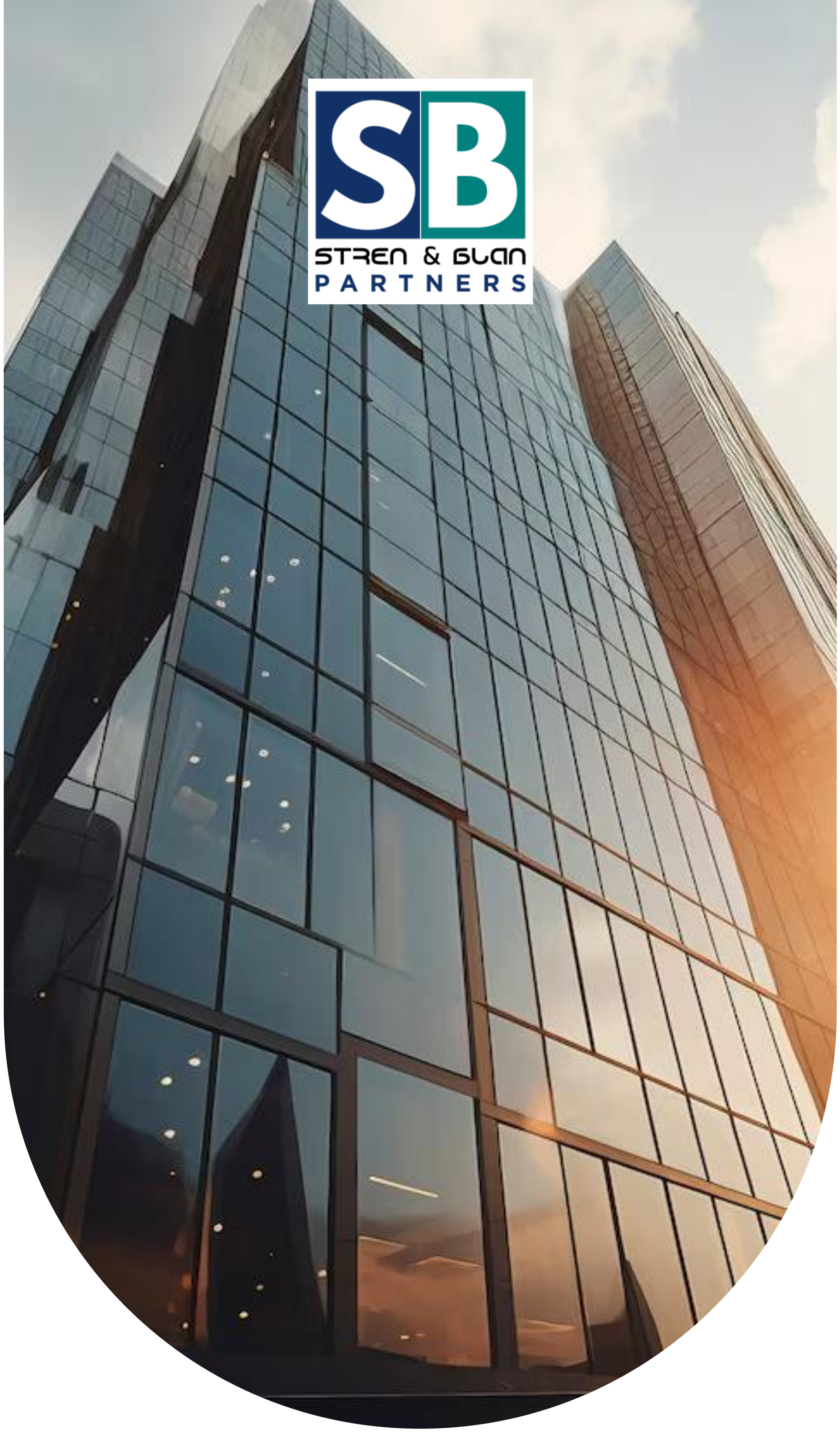

EXPLORING VIABLE OPTIONS FOR THE RECAPITALIZATION OF FINANCIAL INSTITUTIONS IN THE NIGERIAN CAPITAL MARKET

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ABSTRACT

The financial institutions in Nigeria namely commercial banks, insurance companies, investment banks, and so on, have remained relatively resilient amidst local and global challenges. Given the critical role of these institutions in spurring economic activity and growth through financial intermediation, the sector is expected to propel Nigeria's growth in the coming years through effective regulation and implementation of fiscal and monetary policies churned out by the Government and the key regulators, such as the Central Bank of Nigeria (CBN). Therefore, recapitalization as a monetary policy becomes critical to achieving this feat amid increasing economic volatility, regulatory changes, and market dynamics challenges.

