THE CHARTERED INSTITUTE OF BANKERS OF NIGERIA CENTRE FOR FINANCIAL STUDIES (CIBNCFS)

COMMUNIQUÉ ISSUED

AT THE END OF THE

BREAKFAST SESSION ON TOXIC ASSETS: EFFECTIVE RISK MANAGEMENT & RESOLUTION STRATEGIES FOR THE FINANCE SECTOR

HELD AT THE BANKERS HOUSE

VICTORIA ISLAND, LAGOS

DATE: SEPTEMBER 19, 2019

1.0 Background

The Breakfast Session on **Toxic Assets: Effective Risk Management & Resolution Strategies for the Finance Sector** was held on Thursday, September 19, 2019 at the Bankers House, Victoria Island, Lagos. The objectives of the Session were, to among other things, sensitize participants on: the IFRS 9 Standard and modalities for its implementation; address the performance and strategies of the Asset Management Corporation of Nigeria (AMCON) in recovering the toxic assets of banks in Nigeria; examine sustainable risk management strategies taking lessons from similar climes; determine the role of all relevant stakeholders in mitigating, minimizing and eliminating toxic assets; discuss best practices in risk management with lessons for the Nigerian financial services industry and Identify gaps in financial and non-financial institution's risk management framework.

In his welcome address, the Director, CIBN Centre for Financial Studies, Professor Olalekan Asikhia noted that the issue of toxic assets had increasingly becoming a matter of concern for banks and regulatory authorities in Nigeria. He stated that though the establishment of the Asset Management corporation of Nigeria (AMCON) has led to a significant reduction in toxic assets with non-performing loans (NPL) of banks reducing from 15% in June 2017 to 9% in May 2019 as confirmed by the CBN[1], several efforts still needs to be put in place as banks continue to grapple with high rates of NPLs. He stressed that such high NPL rates could not only affect the banks bottom line but the efficient functioning of the financial system. He concluded by explaining that the introduction of the new reporting standard called International Financial Reporting Standard (IFRS) 9 where banks are expected to make provisions for existing loan losses as well as losses that might occur in the future is likely to worsen the NPL position of banks in Nigeria.

1.1 Dignitaries Present

Facilitators

a.) Mr Tajudeen Ahmed, Senior Vice President, Asset Management Corporation of Nigeria (AMCON) representing Mr Ahmed Kuru, Managing Director/ CEO, AMCON
b.) Mr. Magnus Nnoka, CRM, President, Risk Management Association of Nigeria and Chief Risk Officer, Coronation Merchant Bank.
c.) Mr. Michael Oladele, Deputy Director, Nigeria Deposit Insurance Corporation (NDIC) representing Alhaji Umaru Ibrahim, Managing Director/CEO, NDIC.
d.) Mr. Okhiria Vincent, Assistant Director, Accounting Standards, Financial Reporting Council of Nigeria (FRCN).
e.) Mr. Abiodun Ogunoiki, CFA, Deputy Chief Risk Officer, FSDH Merchant Bank representing Mrs. Hamda Ambah, Managing Director/CEO, FSDH Merchant Bank.

[1] https://www.pressreader.com/nigeria/the-punch/20190701/282102048220015

2.0 Keynote Address

The Keynote Address was delivered by Mr Tajudeen Ahmed, Senior Vice President, Asset Management Corporation of Nigeria (AMCON), representing Mr Ahmed Kuru, Managing Director/ CEO, AMCON. In the Keynote Address, Mr Ahmed stated that players in the finance sector are quick to develop very lofty risk management frameworks but lack the discipline to follow through. He noted that Proper Planning, Strict Regulation/Oversight, and Accountability as reasons why risk management strategies work in other climes.

He mentioned that since the intervention of AMCON in 2010, the ratio of NPL to Total Loans (after specific provision) reduced from 18.44% in Q1 2011 to 15.75% in Q1 2018. He explained that the restructuring strategies put in place by AMCON to achieve targeted objectives were depressing with over 90% of the restructured accounts failing. Significant portion of funds injected in form of equity in some intervened businesses to stabilize them were also lost as the businesses failed. This led to their efforts being channeled at enforcement in order to recover the debts. He noted that 63% of the recoveries achieved in 2016 were through various forms of enforcement actions. Recoveries through enforcement increased to 71% in 2017 and 80% in 2018.

Mr Ahmed also asserted that toxic assets arise because due processes were breached, critical conditions/covenants were waived, and the oversights required at all levels in the credit value chain were inadequate. He therefore advocated for strong corporate governance by banks and robust regulatory oversight. He reiterated the need to implement consequences to deter abuse of credit processes.

