

**Nigeria: Publication of Financial Sector Assessment Program Documentation—
Technical Note of Banking Cross-Border Issues**

This technical note on Banking Cross-Border Issues for Nigeria was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed in May, 2013. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of Nigeria or the Executive Board of the IMF.

The policy of publication of staff reports and other documents by the IMF allows for the deletion of market-sensitive information.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org Internet: <http://www.imf.org>

**International Monetary Fund
Washington, D.C.**

FINANCIAL SECTOR ASSESSMENT PROGRAM

NIGERIA

BANKING CROSS-BORDER ISSUES

TECHNICAL NOTE

MAY 2013

INTERNATIONAL MONETARY FUND
MONETARY AND CAPITAL MARKETS DEPARTMENT

THE WORLD BANK
FINANCIAL SECTOR VICE PRESIDENCY
AFRICA REGION VICE PRESIDENCY

Contents	Page
Glossary	3
I. Introduction.....	4
II. Cross-Border Expansion of Nigerian Banks	4
III. Cross-Border Coordination Issues	6
IV. Recommendations.....	9
 Figure	
1. Snapshot of Cross-Border Liquidity Flows in January and August 2012.....	6
 Box	
1. The European Bank Coordination “Vienna” Initiative (EBCI)	11
References.....	13

GLOSSARY

BSD	Banking Supervision Department
CAR	Capital Adequacy Ratio
CBN	Central Bank of Nigeria
EBCI	European Bank for Reconstruction and Development “Vienna” Initiative
eFASS	Electronic Financial Analysis and Surveillance System
IFI	International Financial Institution
MoU	Memorandum of Understanding
SSA	Sub-Saharan Africa
UBA	United Bank of Africa
WAMZ	West African Monetary Zone

I. INTRODUCTION¹

1. **Following the significant consolidation of the Nigerian banking sector in 2005-10, Nigerian banks have been becoming more international.** The introduction of new much higher minimum capital requirements and the subsequent banking sector consolidation created a platform for Nigerian banks to expand within the region and more globally. After capitalization, several Nigerian banks found themselves with large amounts of capital while there was an environment of uncertainty about the situation in Nigeria in the aftermath of the 2009 Nigerian banking crisis. This together with new market expansion opportunities gave an impulse to a number of Nigerian banks to quickly expand within West and Central Africa, as well as more globally.
2. **The global crisis itself provided Nigerian banks with opportunities to expand within Sub-Saharan Africa (SSA).** Multinational European and American banks downsized their presence, creating opportunity for African banks to take that niche. Some Nigerian banks took this opportunity, expanded aggressively, and within a couple of years established their presence in more than 30 African countries.
3. **While beneficial for the Nigerian economy, rapid international expansion of the banking activities comes at a price for supervisors and regulators.** With Nigerian banks' presence in many countries in the region and more globally, the Central Bank of Nigeria (CBN) needed to overhaul its traditional supervisory practices and embark on rigorous supervision of its banks on a consolidated basis taking into account all their subsidiaries and branches abroad—a task with which even advanced supervisors still struggle.
4. **This note focuses on issues of cross-border coordination and provides policy recommendations that could be taken into consideration by the CBN.** Section II provides a brief description of the expansion and cross-border liquidity flows of some Nigerian banks. Section III focuses on issues related to supervisory cross-border coordination. Section IV offers some recommendations.

II. CROSS-BORDER EXPANSION OF NIGERIAN BANKS

5. **Several Nigerian banks have expanded abroad, primarily within West and Central Africa over the recent years.** Banks in Nigeria with international activities have to maintain a capital adequacy ratio (CAR) of at least 15 percent, compared with the CAR requirement of 10 percent for the other Nigerian banks. At least two of those banks with headquarters in Nigeria have subsidiaries across Africa and representative offices and/or

¹ The main authors of this Technical Note are Charles Enoch and Elena Loukoianova, with inputs from Dawn Chew (LEG) and Miquel Dijkman (World Bank). The data on cross-border liquidity flows were provided by the Supervision Department of the CBN.

subsidiaries in Europe. According to the current Nigerian regulatory requirements, international subsidiaries of Nigerian banks operate as independent entities, and Nigerian parent banks cannot provide capital to capitalize their subsidiaries abroad.

