NORTH-SOUTH BANK CASE STUDY

NDIC
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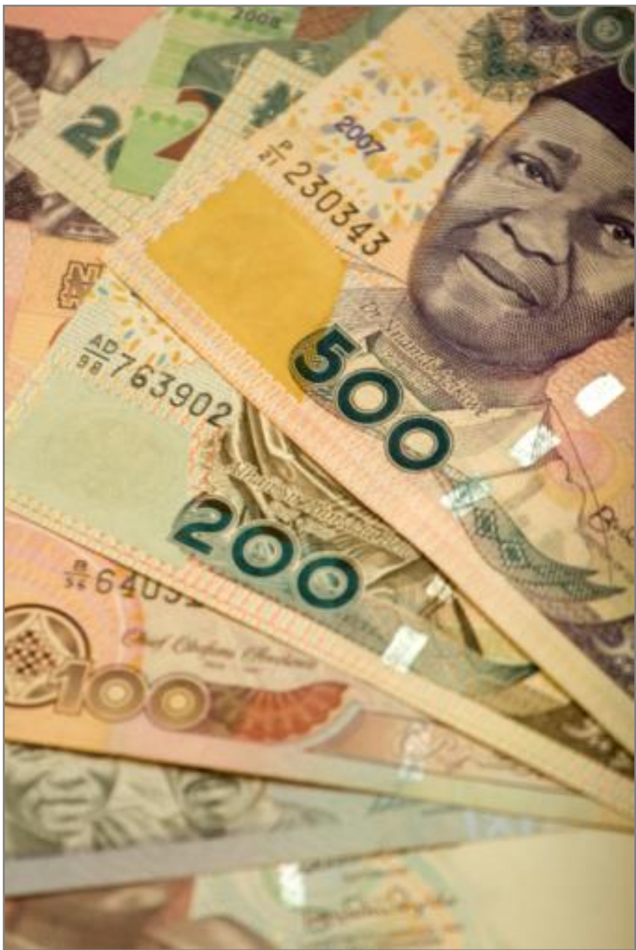
North-South Bank Case Study

The closure

On 16 January 1998, the Central Bank of Nigeria revoked the license of North-South Bank Nigeria Plc for its inability to honor its obligations to its customers. It had operated for a total of 10 years though many wondered how it stayed in business for that length of time. The distress had started from 1992 and stretched until December 1997 following which the CBN revoked its banking license.



Background

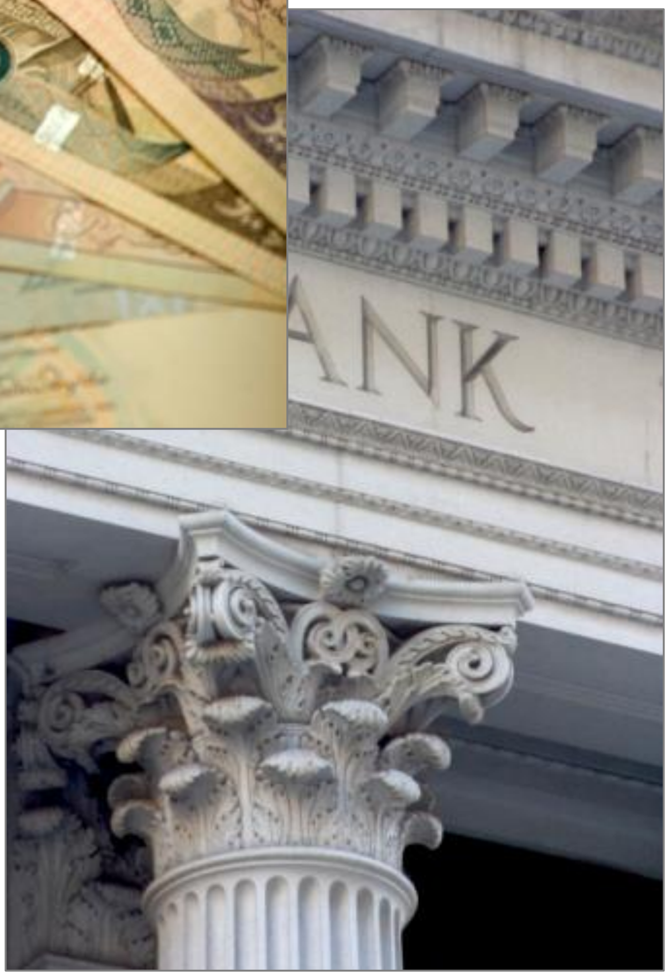
North-South Bank was incorporated as a Private Limited Liability Company on 21 September 1988. It obtained a banking license to operate as a commercial bank on 24 November 1988. By 1991, the bank had become a public liability company. It embarked on two rights issues in 1991 and again in 1992.

