004/2005 ended up with 14 out of the 89 existing deposit money banks having their licenses revoked as a result of their inability to satisfy the new Minimum Capital Requirement of ₦25 billion. Thus, the total number of banks whose licenses were revoked by the CBN since 1994 stood at 49 as at December 31, 2008.

The restructuring and recapitalization of Nigerian banks in 2004/2005 reduced the number of banks to 24. But by 2009, as many as 10 of these surviving banks were again in trouble which necessitated regulatory intervention. In aggregate, the ratio of non-performing loans to total loans had increased to 32.8% in 2009 (from 6.25% in 2008), the ratio of non-performing loans to shareholders' funds had risen to 135.7% (from 16.78% in 2008), while shareholders funds had declined to

₦448.99 billion (from ₦2,802 billion in 2008). The 10 troubled banks had negative shareholders funds and thus failed to meet the minimum capital adequacy requirement. Hence, they were classified as unsound.

World-wide evidence shows that bank failures often result in large costs in terms of the various risks they pose which affect other banks as well as the banking public (Bolzico, et al, 2007). Bank failures tend to impair the stability, health and soundness of the financial system through contagion; while they adversely affect the banking public through loss of deposits, constrained access to finance and reduced confidence in the banking system. These may, in turn, reduce the capacity of the financial system to enhance economic activity and growth, and thus worsen the standard of living.

In order to prevent or ameliorate the adverse effects of bank failures, the banking Regulatory and Supervisory Authorities in virtually all countries established and implemented appropriate mechanisms and policies for dealing with, or resolving, bank failures. Thus, both the policy and practice of bank resolution have become important yardsticks for measuring the extent and effectiveness of the efforts of the regulatory and supervisory authorities in managing bank failures with a view to reducing the collateral damage they may generate.

This study seeks to examine the causes of bank failures in Nigeria and how those failures were resolved. The ultimate aim of this exercise is to identify the relevant lessons that can be drawn from this experience for the design and implementation of Nigeria's Bank Resolution Policy, evaluate the role of the key participants involved in the resolution process, particularly the CBN and the Nigeria Deposit Insurance Corporation (NDIC), the Shareholders, Directors and Management of banks, as well as the banks' depositors and creditors.

II. BACKGROUND

2.1: Bank Regulation and Supervisory Constraints

The institutional, legal and policy constraints in bank regulation and supervision have generally impinged upon effective resolution of bank failure problems in many countries. More specifically, weak supervisory capacity, gaps in the *regulatory legal and policy framework as well as lack of regulatory independence have been shown to be important in explaining the fragility of banking systems in many developing and emerging market economies (World Bank, 2012).*

Financial markets are subject to various limitations of market discipline. Supervision is meant to address these limitations by ensuring that appropriate Rules and Regulations are implemented. Key among these Regulations are those relating to Capital/Asset Ratios, Single Borrower and other Risk Exposure limits, Rules against connected lending, limits to lending to bank officers and board members, as well as Rules for Asset Valuation and Loan Loss Provisioning.

Capacity constraints in bank regulation and supervision affect the effectiveness with which these Rules and Regulations are implemented and enforced. For example, when bank licensing and closure decisions are vested with Ministries of Finance rather than bank Regulatory Authorities, this leads to the risk of political interference in critical decisions that relate to the Nation's economy. In addition, it causes delays in early intervention in dealing with cases of fragile and weak banks. Similarly, the ability of Regulators to monitor risk in the banking system is hampered when supervisory resources (i.e., qualified staff, infrastructure, analytical tools and skills) are limited; and when there is insufficient quality of data and reporting processes. Finally, effective supervision is constrained when the Regulators are denied sufficient power to enforce corrective measures in cases of non-compliance with established Rules and Regulations.

2.2: Banking Regulatory and Supervisory Framework in Nigeria

As Nigeria's banking Regulatory and Supervisory framework was built up over time, these constraints are been addressed. This process began formally with the promulgation of the CBN Act of 1958 and continued with the Banking Decree of 1969, both of which placed the banking industry under the regulation and control of the Federal Minister of Finance. The second leg of the regulatory and supervisory structure was put in place with the establishment of the Nigeria Deposit Insurance Corporation (NDIC) pursuant to Decree No 22 of 1988; but regulatory powers still remained with the Federal Minister of Finance. The CBN introduced a set of Prudential Guidelines for licensed banks in 1990; as the necessary compliments to the Capital Adequacy Requirements and Statement of

Accounting Standards (SAS10) that were already in place. These guidelines spelt out the criteria to be adopted by banks in classifying non-performing loans.

Eventually, both the CBN Act 24 of 1991 and BOFIA 25 of 1991 transferred banking regulatory powers from the Minister of Finance to the CBN. But the power of the CBN to appoint NDIC as liquidator was lost, forcing the Corporation to apply to the Federal High Court to be so appointed. Furthermore, the Bank and Other Financial Institutions (BOFI) (Amendment) Decree of 1998 gave the CBN the power to vary or revoke any condition subject to which a license was granted or to impose fresh or additional conditions for the granting of a license to transact banking business. Thus, the Decree of 1988 granted the CBN powers to withdraw licenses of banks. A further amendment of the BOFI Decree in 1999 extended the provisions relating to failing banks to other financial institutions. In addition, it empowered the CBN Governor to remove any Manager or Officer of a failing bank or other financial institutions.

2.3: Macroeconomic Policy Environment

Developments in the Nigerian economy during the 1980 – 99 period broadly captured the business and policy environment in the context of which many banks operated successfully while some other banks eventually failed. This environment evolved in several broad but distinct phases. The first phase was triggered by the world oil price slump of 1981 and sustained by the policy responses which were aimed at managing the resulting economic down-turn. The trends on several macroeconomic indicators revealed the adverse consequences.

More specifically, as Nigeria's oil export earnings fell by 47.2% between 1980 and 1983, total export earnings declined from ₦14.2 billion in 1980 to ₦7.5 billion in 1983. An immediate result of this was the deterioration of the trade balance from a surplus of over ₦5 billion in 1980 to a deficit of ₦1.4 billion in 1983. In addition, outstanding external debt rose by 693.2% from ₦1.9 billion in 1980 to ₦14.8 billion in 1984; while the Federal Government's domestic debt rose by 212.8% from ₦8.2 billion in 1980 to ₦25.7 billion in 1984. This general trend was also reflected in Nigeria's total External Reserve Position which declined from US$5.5 billion in 1980 to US$0.2 billion in 1983. Ultimately, these negative *macroeconomic trends were also reflected in the real Gross Domestic Product (GDP) whose value (at 1980 constant basic prices) fell by 10.6% from ₦205.2 billion in 1981 to ₦183.6 billion in 1984.*

The second phase of these developments which shaped Nigeria's business and policy environment spanned the period from 1985 to 1993. It began with the recognition that the austerity measures and Trade and Exchange Rate Restrictions which constituted the primary economic policy responses to the oil shock had failed by focusing on short – term measures. The restrictive measures compressed Total Imports by 53.4% from ₦12.8 billion in 1981 to ₦6.0 billion in 1986; and appreciated the official Exchange Rate by 38.8% from US$1=₦1.83 in 1980 to US$1 = ₦1.12 in 1986. As a result, Inflation Rate rose sharply from an annual average of 13.48% during 1980 – 82 to 30.7% during 1983 – 84. In addition, a thriving Foreign Exchange parallel market was created; while Manufacturing Capacity Utilization Rate began a downward spiral, as it declined by 50.1% from an average of 73.3% in 1981 to 36.6% in 1986.