6. **One regional bank, discussed further below, (with mostly Nigerian ownership) has headquarters in Togo, while its main subsidiary with about 44 percent of the total assets domiciles in Nigeria.**² This banking group is present in 32 countries across West and Central Africa, and has a subsidiary in Europe and representative offices in London and the Middle East. This bank became one of the top five banks in Nigeria in terms of assets in 2011, after acquiring another Nigerian bank.³ The bank-group risk management is consolidated and risks are managed from the headquarters.

7. **Several Nigerian banks have quite active cross-border liquidity flows.** Notably, some of them are net cross-border liquidity providers. However, some borrow from Western countries (the United Kingdom and the United States) and then place liquidity in their subsidiaries in Africa. This could have several reasons. Banks may be involved in the carry trade, borrowing under low interest rates in Europe or the United States and then placing liquidity in countries with higher interest rates (for example, buying local treasury bills or other government papers). Also, some banks may require capital to meet local CAR or minimum capital requirements, and be able to book these flows could be booked temporarily as capital.

8. **Cross-border liquidity flows of Nigerian banks fluctuated from month to month in 2012, as Nigerian banks have been becoming more active in the region.** For example, according to the CBN data, cross-border liquidity flows were higher in August than in January 2012. More generally, the amount and range of destinations of cross-border liquidity flows have increased during 2012 (Figure 1). This reflects rising activity of Nigerian banks and their expansion in the region. However, the magnitude and volatility of cross-border liquidity flows may complicate the operation of monetary policy. Moreover, it highlights the need for supervisors to have a full understanding of the banks' activities outside the country, and hence need for close mutual cooperation with foreign supervisors.

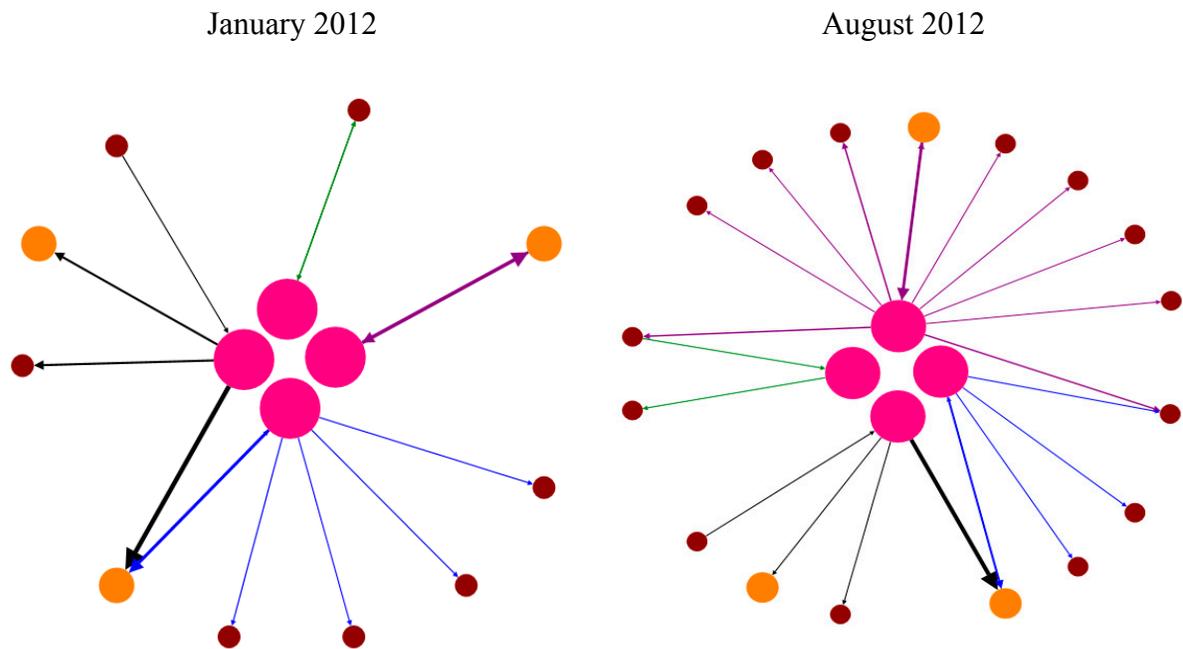
9. **However, the CBN does not seem to have the information on cross-border liquidity flows from the above mentioned subsidiary of the large regional banking group headquartered outside Nigeria, as it supervises it as a stand-alone bank in Nigeria.** Thus, the figure below contains only the information on other Nigerian banks with the presence abroad. Being a subsidiary of a foreign parent, this regional bank is supervised