Nearly two decades since the last recapitalization process occurred in the banking sector, the sector is poised to play a crucial role in accelerating economic growth and achieving the government's 2030 vision of a trillion-dollar economy. On this note, this article aims to review the rationale, and impact of the current recapitalization program for financial institutions, especially the banking sector, highlighting its critical role in strengthening financial stability and driving economic growth while exploring some options these institutions should consider in the capital markets to meet the requirements.

INTRODUCTION

Financial Institutions And The Capital Markets

The interrelationship between financial institutions and capital markets is crucial and deeply intertwined. Financial institutions play a significant role in capital markets by directing capital efficiently. For instance, banks collect deposits and provide loans, which supports the smooth operation of capital markets. Historically, financial institutions in Nigeria have also channeled capital outflows to less developed infrastructure due to limited local investment opportunities but with the Central Bank's efforts, domestic market instruments such as debt and equity have been developed to provide local investment options and reduce reliance on foreign markets.

Capital markets, which encompass platforms like stock exchanges and bond markets, are vital for channeling savings and investments between those with excess capital (suppliers) and those in need of capital (borrowers, including businesses, governments, and individuals). Financial institutions act as intermediaries in this process, offering services such as lending, underwriting, and asset management to facilitate the flow of funds.

This symbiotic relationship ensures liquidity, supports economic growth, and enables efficient resource allocation, with financial institutions participating in capital markets activities to manage investments and risks while providing clients with access to capital.

Recapitalization: The Rationale and Practicality

Recapitalization involves raising capital to enhance a bank's financial position. This process of recapitalization includes issuing new shares and obtaining funds from external sources to increase the capital base of the banks. A robust capital base is essential because it allows banks to have more money that will help absorb losses from non-performing assets and is a critical element of banking sector reforms.[1]

Also, recapitalization is a significant restructuring of a financial institution's capital to restore its financial stability and optimize its capital structure.[2] Companies typically engage in recapitalization to strengthen financial stability, improve performance, and achieve a more sustainable balance between debt and equity.

Additionally, recapitalization can optimize the debt-to-equity ratio, balancing the capital structure to enhance stability and financial flexibility. Moreover, companies may use recapitalization to fund growth initiatives, such as mergers, acquisitions, or capital expenditures, aligning with their long-term strategic goals.

Bank Recapitalization in Nigeria

The ongoing recapitalization exercise in Nigeria's banking sector has the pivotal objectives of strengthening banks and mitigating systemic risks. A similar exercise was initiated in 2004 when the CBN brought into force, the risk-weighted measure of capital adequacy recommended by the Basel Committee on Banking Supervision (BCBS) in 1990 and raised the capital requirement for financial institutions from N2 billion to N25 billion which was a significant increase for the banking sector.[3] This increase generated a lot of controversies and led consolidation of financial institutions in the industry, taking the number of banks from 89 (eighty-nine) to 24 (twenty-four) in 2006.

The most recent and the second recapitalization exercise in the banking sector in Nigeria took place on 28th March, 2024 when the CBN issued a circular announcing a new recapitalization policy for commercial, merchant, and non-interest banks in Nigeria, effective from 1st April, 2026 (the "Recapitalisation Circular") aimed at strengthening the Nigerian financial industry and expressly noted as part of the Nigerian Government's objective to achieve a $1 trillion economy in gross domestic product (GDP) terms by 2030.