This led to the adoption and implementation of a Structural Adjustment Programme (SAP) supported by the World Bank and International Monetary Fund (IMF). SAP focused its primary attention on the economy's structural defects by beginning the process of deregulating key product and factor markets and privatizing a wide range of Government – owned enterprises. This process involved sequenced trade and exchange rate liberalization, elimination of rigid controls on bank lending to specified sectors of the economy, and liberalization of the licensing of banks.

Movement in the Exchange Rate was, perhaps, the most obvious indicator of the SAP policy stance. The external value of the Naira was successively depreciated to ₦2.6206 per US dollar in 1986, to ₦4.5367 in 1988, through ₦8.0376 in 1990 to ₦22.0511 in 1993. Simultaneously, Total Domestic Debt of the Government rose dramatically from an average of ₦16.4 billion, in 1980 – 84 through ₦37.5 billion during 1985 – 89 to an average of ₦211.9 billion in 1990 – 94. More significantly, an increasing proportion of this debt was held by the banking system; rising from 65% during 1980 – 84 through 66% in 1985 – 89 to 80% during 1990 – 1994. The combined effect of substantial Exchange Rate depreciation and increased *financing of Government debt by the banking system was, inevitably, a sustained increase in the Inflation Rate. The Inflation Rate which averaged 8.13% per annum during 1985 – 87 rose to an annual average of 46.26 % during the 1988 – 95 period, including sub-periods of hyperinflation at annual average rates of 52.94% in 1988 – 89 and 59.40% during 1992 – 95.*

Oil export value recovered significantly due, partly, to the Exchange Rate Depreciation. It rose from ₦11.2 billion in 1985 to ₦13.8 billion in 1993. Similarly, Total External Reserve position improved from an average of US$1.98 billion during 1980 – 84 through US$4.06 billion in the period of 1985 – 89 to US$4.14 billion in 1990 – 94. But the outstanding external debt, measured in Naira, also rose sharply from an average of ₦7.7 billion during 1980 – 84 through ₦104.8 billion in 1985 – 89 to ₦490.7 billion during the 1990 – 94 period.

The average Manufacturing Capacity Utilization Rate retained its downward trend, falling from an average of 59.9% in 1980 – 84 through 40.3% in 1985 – 89 to 37.6% during the period of 1990 – 94. However, real GDP, which had declined successively from ₦205.2 billion in 1981 to ₦183.6 billion in 1984 began its recovery tentatively at ₦201.0 billion in 1985 and reached the over ₦205 billion mark in 1986. Thus, real GDP which averaged ₦195.0 billion during 1981 – 85 increased steadily thereafter to an average of ₦226.9 billion during 1986 – 90 and ₦273.9 billion during the 1991 – 95 period.

The third phase of these developments covered the period between 1995 and 1999; a period which witnessed the reversal of some of the key elements of SAP; including partial re-regulation, particularly of the Exchange Rate. By 1993, SAP-induced Exchange Rate Depreciation had brought the external value of the Naira down to ₦22.0511 per US dollar. In 1994, the Government decided to return to a regime of fixed official Exchange Rates, supported by Foreign Exchange Controls, with the starting rate of ₦21.8861 per US dollar. This rate was maintained up to 1998. In addition, an auction-based autonomous Foreign Exchange Market was established in 1995, starting at a rate of US$1=₦81.0228. By 1999, the two rates had merged at US$1 = ₦92.50.

Key macroeconomic variables responded in various ways, both positive and negative. In the positive sphere, Trade Balance recorded an average surplus of

₦323.9 billion over the 1995 – 99 period compared to ₦51.0 billion in 1990 – 94; Total External Reserve Position rose to an average of US$4.95 billion in 1995 – 99 as against US$4.14 billion during 1990 – 94. Similarly, real GDP averaged ₦309.6 billion over the 1996 – 2000 period compared to ₦273.9 billion in 1991 – 95; while the rate of inflation fell to an average of 9.2% during the 1996 – 99 period.

On the negative side, External Debt Outstanding ballooned, to an average of ₦1027.9 billion during 1995 – 99 as against ₦490.7 billion in 1990 – 94. Similarly, Government Domestic Debt Outstanding averaged ₦551.0 billion over 1995 – 99; an almost three-fold increase from its average of ₦211.9 billion during the 1990 – 94 period. Finally, average Manufacturing Capacity Utilization Rate continued its downward spiral, averaging 31.8% over the 1995 – 99 period compared to 37.6% during 1990 – 94.

2.4: Nigeria's Banking System

The Nigerian banking system has, historically, been dominated by private and Government-owned banks. This bank ownership structure is to a large extent, a replication of the practice in other developing – countries world-wide.

A recent review (World Bank, 2012) provides a broad characterization of State-owned banks and offers an analysis of their key constraints. It argues that certain market gaps in long-term credit, infrastructure, agricultural, and small-scale enterprise finance have generally justified the establishment of State-owned banks in many countries. Over time, however, the prevalence of Government bank ownership has declined. For example, the share of State-owned banks relative to the total assets of the banking system declined sharply in all emerging region, from an average of 67% in 1970 to 22% in 2009. In the case of Africa, the domination of the banking system by State-owned banks has also given way to one with a high share of foreign and privately-owned banks. Nigeria is not an exception to this general trend. More specifically, of the 24 banks operating in Nigeria in 2009, 16 had some Government shareholdings. However, most of these shares had been reduced to below 10% in each case. By comparison, 17 of the banks had private foreign shareholders, including at least four banks whose foreign shareholding was at least 50%.

The phasing out of State-owned banks was generally attributed to their relatively poor financial performance which in turn, impaired their ability to fill the market gaps in long-term finance that originally justified their creation. Historical evidence suggests that State-owned banks were "loss-making machines" which were not geared toward profitability or the aggressive enforcement of loan repayment. Hence, State-owned banks generally had lower profitability, lower interest margins, higher overhead costs, and a higher proportion of non-performing loans, than comparable private banks.

The structure and performance of Nigeria's banking system reflected both the positive and negative impacts of the regulatory framework and the business and policy environment of the 1980 – 99 period. Generally, all indicators of banking system growth increased over this period. For instance, the number of commercial banks which stood at 20 in 1980 increased to a peak of 66 in 1993 before falling back to 54 in 1999. In terms of period averages, the number of commercial banks increased from an average of 23 during 1980 – 84 through 36 during 1985 – 89 to 64 in 1990 – 94 before falling to 60 in 1995 – 99. The number of commercial bank branches was 740 in 1980 and rose steadily to its peak figure of 2407 in 1991. The period averages began with 991 during 1980 – 84, rising by 55.1% to reach an average of 1537 during 1985 – 89; it rose further by 43% to an average of 2198 in 1990 – 94. By the 1995 – 1999 period, the average number of banks branches had climbed to 2310.