3.0 Highlights of the Session

The following were highlights of the session:

3.1 Overview of Toxic Assets

- In the Nigerian context, the origin of toxic assets in the financial system can be traced to careless decision making, selfish interest, weak risk management frameworks and bad risk management practices which altogether points to weak corporate governance.
- Significant successes recorded by similar vehicles like AMCON set up for NPL remediation in other jurisdictions namely; Europe, Canada, USA had been accounted for by economic growth, implementation of consequences and availability of appropriate legal and market infrastructure.
- The reduction of toxic assets in Nigeria requires a holistic approach. This would include institutional, market and legal reforms.
- In Nigeria, the tolerable NPL ratio is 5%. Anything above 5% should be of serious concern.
- One problem Nigeria faces is pro-cyclicality. Nigeria operates in a pro-cyclical environment (a shock in one sector e.g. Oil sector affects other sectors of the economy). In addition, Nigeria's risk assessment model is pro-cyclical because provision is only made when losses had occurred.

- To reverse that trend, IFRS 9 was implemented. IFRS 9 is forward looking and therefore countercyclical. Bank are now to take cognizance of and monitor both internal and external indices (macro-economic indices) when creating loans.
- A significant portion of loans that go bad in the Nigerian banks are director related (Insider related loans). This is also a reflection of weak corporate governance and consequences management in the country.
- There is an established correlation between NPL level and the quality of Corporate Governance.
- The One/ Single balance sheet model introduced by the CBN by which a bank could attach or take other assets of a defaulting obligor held in other banks to offset its loan obligation is expected to reduce NPL as recalcitrant debtors would have nowhere to hide.
- The primary objective of creating AMCON is to stabilize the banking industry by acquiring toxic assets during systemic crisis. AMCON is therefore designed to have a defined life span. Continued existence of AMCON may lead to moral hazards which could undermine the success made so far.
- The regulatory authorities in Nigeria has continued to implement pragmatic actions to tame the incidence of high NPL and in particular manage the impact on the health of banks. Some such actions included; strategies to prevent contagion, liquidity support, enhancement to regulation of financial holding companies, large explores, portfolio concentration and insider related loans.
- As part of its 5 year strategy for the banking industry, the CBN plans to increase the minimum regulatory capital requirement for banks. This is aimed at enhancing the resilience of the industry and the individual banks.

3.2 Causes of Bad loans

- Loans go bad because banks give facilities that are bad from the beginning either because of lack of sufficient knowledge about the business of the customer (such as wrong cashflow projections) or as a result of insiders' fraudulent collaborations.
- Changes in macroeconomic environment turn good loans to bad loans
- Changes in regulation e.g. changing tariffs on imported goods which affect the business models of businesses engaged in importations.
- Poor risk management culture and
- Bad corporate governance practices such as insider abuses.

3.3 Discussions on the International Financial Reporting Standard 9 (IFRS 9) and Prudential Guidelines for Nigerian Banks

3.3.1 Overview and Impact

- Under IFRS 9, banks are required to make provisions for existing loan losses as well losses to be incurred in the future.
- Prudential guidelines stipulates how banks are to provide for loan losses. This was divided into three categories namely, Substandard (30%), doubtful Loans (50%) and lost (100%).
- International Accounting standards (IAS) 39, IFRS 7 and IFRS 9 deals with the presentation, disclosures and measurement of financial instruments.

- IFRS 9 deals with expected credit losses as against incurred losses in IAS 39. Organizations are to make provision for losses immediately they create loans considering the probability of default.
- IFRS 9 takes into consideration the time value of money.
- Moving from IAS 39 to IFRS 9 means higher provisioning since banks provide for potential or future losses.
- To mitigate the impact from regulatory stand point (especially the impact of computation of Capital Adequacy Ratio) the CBN granted transitional reliefs to banks. Under the program, banks are allowed to amortize the day 1 impact of the adoption of IFRS 9 accounting standard over a period of four (4) years. This was consistent with the practice in other advanced jurisdictions.
- IFRS 9 is principle based therefore creates concerns over assumptions and judgments as there may be asymmetry of assumptions. To mitigate this, the CBN and NDIC would continue to review the appropriateness models and assumptions underpinning banks loan loss provisioning under IFRS 9.