² Ecobank Group Results Presentation for the 6 Months Ended 30 June 2012, 6 August 2012, www.ecobank.com.

³ This bank is within top four banks by deposits, and within top two banks by branch network in Nigeria.

as a stand-alone bank in Nigeria, and CBN supervisors may not have good understanding of the operations and the governance structure of the total banking group. This presents a challenge, as the domestic supervisors may not necessarily have a grasp of cross-border liquidity flows, risk management, and capital allocation within the banking group as a whole.

Figure 1. Nigeria: Snapshot of Cross-Border Liquidity Flows in January and August 2012



Notes: *Pink* vertices represent Nigerian banks with cross-border liquidity flows; *Orange* vertices – U.K. and U.S. institutions; and *Maroon* vertices – African countries of cross-border flow destinations. Edges of the same color correspond to flows to and from the same Nigerian banks. The thickness of the edges approximately corresponds to the amount of flows; and arrows represent flow destinations.

III. CROSS-BORDER COORDINATION ISSUES

10. **In tandem with the regional expansion of Nigerian banks, the CBN has gradually enhanced cross-border oversight.** It has created a unit dedicated to the supervision of cross-border institutions in the banking supervision department (BSD), and it has put in place a Framework for the Supervision of Cross-Border Institutions, providing guidance on the supervision of offshore subsidiaries and supervisory cooperation with host countries. Bilateral MoUs have been established with a significant number of jurisdictions with Nigerian banking presence.⁴ The MoUs contain details on information sharing, on-site

⁴ The CBN has entered into bilateral MoUs with all English-speaking West African countries, Bank of Ghana, COBAC, China Banking and Regulatory Commission, Bank of Uganda, FSA, South Africa Reserve Bank, National bank of Rwanda, Bank of Zambia, Central Bank of Kenya, BCEAO, Central Bank of the Gambia,

(continued)

examination confidentiality of shared information, and consolidated supervision.⁵ However, the MoUs do not cover aspects related to crisis management and resolution. In recent times, the establishment of MoUs with host regulatory authorities has become a pre-requisite for the initiation of Nigerian banking operations in foreign jurisdictions.

11. **While progress has been made in cross-border supervision, some elements still appear rudimentary.** There is a general “college of supervisors” in the West African community (WAMZ), which meets on a regular basis. However, this college is different from those established to monitor cross-border banking activities in other parts of the world in that participation is by country representation rather than as appropriate bank-by-bank. There are no specific colleges of supervisors for Nigerian banks with foreign subsidiaries, nor is there a supervisory college for the regional bank described above. At present, CBN supervisors have no capacity to verify information submitted by the above mentioned subsidiary regarding intra-group liquidity and capital flows across the borders. Although this may not be a problem in quiet times, recent experience for instance in Eastern Europe has demonstrated that problems in subsidiaries that are not thought to be systemic from the parents’ point of view may nevertheless be systemic in the countries where they are located, especially where these are smaller open economies. In several such countries in West and Central Africa, the banking system is dominated by Nigerian banks. Nigeria may therefore be seriously affected by adverse developments in those countries, both directly through the Nigerian banks located there, as well as by possible broader mistrust of Nigeria in those countries if it is not seen to be acting in a constructive “good neighborly” way.