The total deposits of commercial banks increased significantly over the 1980 – 99 period. These deposits rose successively from ₦10.81 billion in 1980 to ₦476.3 billion in 1999. In terms of period averages, total deposits rose by 71% from 13.2 billion during 1980 – 84 to ₦22.6 billion in 1985 – 89; increased by 262% to reach the 1990 – 94 average of ₦81.9 billion, with a further 253% increase to an average of ₦289.1 billion during 1995 – 99. Total loans and advances of commercial banks enjoyed a similar uninterrupted growth experience over the 1980 – 99 period. During 1980 – 84, total loans and advances averaged ₦9.1 billion and rose by 84.9% to reach ₦16.8 billion in 1985 – 89. During 1990 – 94, this average had increased to ₦39.5 billion or by 135.5%. Finally, a further increase of 436.7% brought the average value of total loans and advances to ₦211.9 billion during

1995 – 99. Correspondingly, the Average Loan/Deposit Ratio was 68.5% in 1980 – 84; this ratio rose to 74.2% during 1985 – 89, fell to 48.2% in 1990 – 94 and rose again to 73.3% during 1995 – 99. Thus, the Average Loan/Deposit Ratio for the commercial banks remained well within the prescribed 80.0% limit. Liquidity Ratio which averaged 49.30 (1980 – 84), 46.30 (1985 – 89), 40.60 (1990 – 94), and 44.80 (1995 – 99) also remained within the 25% to 30% prescribed limit relevant for that period, while also meeting the more recent 40% prescription.

Table 1 presents some relevant Money Market and Inflation Rates which are worth examining in terms of their implications for commercial bank deposit mobilization and lending during the 1980 – 99 period. The rising trend in the Minimum Rediscount Rate (MRR) over the first three sub-periods suggests a tightening of Monetary Policy over those sub-periods, followed by a loosening of the policy stance during the last period. This trend is essentially replicated by that of the treasury bill rate.

Table 1: Selected Average Money Market and Inflation Rates

Rates (%)	*1980 – 84*	*1985 – 89*	*1990 – 94*	*1995 – 99*
Minimum Rediscount Rate	*7.60*	*12.20*	*17.60*	*14.56*
Treasury Bill Rate	*6.50*	*11.60*	*18.40*	*13.34*
Inflation Rate	*20.37*	*26.05*	*42.52*	*17.65*
Savings Deposit Rate	*7.20*	*12.78*	*15.87*	*7.98*
Maximum Lending Rate	*11.15*	*17.03*	*27.36*	*22.70*

Source: CBN, Statistical Bulletin, Dec., 2008

While it is typically argued that tightened Monetary Policy tends to reduce inflation, it is not clear that this effect can be inferred from the data in Table 1 given the high rates of inflation during the first three sub-periods. One thing is clear, however: in each of the four sub-periods, the Inflation Rate was several *multiples of the Savings Deposit Rate. Hence, the Real Savings Rate was negative, savers were penalized and savings discouraged through the 1980 – 99 period. The second thing which is clear derives from the difference between the Savings Deposit Rate and the Maximum Lending Rate. This margin which was 3.95 percentage points during 1980 – 84, rose by 7.6% to reach 4.25 percentage points during 1985; then rose by 170.1% to reach 11.49 percentage points in 1990 – 94, from which another 28.1% leap moved it to 14.72 percentage points during 1995 – 99. What this trend conveys is a commercial banking system which lacked effective competition and where efficient banks could develop oligopolistic dominance and reap supernormal profits.*

III. THE JOURNEY TO FAILURE

3.1: Introduction

Pan African Bank (PAB) Ltd. commenced operations in 1971. From the early 1980s, it became clear that PAB was troubled. Hence, from 1987, PAB was placed under various stages of 'intensive care', first by its shareholders and subsequently by the Regulatory Authorities (the CBN and NDIC). Eventually, its license was revoked on 16 January, 1998. Based on available records, this section chronicles its eleven-year journey to failure between 1987 and 1998, by examining trends in its operational indicators, income and expenditure, key financial conditions as well as regulatory compliance.

3.2: Trends in Operational Indicators

This subsection seeks to uncover the characteristics of PAB's operational indicators, i.e., deposits, loans and advances, which might have hastened it to its eventual failure. It will also identify what could have been done, but was either not done or not done well enough, to prevent the bank's failure.

Table 2 presents data on total deposits, loans and advances and the ratio of loans and advances to deposit of PAB over the 1983 – 96 period. Total deposits exhibited an erratic trend over this period; as the total rose and fell virtually every other year. Starting at approximately ₦189 million in 1983, total deposits peaked at

₦712 million in 1993 and steadily declined thereafter. There were dramatic increases in total deposits between some years; as well as sharp declines between other years. The sudden withdrawal of Government deposits from commercial banks in 1989 appears to have had limited impact on PAB's deposit trend. Its total deposits declined from ₦319 million in 1988 to ₦275 million in 1989, and further to ₦265 million in 1990. But by 1991, total deposits had jumped to ₦413 million, and increased further to ₦595 million in 1992 and ₦712 million in 1993. Aside from the volatility of total deposits over time, the structure of deposits appears stable; with the share of savings in total deposits rising steadily from 23% during 1983 – 87, through 38% between 1988 and 1992, to 57% during the period of 1993 – 96.

Total loans and advances increased over the 1983 – 96 period at a more steady pace than total deposits; rising from approximately ₦208 million in 1983 to the peak figure of ₦1172 million in 1996. In spite of the steadier trend in total loans and advances, there were several notable sharp declines and increases between some years which should have generated some concern. It is clear, however, that one of the two issues which constituted the main points of contention between PAB and the Regulatory Authorities was the persistent tendency of the bank to over-lend. Over the 1983 – 86 period, the ratio of loans and advances to total deposit averaged 127%. This ratio fell to an average of 117% during 1987 – 92; but rose sharply again to 147% over the 1993 – 96 period. Thus, PAB's extent of over-lending stood in sharp contrast to both the 80% ratio prescribed by the Regulatory Authorities and the average of 75% maintained, by all commercial banks, during the 1983 – 96 period.

The second issue relates to PAB's credit management problems and the resulting challenge of non-performing loans. The increasing incidence and magnitude of this challenge over time is documented in various Bank Examination Reports issued over the 1988 – 96 period. As at 31 August 1988, for instance, as much as 70% of PAB's outstanding loans and advances were classified for harboring one defect or the other, with a recommendation that the provision for bad and doubtful accounts should be increased to ₦198.5 million from the existing level of ₦15.3 million. Due to continued weaknesses in credit administration, the bank's credit *portfolio was rated as poor, as at 31 July 1990, with 89% of total outstanding credits harboring significant defects.*

<u>Table 2: Trend in PAB's Deposits and Loans and Advances, 1983 – 1996</u>

	Total Deposits (Nm)	*Loans and Advances (Nm)*	*Ratio of Loans and Advances to Deposits*
1983	*188.7*	*207.6*	*1.10*
84	*229.6*	*264.0*	*1.15*
85	*210.3*	*308.8*	*1.46*
86	*203.8*	*335.2*	*1.64*
87	*248.5*	*253.7*	*1.02*
88	*318.7*	*294.3*	*0.93*
89	*275.3*	*340.8*	*1.24*
90	*264.6*	*433.2*	*1.64*
91	*412.7*	*510.9*	*1.24*
92	*594.9*	*470.2*	*0.79*
93	*712.2*	*925.9*	*1.30*
94	*682.9*	*845.0*	*1.24*
95	*644.0*	*869.4*	*1.35*
96 (May)	*595.1*	*1172.3*	*1.97*

Source: CBN/NDIC Examination Reports

This led to the requirement that the bank's Loan Loss Provision should be increased from ₦263.8 million to ₦284.7 million. By 31 December 1992 when the bank's outstanding Loan Portfolio was ₦470.2 million, 74% of it was classified, including ₦326.8 million being regarded as lost. This trend worsened rather than being improved over time. Thus, by 31 July 1994, the proportion of Classified Loans to Total Loans had increased to 77.4%. The last Examination Report of the bank shows that as at 31st May 1996, the quality of PAB's assets had deteriorated further. More specifically, out of the total credit of ₦1,171.3 million, ₦1,169.7 *million or 99.8% of the facilities had become delinquent, including ₦1,168.0 or 99.6% regarded as lost.*

3.3: Trends in Income and Expenditure

The trends in PAB's Operational Performance Indicators described above have significant implications for its income and expenditure trends. Table 3 offers data on income, expenditure and profit/loss position of the bank over the 1983 – 96 period.