At the peak of its operations, North-South Bank had 16 branches and nine members on its Board. Its demise started with the progressive closure of many of its branches and this gradual deterioration culminated in the revocation of its banking license.

Review of issues

1. Board and Management

The bank had a nine-member Board of Directors which interfered with the day-to-day operations of the bank despite clear regulatory directives to the contrary. For instance, the Board ejected a bank staff member from the bank property in favor of a non-bank tenant and this affected morale of staff. It also interfered in the recruitment of



middle-level staff which was seen to erode the quality of bank staff. Furthermore, in 1993, the Board approved a dividend payout of NGN10,438,616 (ten million four hundred and thirty eight thousand six hundred and sixteen naira) which was not supported by the bank's profit and loss position for that year. The Board had four board committees – i. Board Ad Hoc Committee to review Non-Performing Loans ii. The Board Establishment Committee iii. Board Tenders Committee and iv. Board Research Committee. It evidently did not have a Board Credit Committee to evaluate all loans above a stated threshold or peculiar type. It appeared that the board used these committees to interfere in daily operational processes of the bank rather than conducting its oversight duties of policy setting and monitoring.

Likewise, management was diverted to real estate business leaving its management and supervision functions poorly performed. Several branches went without monitoring for years as the inspection department of the bank only had two officers with cognate banking experience whilst the other staff were unqualified for their functions. The bank witnessed high rates of unauthorized lending and poorly secured loans which resulted in outright fraud.

2. Operations

By 1993, the bank operated sixteen branches across Nigeria. However, between 1996 and 1998, the bank was forced to close four of these branches due to its inability to meet its obligations to depositors and its inability to pay the rents due.

There were constant breaches in its operations. For instance, the bank had sought and obtained approval to invest NGN10,000,000 (ten million naira) in Express Discount Ltd. However, the bank went ahead to invest NGN15,000,000 (fifteen million naira). There were other operational issues such as:

- Poor record keeping – evidenced by the lumping together of invisible trade transactions in the register instead of separation into different sub-heads, refusal to maintain proper records of unutilized L/Cs balances repurchased

  and the failure to record some bills for collection.
- Deficient documentation – evidenced by the bank processing and storing copies of expired passports in the purchase of Personal and Business Travel Allowance (PTA / BTA).
- Contravention of laws and regulations – evidenced by the transfer of money to beneficiaries abroad without documentation and for unascertainable purposes, over-charge of customers on

invisible trade i.e. commission of 1% charged rather than the maximum 1/2% stipulated by the bankers tariff, foreign exchange contravention as NERFUND loan of USD60,397.76 (sixty thousand three hundred and ninety seven dollars seventy six cents) was extended to a customer without documentation.

3. Accounting Systems and Control

In spite of computerization, the bank's accounting system was full of errors and deliberate falsification of records. Examiners from CBN and NDIC noted with dismay, that the records at the head office of the bank were kept in such a manner that one could not rely on them for any purposeful analysis or verification. The poor accounting and control was evident in improper account classification, non-reconciliation of accounts with the Central Bank, existence of outstanding items in the account for extended periods of time, misclassification of accounts and inaccurate statutory returns.

Internal controls were largely ineffective and thus permitted fraud at several branches. Staff cash advance registers were not properly kept and allowed for unretired sums over several years.

The computer / IT department reported to the accounts department rather than the Chief Executive Officer. This compromised its authority. In addition, most of the staff of the bank using systems were not properly trained for the interface, making their outputs paltry. The computerization appeared hurriedly implemented as source codes were not acquired from the vendor making the system largely inflexible and constraining migration to higher versions, standards and systems.