The policy mandates banks to recapitalise by introducing new minimum capital requirements. This new policy aims to further strengthen Nigeria's financial system by pegging the minimum capital base for commercial banks with international authorization at N500 billion, for commercial banks with national authorization, the minimum capital requirement is N200 billion, and for commercial banks with regional authorization, the minimum capital requirement is N50 billion.[4] Banks are also required to comply with the Capital Adequacy Ratio (CAR) relevant to their license category while trying to meet the new capital requirements.[5]

[1] Centria University of Applied Sciences Recapitalisation of Banks and Its Effects on The National Economy Comparative Analysis Of Nigerian and Finnish Banks.
[2] Ayo Othihiwa Partner & Head Financial Services KPMG Nigeria Nigeria's Banking. Accessed 6th of August 2024.
[3] Basel Committee on Banking Supervision Core Principles Methodology

In the wake of this, banks face a more challenging macroeconomic climate, including rising inflation due to the naira's depreciation. Nevertheless, banks must raise funds before the deadline[6] while also establishing innovative business models for a post-recapitalization climate, taking bigger risks and stay afloat in times of trouble, supporting different sectors of the economy, and improving confidence in the banking system.[7]

Viable Options for the Current Recapitalization of Financial Institutions in the Nigerian Capital Markets

The capital market plays an important part in this process since it provides banks with access to numerous financing choices, such as equity financing. Banks can issue additional shares to raise funds from investors. Rights offerings allow existing shareholders to acquire more shares at a reduced price.

Moreover, recapitalization through capital markets whether private or public, helps banks meet regulatory capital requirements, improve capital adequacy ratios, enhance credit capacity, and strengthen financial stability. This process also aids in restoring investor trust and improving risk management.[8]

However, recapitalization options through capital markets vary, and each option has distinct implications. According to the CBN, banks must adhere to these viable recapitalization options which include:

A. Capital Infusion by way of Public Offerings

Equity infusion by way of a public offering involves raising capital for a financial institution by issuing new shares to the public through the capital market. It is a method of investment that allows individuals and organizations to invest in the shares of a public company and become part owners as well. This recapitalization option is open to public entities and private companies wishing to go public. Also, public offering can be executed through a right issue or a private placement.[9]

Currently, banks such as Guaranty Trust Bank[10] and Fidelity Bank[11], have undertaken initiatives to raise capital through public offers.

A rights issue allows existing shareholders of a financial institution to purchase additional shares at a discounted price, giving priority to existing shareholders. Essentially, a financial institution seeking recapitalization may opt to offer its existing shareholders additional shares in the financial institution at a discounted price. Currently, access Holdings Plc has flagged off its scheme to raise a total of N351 (three hundred and fifty-one) billion by way of a rights issue to existing shareholders.[12]

[4] Circular on all commercial, Merchant and Non-interest banks and promoters of proposed banks. Accessed 6th August 2024
[5] Ayo Othihiwa Partner & Head Financial Services KPMG Nigeria Nigeria's Banking. Accessed 6th of August 2024.
Between April 1, 2024, and March 31, 2026, the nation's 25 commercial and six merchant banks are expected to shore up their minimum share capital by as much as 100 percent.
[7] Business Day Another round of bank recapitalization. Accessed 6th August 2024.
[8] Vanguard Bank recapitalization, diversification key to Nigeria's trillion-dollar economy. Accessed 8th August 2024.
[9] Securities and Exchange Commission Circular Modes of public offering. Accessed August 8th 2024.
[10] Naira metrics GTCO Plc opens public offer to raise N400.5 billion. Accessed August 8th, 2024
[11] Naiarametrics Fidelity Bank's public offer and rights issue extended by N78.35 billion to August 12. Accessed August 8th 2024.
[12] Access Holdings embarks on N351 billion rights issue to strengthen capital base. Accessed August 8th 2024.

Private placement is a method of raising capital where securities are sold directly to a select group of investors, rather than through a public offering. This group typically includes institutional investors, accredited investors, or a small number of wealthy individuals. For approval, the company must get prior consent from the Commission and meet certain conditions:

a. The company must demonstrate an urgent need for new funds or expertise, proving that private placement is the only feasible option.

b. Securities can only be offered to a maximum of 50 subscribers.[13]

In a bid to achieve the recapitalization quota, a financial institution can employ a combination of these options for instance a rights issue and a public offer, depending on its financial strategy and board decisions. Utilizing both methods can provide the institution with a flexible approach to meet its capital needs, optimize its market presence, and cater to a diverse group of investors.