Table 3: Income, Expenditure and Profit/Loss Trends, 1983 – 96

	Income (₦m)	Expenditure (₦m)	Profit/Loss (₦m)
1983	32.1	31.0	1.0
84	24.6	33.3	(8.8)
85	10.8	34.0	(23.3)
86	10.2	33.8	(23.5)
87	50.5	44.4	(6.1)
88	68.8	134.9	(66.1)
89	79.8	71.7	(8.1)
90	75.0	76.6	(1.6)
91	88.0	86.1	1.9
92	170.0	264.3	(95.2)
93	200.5	456.8	(256.4)
94	128.8	327.8	(199.0)
95	198.7	173.3	25.4
96 (May)	51.4	52.4	(1.0)

Source: CBN/NDIC Examination Reports

The year-by-year trend of PAB's income over this period is rather erratic. Period averages provide a clearer picture. Thus, Average Annual Income generally increased over the entire period, rising from ₦25.6 million during 1983 – 87, through ₦96.3 million in 1988 – 92, to ₦144.9 million during the 1993 – 96 period. In similar periodic average terms, expenditure generally increased more sharply *than income over the entire period. In particular, Average Annual Expenditure rose from ₦35.3 million during 1983 – 87, through ₦126.7 million in 1988 – 92, to ₦252.6 million over the period of 1993 – 96. Thus, the PAB accumulated losses over each of these three periods which added up to ₦660.9 million. These losses rose from an annual average of ₦9.7 million during 1983 – 87, through ₦30.4 million in 1988 – 92, to ₦107.7 million during the 1993 – 96 period.*

In general, the bulk of PAB's income was derived from interest on loans and advances. This income was, in turn, expended largely on interest, on deposits, overhead costs as well as on Loan-Loss Provisioning. Over time, the bank's earning capacity deteriorated along with its asset quality. Hence, by the mid-1990s, the bank's Gross Earnings could no longer absorb interest expense, overhead costs and appropriate Loan-Loss Provisioning requirements.

3.4: Trends in Key financial Conditions

The adverse trends in PAB's income, expenditure and profit/losses had significant consequences for its capital and liquidity, both of which are associated with specific prudential benchmarks by the Regulatory Authorities. The discussion below focuses on trends in the bank's Capital Adequacy and Liquidity Ratio over time.

As early as at 31 August 1988, PAB's balance sheet showed that its shareholders' fund was down to ₦23.1 million, while its Adjusted Capital was – ₦69.5 million. This showed that the bank's capital had been eroded by Loan Losses. By 1988, its ratio of capital to risk assets was -3.2%. The situation worsened two years later. More specifically, the bank's Adjusted Capital as at 31 July 1990 was – ₦75.4 million; while the fresh fund injection required to meet the prescribed 7.25% Minimum Risk Weighted Assets Ratio was put at ₦101.1 million.

Within another two years, the bank's Adjusted Capital had deteriorated to – ₦143.6 million and the Bank Examination Report of 1992 recommended that a minimum fresh capital of ₦217 million should be injected to (a) clean up its negative capital of ₦143.6 million and (b) provide a Minimum Risk-Weighted Capital Asset Ratio of 8% amounting to ₦73.7 million.

The downward spiral had taken hold and was moving at an accelerated speed. Thus, by July 1994, the bank's adjusted capital had fallen further to – ₦428million; while the Risk-Weighted Capital Assets Ratio fell from -15.6% (in December 1992) to -120%. As a result, the new recapitalization requirement had increased to over ₦478 million. The last Bank Examination Report of the bank indicated that, as at 31st May 1996, the Adjusted Capital of the bank was – ₦556.3 million and its Risk-Weighted Capital Asset Ratio was - 287.7%. This report finally recommended the injection of fresh funds of ₦701.6 million.

As PAB's capital position progressively deteriorated, so did its liquidity position. Although the bank was able to meet the 25% prescribed Liquidity Ratio until March 1993. From April to September, PAB's Liquidity Ratio remained below 25%, followed by a brief reprieve during October to December 1993. During the entire period from January 1994 to April 1996, the bank's actual Liquidity Ratio was less than the prescribed minimum. In fact, between June 1994 and April 1996, the bank's Liquidity Ratio remained negative for every month.

3.5: Regulatory Compliance

Virtually all the signs and symptoms of failure described above were identified in the series of Bank Examination Reports which also made recommendations for dealing with them. It is therefore, clear that the PAB, its shareholders, Board and Management were not unaware of the actions which needed to be taken as a means of arresting the bank's eventual failure. For instance, the bank was advised against its heavy reliance on volatile Government deposits to support its lending operations; it was warned about the dangers of relying on Short-Term Funds mobilized from the Money Market to sustain its large volume of non-performing loans and advances, and it was admonished regarding Management deficiencies that impaired effective credit documentation and permitted massive insider-lending and frauds.

In addition, there were many other specific regulatory rules which the Regulatory Authorities sought to enforce for the benefit of PAB and its survival but which *were not effectively taken up and acted upon by the bank. Many of these relate to Loan-Loss Provisioning and Capital Injection. For instance, the Issued Share Capital, which stood at ₦10.741 million up to 1987, was increased to ₦50 million as the shareholders were persuaded to inject fresh funds to the tune of ₦39.259 million. The shareholders also granted PAB a 15 – year loan of ₦41.346 million. But the further recommendation that this loan should be converted into equity in order to ameliorate the bank's Capital Inadequacy was not implemented. In the same way, the successive recommendations of the Regulatory Authorities for the injection of fresh capital were often ignored. The same reaction followed the imposition of 'holding actions' on the bank by the Regulatory Authorities in 1990. This directed that no new loans and advances should be granted by the bank without the approval of the Regulatory Authorities. In spite of this, however, the bank's credit portfolio continued to expand at an accelerated rate. Recommendations regarding Loan-Loss Provisions were also not adhered to. In 1990, for instance, when the examiners recommended a provision of ₦101 million to mitigate impairment of Credit Portfolio, the bank's Board contended that this was excessive and decided that ₦62 million was adequate.*

Finally, PAB's record keeping and reporting routinely violated relevant Regulatory Rules. For example, the Bank's Examination Report of 1990 shows that the bank had consistently and inaccurately reported the magnitude of its accumulated losses until 1988 when it was compelled to apply provisions for bad and doubtful debts acceptable to the Central Bank of Nigeria (CBN) to its operating results. This deception typically enabled the bank to declare 'paper profits'. Eventually, the failure of PAB to observe the prescribed Prudential Guidelines over time and inability to recapitalize necessitated the decision to take over the bank by the Regulatory Authorities in May 1993.