12. **The CBN is a member of the College of Supervisors of the West African Monetary Zone (WAMZ), held quarterly.** The college of the WAMZ is generic, aimed at enhancing coordination, cooperation, and information exchange among supervisors in the WAMZ area, rather than a college aimed at strengthening the supervision of a specific bank—whose geographical mapping does not match the composition of the college. The CBN and relevant host country central bank have commenced joint examinations of Nigerian banks in West African countries (The Gambia, Ghana, Guinea, and Sierra Leone). The CBN also participates in the core college established by FSA for Standard Chartered Bank.

13. **According to the CBN, initial experiences have been encouraging, but it faces some serious challenges in further strengthening of cross-border supervision.** Among the obstacles are language barriers, differences in quality of supervision, reporting

Bank of Sierra Leone, WAMZ (the Gambia, Ghana, Guinea, and Sierra Leone), Bank Negara Malaysia, Central Bank of Liberia, and Central Bank of Guinea.

⁵ Section 33960 of the CBN Act empowers the CBN to enter into agreements or arrangements with other regulatory authorities in Nigeria or in other countries for the promotion of mutual cooperation and exchange of information for enhancing supervision and regulation, conditional upon assurances of confidentiality.

requirements, and off-site monitoring systems. Some of the Nigerian banks have expanded into jurisdictions where supervisory and enforcement capacity is weak, data reliability problematic, and prudential returns are not subject to rigorous supervisory scrutiny. The CBN is aware that it has vested interest in strengthening capacity in these jurisdictions, and it has opened its supervisory training program for foreign inspectors. The CBN is also actively promoting the harmonization of reporting requirements and off-site monitoring tools through the adoption of Electronic Financial Analysis and Surveillance System (eFASS).

14. **Ecobank, a pan-African financial conglomerate, presents particular cross-border supervisory challenges.** Although it is headquartered in Lomé, the regional supervisory authority in Abidjan is responsible for exercising consolidated supervision. In light of supervisory weaknesses observed in some countries where the bank is located, this is a challenging task. Further, the Togolese operations account only for a small share of the group's asset and deposit base, while the Nigerian subsidiary accounts for the largest single share of the bank's activities. While the CBN supervises the Nigerian operations on a stand-alone basis, it does not preclude an impact from losses elsewhere in the group, nor would there necessarily be good oversight of any hidden build-up of intra-group exposures, adjusting intra-group pricing of centralized activities to favor particular locations, nor of double gearing of capital. Moreover, it seems that the CBN supervisors may not even have good communications (even memoranda of understanding (MOUs)) with supervisors of other subsidiaries of the same banking group located in other African countries, nor until recently with the supervisory agency responsible for supervision in the country where the bank is headquartered.⁶

15. **A recent CBN circular⁷ issued in May 2012, restricting Nigerian banks' capacity to capitalize their foreign subsidiaries, would seem to be an unnecessary restriction on an activity that would generally be managed through the supervisory process.** The circular prohibits parent Nigerian banks from providing further capital outlays to foreign subsidiaries to augment their capital needs. Instead, banks are encouraged to consider options such as mergers and acquisitions and sourcing fresh capital from the host country capital markets. Where such capital cannot be replaced, parent banks were required to submit capital strategies by June 30, 2012. Although the CBN has stated that it would allow for exemptions for well-capitalized parent banks, the Circular does not seem to provide for any exemptions. The circular must be predicated on the assumption that banks do not understand their own

⁶ Amongst the shareholders of this bank are the International Finance Corporation, and a large South African financial institution which has recently increased its stake in the bank. Both of these conduct their own due diligence of the bank, which provides considerable reassurance. Nevertheless, the CBN cannot rely on outsourcing its supervisory responsibilities, and needs to have a complete picture of the bank that it generates itself.