Upon the approval of the Securities and Exchange Commission (SEC)[14], these banks or financial institutions can leverage the market variables to raise the needed funds and/or engage in various forms of business combinations to reduce their debt burden and improve their financial health.

B. Mergers and Acquisitions

Recapitalization can also involve mergers and acquisitions. Specifically, a merger combines two or more companies into a single new entity, integrating their workforce, operations, and assets. In recent years, the Nigerian banking industry has experienced significant mergers and acquisitions due to recapitalization rules, with the CBN recently on 6th August 2024 approving the merger of Providus and Unity Bank, pending SEC approval.[15] This development reflects a response to heightened minimum capital requirements.

Typically, mergers aim to increase market share, reduce competition, or expand into new markets. Additionally, acquisitions occur when a financially stable institution purchases both shares and assets of another entity in need of capital to enhance its operations.

C. Changes to License Authorisation

Whilst the ability to upgrade has always been available to banks and presents an opportunity for banks within a lower licensing tier to increase their authorization to a higher tier, financial institutions have also been given the mandate of downgrading their licence in case they are financially incapable of carrying out the activities of their present tier or status. This license downgrade will also provide a lifeline for banks that would otherwise struggle to meet the capital requirements but for whom M&A transactions may not be a preferred option. Such banks can now downgrade

[13] Rule 340 of The Securities And Exchange Commission Rules And Regulations, 2013
[14] FRAMEWORK ON BANKING SECTOR RECAPITALISATION PROGRAMME – 2024
[15] Central Bank of Nigeria Press Release CBN Approves Financial Accommodation For Unity Bank and Providus Bank Merger. Accessed August 7th, 2024

their authorization and develop long-term strategies for a sustainable capital base under a revised operational platform.

D. Another Option Available to Financial Institutions in Nigeria

Government bailouts and regulatory interventions are essential for maintaining stability within the financial system and supporting recapitalization efforts of financial institutions. For instance, during the 2008-2009 financial crisis, the Central Bank of Nigeria intervened by injecting N620 billion (Six Hundred and Twenty Billion) into the banking sector through unsecured and subordinated debt. This intervention provided guarantees for interbank lending, foreign credit lines, and pension deposits.[16]

Recently, the CBN has approved a financial package of N700 billion (Seven Hundred Billion) to assist in the merger between Unity Bank Plc and Providus Bank Limited.[17] According to the apex bank, this funding is designed to address Unity Bank's obligations to the CBN and other stakeholders, reinforcing the stability of Nigeria's financial system. Such interventions are guided by the CBN Act and aim to ensure the financial system remains robust.

In summary, financial institutions should consider a diverse set of viable options, including government bailouts and interventions, to effectively recapitalize and enhance their positions in the Nigerian capital markets.

POLICY RECOMMENDATIONS

The role of policy implementation in the financial sector cannot be over-emphasized. Implementing policies to streamline the recapitalization process and accelerating the regulatory approval processes for equity capital raise and mergers and acquisitions would be worthy of improvement.

Also, improving market confidence through greater transparency and disclosure is critical. Mandating stronger transparency and disclosure standards will help to boost investor trust. Strengthening corporate governance principles will enhance accountability and limit risks, hence increasing investor trust. To facilitate access to finance, Nigeria's capital markets must be developed and strengthened.

Finally, financial institutions should be mandated to establish comprehensive risk management frameworks to reduce potential risks. Regular stress testing will assist examine these institutions' resilience under various economic scenarios, ensuring they are ready for possible downturns.

[16] NDIC Quarterly Update Bail-In As An Alternative Failure Resolution Mechanism In Nigeria https://ndic.gov.ng/wp-content/uploads/2020/08/NDIC-Quarterly-Vol.-30-No-4-2016-Article-Bail-In-As-An-Alternative-Failure-Resolution-Mechanism-In-Nigeria.pdf accessed August 7th, 2024.
[17] Section 42 (2) of the CBN Act, 2007.

CONCLUSION

The process of recapitalization is essential to the improvement of financial stability in Nigeria. Additionally, it aids in the fostering of growth and guaranteeing regulatory compliance in Nigeria's finance sector. The Capital market is an amplifier of this exercise. Successful recapitalization can lead to a more resilient and competitive financial sector, thereby contributing to overall economic growth and stability.

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