IV. CAUSES OF BANK FAILURE

4.1: Bank Distress

Bank distress is most often the key forerunner of bank failure. In CBN/NDIC (1995), a financial institution was described as 'distressed' when it is characterized by severe financial, operational and managerial weaknesses which have rendered it *difficult for the institution to perform its functions and, thus, meet its obligations to its customers, owners and the economy at large, as at and when due. More specifically, a bank is distressed when it is either illiquid and/or insolvent. Illiquidity prevents the bank from meeting due payment obligations to and/or on behalf of its customers. Insolvency is a situation in which the value of the bank's liabilities are in excess of the value of its assets. In other words, an insolvent bank has negative net worth.*

It is usual, therefore, to have a three-part classification of bank distress. First, a bank may be illiquid but solvent; in this case, while the bank is unable to meet its customers' withdrawal requests, it has realizable assets whose value can more than cover its liabilities. A bank which finds itself in this situation can usually access liquidity support through Inter-Bank Lending and lender-of-last-resort facility of the Central Bank of Nigeria in coping with this temporary problem. Second, a bank may be insolvent but liquid; hence it is able to meet its cash withdrawal obligations by accessing its adequate inflows of deposits, even though the value of its realizable assets is less than that of its liabilities. Faced with this type of distress, the bank requires injection of fresh capital. Third, a bank which is both illiquid and insolvent faces the worst of both situations; it is unable to meet its payment obligations and the value of its liabilities exceeds that of its assets. It therefore needs both liquidity support and new capital injection.

The use of the CAMEL Rating System for assessing the performance of banks enables the Regulatory/Supervisory Authorities to link the type of distress to specific weaknesses and, therefore, causes of the distress. For instance, insolvency may be explained by capital inadequacy that results from accumulated losses and large Loan Loss Provisions for non-performing loans which, in turn, constitute the proximate causes of the erosion of the bank's capital base. Asset Quality Assessment should reveal the trend in the proportion of Classified (i.e., non-performing) Loans and Advances which may threaten Capital Adequacy. Managerial competence will be reflected in the effectiveness of credit administration and internal control which together determine Asset Quality (extent of non-performing loans) and the extent and incidence of frauds and *forgeries. Earnings strength of a bank may be weakened by operational deficiencies that generate losses which can in turn, lead to an erosion of the capital base. Liquidity sufficiency which is necessary for avoiding illiquidity is dependent on managerial competence that, in turn, ensures operational efficiency.*

4.2: Banking Crises and Bank Failure

Studies of banking crises and bank failures for many countries (see, for example, Caprio and Klingebiel, 1996; and OCC, 1988) suggest that key causes include macroeconomic factors, weak incentive system for banks and lax regulations. Beyond these, Management-driven weaknesses such as inadequate loan policies, problem loan identification and management systems, and systems to ensure compliance with internal policies and banking laws have generally also played significant roles in bank failures. In the case of Nigeria, other causes of bank failure that have been cited include political interference, lack of strong regulatory and supervisory enforcement, lack of political will, and inaction towards the resolution of insolvent banks. These are in addition, of course, to the Board and Management incompetence which result in weak internal control systems and deficient management of assets and liabilities. In CBN/NDIC (1995), the causes of bank distress, which may result in bank failure, are specified as failure to meet capitalization requirements, weak deposit base, and mismanagement. In addition, large volumes of non-performing loans (due to poor asset and liability management) have featured prominently as a key factor in bank distress and failure. In the particular case of Government – owned banks, unwarranted interference in bank management, employment of unqualified and/or inexperienced staff, poor risk assessment and insider-lending have been cited as significant factors behind bank failures.

4.3: Why PAB Failed

In the specific case of PAB, a series of Bank Examination Reports issued between 1988 and 1996 offers a good basis for the identification of the key categories of actors whose activities generated changes in a number of critical variables which, in turn, served as the proximate triggers for the bank's lingering distress and ultimate failure. In what follows, each of these is identified; its activities over time and the trend of changes in each of the relevant variables are analyzed.

(a) The Owners

The shareholders of a bank have at least two critical responsibilities that must be performed if the bank is to be kept strong and healthy. One of these is to provide the bank with adequate capital which is maintained over time so that it can acquire necessary infrastructure or cushion losses when necessary. The other is to endow it with a competent Management which would be responsible for its day – to – day operations, free of undue interference by the Board of Directors and/or the shareholders. Reports of various Bank Examinations indicate that the shareholders failed to perform satisfactorily in both respects. According to the CBN Special Examination Report of 1990 (p. 1), PAB was "plagued by Management instability and shareholder interference . . . as the shareholders were unable to endow it with a strong and effective management". A Management crisis followed the sending on compulsory leave of almost the entire Management staff of the bank in March 1985, and the bank was nearly crippled by a liquidity crisis in 1986. Yet the shareholders did not appoint Technical Managers to take over Management responsibilities at the bank until March 1987; a delay of two years. In addition, there was considerable instability at the board level. Often, the bank operated over long periods of time without a Board; and when there was a board, there was also lack of continuity in its membership. Many policy decisions that should be taken by the Board were routinely referred to the shareholders whose decisions were often delayed, if made at all.

The shareholders neglected the effective performance of its duty to provide and maintain the capital of the bank both directly and indirectly. In direct terms, the *fresh capital injections recommended by various Bank Examination Reports were often ignored. Indirectly, the bank's capital position was frequently worsened by the actions or inactions of the Government. As the Bank Examination Report of 1988 documents, substantial balances remained outstanding on some of the Government-guaranteed facilities; while indebted ex-directors of the bank had refused to service their debts. These contributed to the mounting non-performing loans and Loan Loss Provisions which eroded the bank's capital. Furthermore, the sudden withdrawal of Government and parastatals deposits from the bank in 1989 worsened its liquidity position.*

The recurring recommendations in virtually all the Bank Examination Reports issued between 1988 and 1996 focused on two critical issues, i.e., that the recapitalization of the bank should be pursued vigorously by its owners, and that the owner should endow the bank with an adequate, experienced and competent Management as the only effective means of taking the bank out of its distressed position and pre-empting its failure. To the extent that neither was effectively responded to by the shareholders, the bank's failure became a fait accompli. Hence, it is reasonable to conclude that the shareholder's action and/or lack of action constituted a major cause of PAB's eventual failure.

(b) Board of Directors

The Board of Directors of PAB was incapacitated in various ways. It was frequently not constituted and when constituted, there was little regard for continuity in its membership; while its members lacked the requisite experience. Hence, in its operations, the Board continually referred routine policy matters to the shareholders. This often meant that such matters were not decisively addressed in a timely fashion. Having been handicapped in dealing with policy issues, the Board strayed into matters that should normally lie within the purview of Management.

In addition, the members of the Board became recalcitrant debtors to the bank. The ex-directors of the bank who were indebted to it refused to fulfill their debt service obligations. Perhaps because serving members of the Board were also indebted to the bank, they apparently lacked the moral authority to ensure that *an aggressive debt recovery programme was implemented by Management. In the same way, they failed to help the bank by ensuring that debts that were either owed directly by the shareholders or guaranteed by it were serviced and fully repaid as and when due. Furthermore, the Board failed to effectively perform the critical task of ensuring that the shareholders fulfilled their responsibility of providing adequate capital for the bank.*

(c) The Management

Every Bank Examination Report issued on PAB between 1988 and 1996 found significant deficiencies in the Management of the bank and made clear recommendations for improvements that were never implemented. One of these Reports noted that the bank lacked a strong and effective Management from its inception in 1971. Another reported on the Management crisis which rocked the bank in March 1985 when almost the entire Management staff was sent on compulsory leave. Two years later, the shareholders acted by appointing a Consultancy Company, AVC Fund Ltd, as Financial Adviser and Technical Manager to manage and reorganize the bank in the context of a three-year contract.