4.0 Recommendations

Recommendations from the session are outlined below as follows:

4.1 Financial Institutions & Businesses

- Banks should strengthen their internal control and adhere to their credit underwriting standards.
- All stakeholders should promote and encourage sound ethical standards. Banks should take advantage of the expertise of knowledge persons and entities in the sectors and industries they service to develop internal capacity and for better understanding of the associated risks in those sectors. This is expected to minimize incidences of NPL.
- Early actions should be taken by banks when there are signs of default to prevent NPL build up.
- Banks should consider securitization and debt factoring as strategic options to manage and reduce NPL.
- Restructure loan facilities when there are changes in macroeconomic environment.
- Improve corporate governance in banks and put in place effective risk management process that is in line with regulation, best practice and internal credit policies at all times.
- Ensure appropriate structure for loans. A situation where short-term loans are offered for long-term projects leads to a mismatch which may affect the abilities of obligors to adequately service those loans.
- Implement and enforce consequence management. This discourage bad behaviours and engender market discipline.
- Improve risk management knowledge of officers and directors by subscribing to relevant industry reports.
- Ensure prompt adequate rendition of returns to the appropriate authorities on loan defaulters to facilitate timely remediation actions.
- Banks to leverage big data and relevant technologies to enhance credit appraisal and monitoring.
- Banks to lend strictly to individuals and companies with proven track record, staring characters and bankable business case.

- The Bankers Committee should make the CIBN/RIMAN certification mandatory for Credit Risk officers as a deliberate strategy to enhance professionalism and capacity building in the industry.
- Banks should be honest in their judgement.
- Banks should strike appropriate balance between short term income objectives and the long term sustainability of their loan book by implementing systems and policies that would ;
  - Entrench due process while meeting customers' expectations
  - Define, monitor and enforce risk limits. Banks are required to define risk acceptance criteria, conduct detailed due diligence on the capacity and characters of existing loan customers and prospects.
  - Leverage appropriate technologies like Artificial Intelligence (IA), Internet of Things (IoT), Robotics to service customers more efficiently and promptly while ensuring that the associated risks are mitigated.
  - Build expertise in different industries to make loan process faster i.e. have risk managers with expertise in different industries.

4.2 Regulatory & Judicial Institutions

- Strengthen legal processes with a view to reducing the frustration associated with litigations and adjudication.
- Establish special courts for banking related cases. This is expected to drastically improve adjudication process with tangential benefits for NPL resolution.
- Assign banking related cases to judges who have experience and/or specialized training in banking and financial matters.
- Improve on information disclosure on loan defaulters in order to enhance market discipline while appropriate actions are taken against parties at faults.
- Encourage a risk aware culture in institutions.
- The regulatory authorities should consider introduction of a framework for industry spectrum with a view to harmonizing industry practices on some critical elements of IFRS 9 like the determination of the Probability of Default (PD), use of management overlays and forward looking indicators (FLIs).
- In order to deal with pro-cyclicality in the environment, the Nigerian economy should be diversified from sole dependency on oil thereby reducing its susceptibility to external shocks.
- Consider and implement counter cyclical measures to reverse the perennial cycle of bubble and burst.
- Ensure institution of strong corporate governance and risk management practices as well as robust credit underwriting standards
- Ensure banks are consistent with the objective of enhancing long term resilience of the individual institutions and the system at large.
- Create conducive environment by ensuring policy consistency and prompt resolution of NPL in the industry.
- Blacklist loan defaulters to serve as a deterrence.
- Develop a roadmap to deal with NPL holistically.

- AMCON should expand its Asset Management Partners (AMP) initiative to improve on its loan recovery efforts and also share its expertise in this area with banks.

4.3 The Chartered Institute of Bankers of Nigeria (CIBN) and CIBN Center for Financial Studies (CIBNCFS)

- The professional certification offered by the CIBN and Risk Managers Association of Nigeria (RIMAN) should be made mandatory for those who have oversight functions or are involved in risk management activities in banks..
- The CIBNCFS to develop NPL model that would provide reliable early warning signals on asset quality in the Nigerian Banking Industry.
- Organize fit for purpose training, seminars and workshops on contemporary developments and areas of identified skill gaps in the industry.

5.0 Conclusion

Toxic assets is an issue bedeviling all economies of the world as it is not peculiar to Nigeria. While it cannot be completely eradicated, it can be minimized. It is therefore important for all stakeholders in the value chain to take a holistic and strategic approach to minimize its effect. To mention a few, it was agreed at the end of the session that financial institutions should strengthen their internal control, improve corporate governance practices as well as promote the right culture. They should also adhere strictly to IFRS 9 which ensures early actions are taken when there are signs of default. Regulators should strengthen the legal and regulatory framework as well as create an enabling environment while other important players in the ecosystem like the CIBN and RIMAN should make training of risk managers mandatory.

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