⁷ BSD/DIR/GEN/RFS/05/024, May 18, 2012.

commercial self-interest and would transfer capital where there is no business case to do so. Transfer of capital overseas would however already be expected to be a topic of discussion between a bank and its supervisor. Existing prudential requirements already grant the CBN discretion to refuse outflows of capital. On the other hand, enforcing this directive risks undermining the goodwill and trust of host authorities necessary to strengthen home-host cooperation and coordination, and in that regard may cause a bigger problem for Nigerian banks. In any case, this circular would not prevent the Nigerian operations of subsidiaries of foreign banks, including regional banks, from moving capital upstream to headquarters or to other subsidiaries on this foreign parent.

IV. RECOMMENDATIONS

16. **It is important that the CBN further enhances its work in improving cross-border supervision, including home-host coordination and cooperation.** The CBN is encouraged to learn from recent external developments, both positive and negative, for instance regarding supervisory colleges for individual banks, and regional initiatives to mitigate the impact of bank withdrawals from countries where the impact may be thought not systemic from the point of view of the bank but deeply systemic from the point of view of the country concerned. In this later regard, the Vienna Initiative established for countries in Central and Eastern Europe could provide a useful example (Box 1).

17. **In particular, the following is recommended to underpin the position of Nigerian banks in the countries of the region and to mitigate the risks of the expansion through the region:**

- The CBN should withdraw the CBN Circular BSD/DIR/GEN/RFS/05/024 (dated May 18, 2012). Instead, it should consider capitalization needs on a case-by-case basis and rely on prudential requirements to control the outflow of capital or require specific bank measures to avoid any deleterious impact. The CBN should expand the scope of cross-border MoUs to include crisis management. Ideally, home and host authorities would pre-agree on key aspects, such as exchange of information, decision-making powers, and procedures. These arrangements should also cover possible future divestment of foreign undertakings. It is important that the interests of smaller host countries, where Nigerian banks have a dominant presence, but whose share of group assets and deposits is fairly low, are taken into consideration. In its capacity as home supervisor, the CBN should take the lead in initiating a dialogue with host authorities on establishing colleges of supervisors for those Nigerian banks that have a significant cross-border presence. Within such colleges, crisis management groups can be set up to ensure that relevant information is shared and recovery and resolution plans prepared on a group wide basis. The current “college” from WAMZ might be adapted to form bank specific colleges and perhaps have a coordinating role across such colleges.

- Despite supervising a subsidiary only, the CBN should initiate discussions with the regional banking supervisor responsible for supervising Togolese banks to establish a supervisory college for Ecobank, as the Nigerian operations of this group are the largest in terms of group assets and deposits, and the Nigerian subsidiary is one of the five largest banks in Nigeria.
- The CBN should participate actively on the colleges of those overseas banks that have Nigerian subsidiaries. In such cases where it has not been invited to participate in the college, it should seek an invitation—not just to assess the broader standing of the particular subsidiary but also to get a better understanding of how colleges of supervisors can work.
- The CBN should initiate mechanisms for the mutual recognition of decisions made in other jurisdictions in the context of insolvency or reorganization proceedings, subject to conditions such as non-discriminatory treatment of foreign creditors and reciprocity.
- The CBN should consider establishing ex-ante burden sharing arrangements⁸ that would enable home and host authorities to act quickly during a crisis and avoid protracted negotiations, but not to an extent that it implicitly cedes sovereign rights and compromises domestic depositors and creditors.⁹
- The CBN should improve data collection and granularity on cross-border transactions and funding flows of Nigerian international banks as well as subsidiaries of foreign banks by institution and by each transaction, making sure that the supervisors would be able to verify details of each cross-border transaction, as well as repayment of liquidity placements abroad.