Unfortunately, this action did not succeed in solving the bank's Management problem. In the opinion of the CBN Special Examination Report of 1990 (p. 3), "the Technical Manager did not possess the experience and exposure to undertake the herculean task of turning the bank into a profit making institution". In spite of this, the three – year contract was not ended at its expiry date. Hence, the Technical Manager remained in place until March 1993.

Subsequent Bank Examination Reports documented a long list of Management deficiencies. Included among these are the following: lack of lending policy, lack of specific authorized lending limits for bank officers, lack of adequate project appraisal, lack of adequate supervision of bank branches, non-functional inspection department, lack of effective internal control, lack of adequate number of experienced staff, and poor credit administration. These deficiencies generated, in turn, several problems. The most glaring among these include over-lending, asset and liability mismatch, non-compliance with regulatory rules, increasing *losses from frauds and forgeries, mounting volume of non-performing loans and advances, and rising operational losses.*

Every one of the Bank Examination Reports also made specific recommendations on the need for the bank to have a more competent Management. For instance, the 1988 Report recommended that a substantive Managing Director should be recruited quickly and that bank branches should have experienced staff. The 1990 Report called for the installation of competent Management, overhaul of the Credit Administration machinery, and elimination of over-staffing caused by quota-based recruitment. In the 1993 Report, the bank was advised to establish a functional Management Credit Committee, Assets and Liabilities Committee; re-structure and staff the Credit Department and Loan Review Unit with those knowledgeable in credit appraisal, review and control; and enhance the quality of manpower, accounting system and internal controls. None of these recommendations was implemented before the bank was taken over by the Regulatory Authorities.

This take-over was based on the judgment that, due to the unabated deterioration of the bank's financial conditions, it could not continue as a going-concern under the control of the shareholders, its Board and Management. Clearly, Management incompetence contributed significantly to the increasing operational losses and the rising Loan-Loss Provisions for the mounting volume of non-performing loans. These, in turn, completely eroded the bank's capital to the extent that its net worth became negative and it could not meet any of the prudential requirements. Hence, it is impossible to avoid the conclusion that Management incompetence was a key cause of the failure of PAB.

(d) Consequences

The culpability of each of the three categories of actors, i.e., the shareholders, the Board of Directors, and the Management, has been discussed and assessed above. The focus will now shift to the effects and consequences of what these actors did or failed to do.

The Bank Examination Reports documented various instances of reckless extension of credits over time by the bank. Over-lending was thus one of the negative consequences of the bank's weak Management. In 1988, the ratio of loans and advances to deposits was as high as 110%. For the five-year period up to 1992, this ratio average 130%. The bank unwisely relied on Short-Term Funds mobilized from the Money Market to sustain this unhealthy habit. Correspondingly, the volume of non-performing loans and advances increased; and the recommended Loan-Loss Provisions rose from ₦198.5 million in the 1988 Examination Report to ₦284.7 million in 1990, ₦339.5 million in 1993, ₦420.7 million in 1994 and to ₦1,303.2 million in 1996. By 1990, the bank's capital had been completely eroded; hence, a minimum fresh capital injection of ₦101 million was recommended. Over time, the Minimum Fresh Capital Requirement increased to ₦217 million in 1993, through ₦479 million in 1994 to ₦702 million in 1996. These recommended increases were considered necessary to shore up the capital and Capital/Asset Ratio Positions which had turned negative since 1992. In particular, the bank's Adjusted Capital stood at – ₦144 million in December 1992, fell to – ₦428 million in July 1994 and further to – ₦556 million in May 1996. The corresponding Capital/Risk Asset Ratios were –15.6%, –120.0% and –287.7%, respectively.

These critical indicators of the bank's financial conditions all showed, by their magnitude, sign and trend that PAB was in an irrecoverable downward spiral. They may, therefore, be viewed as the final triggers of the demise of the bank. However, they in fact constitute only the effects and consequences of the actions and/or inactions of the key actors previously discussed.

V. RESOLUTION

5.1: Bank Resolution Framework and Process

Bank resolution involves the combination of a set of institutional arrangements, procedures and measures that come into play in the process of solving the problem of an unviable bank. The key purpose of the Bank Resolution Framework is to facilitate an orderly exit of a failing bank from the system in a manner which protects public interest by maintaining financial stability, preserving confidence in *the banking system, and protecting depositors. Thus, bank resolution is an integral part of the banking system's regulatory and supervisory framework. But it occurs at the last stage in the life of a bank, when measures taken during the earlier stages of routine and intensive supervision, including prompt corrective actions and recovery plans, have failed to improve the situation. At this point, it is generally accepted that the bank is no longer viable and, hence, the Regulatory Authorities must proceed to implement the bank resolution process in accordance with the established triggers and corresponding actions.*

A key element of the Bank Resolution Framework is an adequate legislation that specifies the legal powers and processes for an orderly winding down of a failed bank. This ensures that the relevant institutions and regulators have all the necessary authority to initiate, conduct and supervise failure proceedings. These include the ability to administer, restructure, collect assets and liquidate the failed banks; as well as the legal power to revoke bank licenses, remove and replace the Management of failing banks, and to override shareholders' rights.

An efficient Bank Resolution Framework should place emphasis on early intervention. This is because the costs of not dealing with the problems of a failing bank quickly can be high, as weaknesses can grow rapidly, making resolution efforts more difficult and expensive. The effective and timely intervention and resolution of failing banks serve several critical purposes. It can minimize aggressive risk taking by banks and, thus, reduce bank fragility. It may induce both depositors and creditors to exert more market discipline on banks. It may, in addition, reduce the risk of contagion. This is the risk that even a solvent bank may rapidly become insolvent as it experiences a run by depositors motivated by real or imagined problems affecting the bank or, even more unpredictably, other similar banks which depositors may assume to be in a distressed state. These considerations justify the need for quick intervention before a failing bank experiences the onset of actual bankruptcy.

The specific triggers for early intervention are typically related to such indicators as Capital Adequacy, Capital/Asset and Liquidity that are ratios below the required *prudential levels, and persistent lack of compliance with requirements from the Regulatory and Supervisory authorities. In general, these triggers should lead to a failing bank being placed into resolution before it becomes balance sheet insolvent. This reflects a key principle of bank resolution that it should be initiated at a 'regulatory threshold', i.e., when the distressed bank's net financial position has fallen below a specified level but it retains a positive net worth (see IMF/World Bank, 2009). The purpose of this principle is to increase the chances of an orderly and rapid resolution in a manner which preserves as much as possible of the remaining franchise value of the bank.*

5.2: Resolution of PAB

The discussion in section 5.1 above broadly reflects the key elements of a fully developed and mature Bank Resolution Framework and process. But the framework which existed in Nigeria during the late 1980s through the mid – 1990s, when the resolution of PAB took place, was not yet fully developed. Thus, the legal framework under which various phases of PAB's resolution were implemented was derived from the relevant provisions of Bank and Other Financial Institutions Act (BOFIA) of 1991. These provisions endowed the Central Bank of Nigeria (CBN) with the necessary power of intervention for the purpose of implementing the resolution of failing banks.