4. Risk Assets

Due to the defective accounting processes at the bank, a misleading position of its risk assets exposure was presented. As at the closure of the bank in 1998, total exposure of the bank on loans and advances amounted to NGN832, 478,000 (eight hundred and thirty two million, four hundred and seventy eight thousand naira). Around a third (32%) of this i.e. NGN267,622,000 (two hundred and sixty seven million six hundred and twenty two thousand naira) were insider related loans and advances.

Loans were poorly secured, making the realization of the outstanding balances difficult. Although about, 45.48% of the total loans had some form of security deposited, only a quarter i.e. 11.62% of the securities were perfected. This overwhelmed the bank with a large number of non-performing loans and advances. Of the NGN832,478,000 (eight hundred and thirty two million four hundred and seventy eight thousand naira) loan portfolio, only NGN97,710,000 (ninety seven million seven hundred and ten thousand naira) were performing.

Five years before the eventual closure of the bank, examiners observed that financial performance figures had been distorted i.e. there was a deliberate inclusion of non-existing liquid assets in the banks reports. The June 1993 report to the Central Bank showed that the bank had a total of NGN116,000,000 (one hundred and sixteen million naira) in liquid assets while in reality the actual position was NGN42,000,000 (forty two million naira) representing an overstatement of 176% of the real position.

Furthermore, the bank relied on non-existing assets to grant several new credits so that its credit exposure which stood at NGN309,932,777 (three hundred and nine million nine hundred and thirty two thousand seven hundred and seventy seven naira) increased to NGN832,478,000 (eight hundred and thirty two million four hundred and seventy eight thousand naira) by January 1998 when its banking licence was revoked.

Examination reports reveal that the bank had been under stress from 1992 due to its inability to settle matured inter-bank placements. It continued to rely on CBN overdraft facility, having tied up its loanable funds in unsecured non-performing loans and advances.

5. Financial Malpractice

This can be reviewed under five key areas:

i. Poor accounting and control – Both the Board and Management found basis in the false accounting records for overtrading with the bank's poor asset base. This false reporting deceived regulatory officials to keep the ailing bank in existence for much longer than its prudential performance justified.

ii. Poor corporate governance – This was evidenced by the frivolous granting of loans and advances, poor supervision of the accounting and control function, huge size of unsecured loans, the long time it took the bank to perfect its ownership of its only operational subsidiary and its inability to meet its placement obligations at maturity. Key management staff were divided in their loyalty as some key management staff of the bank held directorship positions in other financial institutions (see Exhibit 3).

iii. Careless credit administration – The bank borrowed short and lent long. It relied on short-term deposits, time and fixed deposits with short maturity periods (between 30 and 90 days) while lending funds on a longer term basis to non-performing customers. The bank hid this situation by under-providing for bad and doubtful debts over the years, declaring profits which should have been losses if the correct provisions were made. Capital adequacy computation of the bank as early as 30th June 1993, showed that its risk weighted asset ratio of 5.39% was below the prescribed minimum of 8%. By 1995, the ratio was negative 95% (-95%), which meant that it was technically insolvent. With the erosion of shareholders fund of NGN21,700,000 (twenty one million seven hundred thousand naira), the bank needed to inject additional capital of over NGN93,000,000 (ninety three million naira) for it to correct its illiquidity problem. It also needed to inject NGN908,700,000 (nine hundred and eight million seven hundred thousand naira) to stay afloat. Nothing was done in this regard, rather the Board and Management continued to grant unsecured loans and advances to non-performing accounts.

iv. Poor documentation – Evidenced by account opening riddled with incomplete documentation, loans were granted without fulfilling conditions precedent and the bank did not keep a register of staff advances. It also had no fixed asset register to show additions, disposals and location of assets. Business Travel Allowance was sold on expired and / or incomplete documentation.

v. Regulatory inertia – Evidence suggests that the bank ought to have lost its license at least five years before it finally did. The absence of examination reports after 1995 increased opaqueness and the mystery behind how the bank continued to operate riddled with such issues.

Conclusion

After some years of operations, and the progressive closure of the bank's branches, the bank's license was revoked on 16 January 1998. It was shut to customers, staff, shareholders, suppliers and all who once transacted with North-South Bank.

Following a review of the facts of this case, we can answer many questions including the following:

- Was the persistent board interference in daily management of the bank, the main reason for the bank's failure?
- Why did the regulatory authorities not revoke the bank's operating license from 1995? Was it regulatory inertia?
- What key operating factors led to the bank's insolvency?
- What role did regulatory enforcement or the lack of it play in operational failure of this bank?