In the context of BOFIA, bank resolution is implemented in three phases. During the first phase, the Regulatory Authorities impose a self-restructuring obligation on the shareholders of the failing bank, combined with a 'holding action' mandate. If self-restructuring succeeds, the bank exits the resolution process as a viable and on-going financial institution which returns to the standard regular regulatory supervision. But if it fails to restore the bank to the path of stable recovery, the bank enters the second phase of resolution.

This second phase involves regulatory take-over or assumption of the bank's control by the regulatory authorities. The implementation of this phase of the resolution process may also result in success or failure. If successful, the bank returns to a recovery trajectory, regulatory control is terminated, the bank is sold *to new investors or returned to its shareholders. But if this phase fails to achieve its objective, the bank proceeds to the third phase of the bank resolution process. The third stage consists of the revocation of the failing bank's license and its liquidation. The resolution of PAB involved each of these three phases; the events of each phase are discussed in what follows.*

(a) Regulator–Imposed Self–Restructuring

Prior to PAB's formal entry into the first phase of the bank resolution process, its shareholders were fully aware of its near collapse, due to its poor financial conditions which manifested in both insolvency and illiquidity in the absence of strong remedial measures. Hence, several actions were taken. First, almost the entire Management staff of the bank were sent on compulsory leave in March 1985 as a means of eventually putting in place a competent and efficient Management team. Secondly, after considering and rejecting the option of employing a foreign Managing Director for the bank, due to cost considerations, the shareholders appointed the AVC Fund Limited on 17 March 1987 as Financial Adviser and Technical Manager, on a three – year contract, to manage and reorganize the bank. Thirdly, to address the liquidity problem which almost crippled the bank in 1986, the shareholders procured a ₦200 million loan from the Federal Government which it on-lent to the bank. Part of this loan enabled the bank to redeem its overdrawn account with the CBN; part was used to reduce credit facilities extended to Government contractors, and to shore up the bank's capital base.

The Management contract with AVC Fund Ltd was to implement a re-organization scheme in four phases. The first two phases were to rebuild the bank's Management, operational and internal control systems over the period of March – December 1987. Then, the reorganized bank was to be privatized, in phase III, in 1988, and quoted on the Nigerian Stock Exchange (NSE), during phase IV, in 1989. In converting PAB into a public company the shareholder's equity interest was to be reduced to 25%, provided that, at least, 55% of the shares are held by them.

A joint Special Examination by the CBN/NDIC Examiners was conducted as at 31 July 1990 to determine PAB's current financial condition, especially its ability to continue as a going-concern. In their report, the Examiners were of the view that the Technical Manager lacked the necessary qualification, experience and exposure to undertake the task of turning the bank into a profit-making institution, and that the privatization plan was not feasible, given the bank's deteriorating financial condition. The Report concluded that:

- *The bank's financial condition remains unsound*
- *The bank exhibits insolvency characteristics such as accumulated losses, negative net-worth, and large volume of irrecoverable credits*

Based on this conclusion, the Report indicated that the shareholders would be required to implement the following measures in order to transform the bank into a viable financial institution:

- *Injection of minimum fresh capital of ₦101 million*
- *Sustained debt recovery drive*
- *Overhaul of the bank's Credit Administration machinery*
- *Rationalization of the bank's operational costs, especially overhead expenses.*

That Report led to the imposition of 'holding actions' on the bank by the Regulatory Authorities in 1990. In formal terms, therefore, PAB entered the first phase of the bank resolution process at this point. The NDIC Routine Examination Report of 1992 focused on the safety and soundness of the bank through a review of its capital, asset quality, Management, earnings profiles, liquidity, and accounting and internal control systems. This was the first attempt to appraise the impact and effectiveness of the regulator-imposed self-restructuring phase of PAB's resolution. The findings of this 1992 Report indicated a worsening rather than improvement of the bank's financial condition. As a result, its recommendations were similar to those made in the 1990 Report. In particular, it was recommended that:

- *A minimum fresh capital of ₦217 million should be injected into the bank*

- *The Board and Management should establish a functional Management, Credit, Assets and Liabilities Committees*
- *Management should embark on immediate recovery of loans and advances*
- *Extension of further credits should not be entertained until a substantial improvement in the loan portfolio is attained*
- *Concrete steps should be taken to improve the quality of manpower, accounting system and internal controls in the bank*
- *Management should control overhead expenses.*

More importantly, the findings and recommendations of this Report indicated clearly that Regulator-imposed self-restructuring had failed to restore PAB to safety and soundness as an on-going financial institution.

(b) Regulatory Take – Over

The failure of Phase I automatically moved PAB into Phase II of the Bank Resolution Process. More specifically, having failed to observe the prescribed Prudential Ratios in the past (and especially during the Regulator-imposed self-restructuring period), PAB was taken over by the Regulatory Authorities in May 1993. This decision was effected through the constitution of an Interim Management Board (IMB) which was directly responsible to NDIC, the supervising Agency.

The NDIC Routine Examination of PAB in 1994 had the primary objective of determining the current financial condition of the bank since the appointment of the IMB. Particular attention focused on the extent of recoveries made of non-performing facilities, the rationalization of operations and staff with a view to cutting costs and making the bank more efficient in the use of scarce resources; bearing in mind that the ultimate objective of the regulatory take-over phase of the Bank Resolution Process is to return the bank to solvency.

In their report, the NDIC Examiners found that between December 1992 and July 1994:

- *The Adjusted Capital of PAB had fallen from minus ₦143 million to minus over ₦428 million*
- *The Risk-Weighted Capital/Asset Ratio had fallen from minus 15.6% to minus 120%*
- *The proportion of Classified Loans to Total Loans had increased from 74.5% to 77.4%*
- *The recapitalization required had increased from ₦193 million to over ₦478 million*

In addition, the Report suggested that given their poor documentation, inadequate security and age, over 60% of the non-performing facilities may actually be very difficult if not impossible to collect in sufficient quantum to bring the bank out of its current insolvency. It noted that the bank's poor internal controls had been exacerbated by staff rationalization; and that staff motivation was very low and training grossly inadequate to meet the turn-around needs of the bank. Based on these findings, the Report concluded that despite the efforts of the Regulatory Authorities, directly or indirectly through the IMB, the financial condition of the bank had continued to deteriorate. Its primary recommendation was that a recapitalization of the bank by the shareholders should be vigorously pursued.

Given this scenario, the IMB was dissolved in March 1995 and the Regulatory Authorities appointed a Transitional Supervisory Board (TSB), made up of CBN and NDIC personnel. The primary focus of TSB was to protect the bank's assets, recover debts and rationalize its departments, branches and staff.

PAB's last CBN Routine Examination Report of July 1996 revealed the fact that none of these objectives could be met. In the opinion of the Examiners, the Executive Management failed to exercise necessary prudence in the management of the bank's funds. Much of the funds realized were used up in overhead expenses rather than in paying depositors; and the Executives ill-advisedly gave themselves substantial furniture allowances for four years in advance.

All key indicators of the bank's financial conditions worsened significantly between July 1994 and April 1996. Over this period, the bank lost over ₦32.3 million from reported cases of fraud; aggregate deposit liabilities fell by 30.6%, Liquidity Ratio declined from minus 9.99% to minus 23.12%; the bank's shareholders' fund unimpaired by losses fell from minus ₦477.1 million to minus ₦556.3 million; and the Adjusted Risk-Weighted Capital/Assets Ratio fell from minus 120% to minus 288%. Finally, the bank's recapitalization requirement rose from over ₦478 million to over ₦702 million. Under such scenario, liquidation became inevitable.

(C) License Revocation and Liquidation

Following the cancellation of PAB's license and closure in January 1998, the NDIC set its liquidation machinery in motion by obtaining the appropriate winding-up orders from the court and having itself appointed as the official liquidator. The necessary further steps included taking custody of the bank's assets, payment of insured deposits, disposing of the assets and then paying liquidation dividends to uninsured depositors, creditors and shareholders of the bank-in-liquidation.

As liquidator, the NDIC managed the assets of the bank-in-liquidation with the goal of realizing those assets so as to be able to pay liquidation dividends to uninsured depositors, creditors and shareholders. The insured deposits were, of course, paid through the Deposit Insurance Fund. The total amount of insured deposits of ₦360.745 million was fully paid as soon as the necessary account verification and reconciliation exercise was completed. As at 31 December, 2011, recoveries of loans and advances amounted to ₦667.93 million; while physical asset sales yielded ₦350.25 million. Based on these, uninsured deposits were fully paid; while liquidation dividends of ₦251.84 million and ₦293.00 million were declared for creditors and shareholders respectively.

VI. CONCLUSION AND LESSONS

6.1: Conclusion

The bank resolution process was successfully applied in the case of PAB. But it took a long time for the bank to be brought into the bank resolution process and even more time for the process to be completed. For instance, the bank's Adjusted Risk-Weighted Capital/Assets Ratio was not only well below the prescribed minimum but in fact minus 3.2% as far back as 31 August 1988. In effect, the bank was already critically undercapitalized; and if the CBN had the appropriate legal powers at that time, the bank resolution process should have been triggered immediately. Unfortunately, the decision was delayed due to lack of political will on the part of the Nigerian Presidency and insufficient autonomy and powers of the CBN with respect to such decisions at that time.

The delay was costly primarily in terms of the destruction of the bank's franchise value. Fortunately, PAB was a fairly small player in the Nigerian commercial banking system. Its share of total commercial bank deposits averaged 1.0% during 1985 – 89 and declined to 0.6% during 1990 – 94; while its share of total loans and advances of commercial banks fell from an average of 1.8% during the former period to 1.6% during the latter. Hence, the delay in resolving the bank's failure did not inflict significant damage to the commercial banking system in terms of contagion.

6.2: Lessons

The failure and resolution of PAB provided important institutional, technical and policy lessons. In broad terms, the issues around which key lessons may be drawn can be categorized into several groups. These include issues of institutional design and arrangements relating to the ownership and Management of banks as well as the powers of the Regulatory Authorities; technical issues associated with bank restructuring and recapitalization; and general policy issues. Each of these categories is discussed in turn.

It is well established that State-owned banks often have incentive systems that are not well aligned to those of privately-owned profit-making enterprises. As a result, State-owned banks generally performed poorly in comparison with other banks. In addition, the usual principal-agent dilemma confronted by firms in which ownership and Management are separated is often magnified in the case of State-owned banks where the gap between the principal and the agent is much wider.

More specifically, the ultimate principal, in the case of a State-owned bank, is constituted by the citizens of the State for whom the State Government represents the agent. This agent appoints members of the bank's Board of Directors as its agent which, in turn, appoints the Senior Management of the bank as the in situ agent to manage the day-to-day operations of the bank. This multiplicity and layering of agents often generates conflicts in the perceived mandates and responsibilities of the various agents; these, in turn, may cause delays in making decisions or lead to lack of decisions being made. Unlike in the case of privately-owned banks, the real shareholders of a State-owned bank are the people who are amorphous and cannot feasibly take decisions relating to the bank. They are assumed to be represented by the Government which is expected to take the relevant decisions on their behalf. Members of the government would ordinarily have no direct financial stake in the firm. In addition, the members of the board appointed by the government would also have no real stake in the firm either. This lack of personal stake of both Government Officials and Board members in a State-owned bank may explain the various deficiencies that are typically associated with such banks.

In the specific case of PAB, the multiplicity and layering of agents created a great deal of difficulties which was, ultimately, responsible for the bank's failure. The shareholders repeatedly appointed Board members with little regard to their ability, replaced members without paying due attention to continuity in the functions of the board, allowed the bank to operate without a board for significant periods of time, and maintained control over important policy issues whether the board was constituted or not. This provided the opportunity for political *interference which was particularly damaging by ignoring the technical and legal intricacies of banking business.*

These problems are generic to State-owned banks in Nigeria. Hence, a holistic solution had been sought through Regulations which seek to eliminate the problems at source by limiting Government shareholding in banks to not more than 10%.

It is well established that, world – wide, Regulatory Authorities are often slow to close banks; thus allowing for regulatory forbearance due to the various problems associated with such decisions (Beck and Laeven, 2006). In the case of the PAB, closure decision should probably have been taken almost a decade before the time it was eventually taken. This costly delay is a reflection of deficiencies in Nigeria's bank Regulatory and Supervisory structure. More specifically, the reluctance and/or delay in initiating the Bank Resolution Process for PAB can be traced to lack of adequate policy autonomy and legal powers, on the part of CBN and NDIC, to revoke bank licenses and implement the Bank Resolution Programme.

Both of these problems have been addressed. Current legislations provide adequate legal powers to initiate and implement Bank Resolution Processes promptly. In addition, the CBN and NDIC have established clear-cut triggers for determining the corresponding supervisory actions that should be taken in response to various levels of distress that a financial institution may experience prior to failure. The adequacy of relevant policy triggers, policy autonomy and legal powers was in full display during both the bank reform exercise of 2005/2006 and the banking crisis of 2009 – 2011.

Both the restructuring and recapitalization involved in any programme aimed at turning around of an insolvent bank are critical elements which require a great deal of technical expertise. Such expertise may not necessarily reside in the shareholders, Board and Management of a failing bank; in fact, if it did, the bank would not be failing. This suggests that it may not always be adequate for the Regulatory Authorities to implement the regulator-imposed self-restructuring phase of bank resolution without more hands-on guidance. In the specific case of PAB, AVC Fund Ltd. was not a competent Manager for the required restructuring *exercise. At least two Bank Examination Reports confirmed this assessment. But the shareholders did not seek a better option.*

The direct involvement of the Regulatory Authorities in the restructuring of failing banks, as part of the Bank Resolution Process, could have assisted in dealing with some of the other problems of PAB. For instance, the issue of recapitalization could have been better resolved if the Regulatory Authorities had the power to inject capital. The Federal Government policy at that time was that public funds should not be used to bail out banks. It is noteworthy that Loan Capital was an essential component of the toolkit for the 2009-2011 banking reform.

Finally, it is well established that certain fiscal and monetary policies can be counter-productive for failing banks that are undergoing difficult restructuring. In the case of PAB and several other banks, the directive of the Federal Government in May 1989 on withdrawal of Public Sector Deposits from commercial banks had a negative impact on their liquidity at a time when they were already under considerable strain. The Regulatory Authorities were clearly in the best position to bring this concern to the attention of the Federal Government. This may be an important issue for careful consideration in the future.

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