EXHIBITS 1-7

Tabulated Board of Directors at Close, Comparison of Reported and Actual Liquid Assets, Key Management Staff serving at other Financial Institutions, a Risk Asset Review for Loans and Advances, Financial Profile of the bank as at the date (16th January, 1998) of Revocation of its Licence, Deposit Payout as at December 31st, 2004 and Deposit Payout as at December 31st, 2014

Exhibit 1 – Board of Directors at the Close of North-South Bank

1. Air Commodore Dan Suleiman (Rtd) - Chairman
2. Mr. J.O. Koleosho - Managing Director
3. Mr. S. Miner - Director
4. Mr. O. Adeboye - Director
5. Chief N.E. Dotic - Director
6. Dr. O.A. Kupolati - Director
7. Mr. B.W. Juta - Director
8. Dr. S.A. Salami - Director

Exhibit 2 – Comparison of Reported and Actual Liquid Assets

LIQUID ASSETS	REPORT TO CBN NGN million	ACTUAL NGN million
Placements with other banks	71.00	29.00
Call money from other banks	45.00	13.00
Total	**116.00**	**42.00**

Exhibit 3 – Key Management Staff Serving Other Financial Institutions

S/N	NAMES	COMPANIES	STATUS
1.	Mr. J.O. Kolesho	Neighborhoods Bldg. Society	Chairman
2.	Mr. J.O. Kolesho	Interleased Finance Co. Ltd	Chairman
3.	Mr. M.K Ajulo	Capri Finance Ltd	Chairman
4.	Mr. Gbola Onibiyo	Magion Finance Ltd	Chairman
5.	Mr. S.O. Olawuyi	Interlease Finance Ltd	Director

Exhibit 4 – Risk Asset Review – Loans and Advances as at 30 June 1993

	NGN	(%)
Classified Loans / Advances	121,894,725	39.31
Classified Substandard	7,242,679	5.94
Classified Doubtful	50,734,813	41.62
Lost	63,917,233	52.44
TOTAL	**309,932,777**	**100**

Exhibit 5 – Financial Profile of the bank as at the date (16th January, 1998) of Revocation of its Licence

ADDITIONAL CAPITAL REQUIRED (₦' MILLION)	CAPITAL TO RISK WEIGHTED ASSET RATIO (%)	RATIO OF NON-PERFORMING LOANS TO SHAREHOLDERS FUNDS (%)	LIQUIDITY RATIO (%)	CURRENT A/C BALANCE AT CBN (₦' MILLION)	INSIDER LOANS TO TOTAL LOANS (%)	RATIO OF NON-PERFORMING LOANS TO TOTAL LOANS (%)	ACCUMULATED LOSS (₦' MILLION)
779.1	-152	-66.03	-188.38	-650.1	32	88.33	-839.1

SOURCE: NDIC (2005); Bank Liquidation in Nigeria.

Exhibit 6 – Deposit Payout as at December 31st, 2004

TOTAL DEPOSITS AT CLOSURE (₦ MILLION)	TOTAL INSURED DEPOSIT (₦ MILLION)	TOTAL INSURED DEPOSIT PAID (₦ MILLION)	LIQUIDATION DIVIDEND		
			RATE%	AMOUNT DECLARED (₦ MILLION)	AMOUNT PAID (₦ MILLION)
349.868	152.569	80.379	6.07	19.02	5.79

SOURCE: NDIC (2005); Bank Liquidation in Nigeria.

Exhibit 7 – Deposit Payout as at 31st December, 2014

TOTAL DEPOSITS AT LIQUIDATION (₦) MILLION	TOTAL № OF DEPOSITORS AT LIQUIDATION	TOTAL INSURED DEPOSITS AT LIQUIDATION (₦) MILLION	TOTAL EXCESS DEPOSITS (₦) MILLION	TOTAL PAID INSURED (₦) MILLION	№ OF INSURED DEPOSITORS PAID	TOTAL EXCESS PAID (₦) MILLION	№ OF UNINSURED DEPOSITORS PAID
354.747	68,246	155.074	199.673	80.353	7,584	32.410	29

SOURCE: NDIC Annual Report and Statement of Accounts 2014.

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