18. **The CBN would gain from learning from successful international practices in safeguarding cross-border capital and liquidity flows.** This would enhance private-public initiatives towards better cross-border regulation and supervision and increase transparency of regional pan-African banks.

19. **In this regard, the CBN may consider taking initiative in establishing a regional coordination group similar to the Vienna Initiative (Box 1).** The Vienna Initiative has been successful because of close cooperation among international financial institutions (IFIs) and large regionally important international banks (for example, Reiffeizen). Similarly, the regional African initiative of this kind may bring together the World Bank, the IMF, the IFC,

⁸ The Nordic-Baltic Stability Group has entered into an MoU on burden sharing, for example.

⁹ FSB Key Attributes and IMF (2010).

the African Development Bank (AfDB), as well as representatives (CEOs) of large pan-African banks, such as Ecobank and the United Bank of Africa (UBA), and other important regional banks. European and U.S. banks that have significant presence in African countries may also become a part of such an initiative. Moreover, we would suggest that central banks of countries involved would also have their representatives in such a group.

20. **A regional initiative of this kind would work in Nigerian circumstances to facilitate cross-border banking supervision and regulation, crisis prevention and management, as well as monitoring of systemic risk.** A regional coordination group would be effective, as it would bring together private and public institutions in order to maintain and enhance financial stability in the region. There is room to create common regulatory requirements that are related to cross-border capital and liquidity flows and regional banks.

Box 1. The European Bank Coordination “Vienna” Initiative (EBCI)¹⁰

In November 2008, a number of banks with large presence in emerging Europe sent a letter to the European Commission to call for a quick and coordinated response to the problems in emerging Europe and, more specifically, to ensure sufficient funding for banks operating in the region. In response, the Vienna Initiative was created as a coordination platform for multinational banks, their home- and host-country supervisors, fiscal authorities, the IMF, and development institutions to safeguard a continued commitment of parent banks to their subsidiaries and to guarantee macroeconomic stability in emerging Europe.

The EBCI was launched at the height of the financial crisis to provide a framework for coordinating the crisis management and crisis resolution of financial sector issues that were highlighted by the economic downturn and involved large cross-border bank groups systemically important in the emerging Europe region.

Created in January 2009, it brought together public and private sector stakeholders of EU-based cross-border bank groups present in emerging Europe, including international financial institutions (IMF, the EBRD, European Investment Bank (EIB), and the World Bank (WB)); European institutions (European Commission and the European Central Bank as observer); home and host country regulatory and fiscal authorities of large bank groups; and the largest bank groups operating in the region.

The Vienna Initiative’s aims are to:

- Prevent a large-scale and uncoordinated withdrawal of cross-border bank groups from the region—this could have triggered systemic bank crisis not only in individual countries but in the region as a whole.
- Ensure that parent bank groups publicly commit to maintain their exposures and recapitalize their subsidiaries, as part of the overall balance-of-payments support to countries where IMC/EC macroeconomic support programs have become necessary (Bosnia and Herzegovina, Hungary, Latvia, Romania, and Serbia).
- Ensure that national support packages of cross-border bank groups benefit their subsidiaries in emerging Europe and avoid a home bias in dealing with Europe’s banks.

¹⁰ This box is based on the EBRD (2012).

Box 1. The European Bank Coordination “Vienna” Initiative (EBCI) (concluded)

- Agree on basic crisis management and crisis resolution principles in the region. Host countries authorities are responsible for appropriate macroeconomic policies; liquidity support in local currency irrespective of bank ownership; and supporting their deposit insurance schemes. Parent bank groups—and the home country authorities behind them—are responsible for providing funding in foreign exchange and recapitalizing subsidiaries.
- Strengthen cross-border regulatory cooperation and information sharing in the context of IMC/EC-supported programs and beyond.

The EBCI has successfully completed its crisis-management phase:

- *It has helped resolve the “prisoner’s dilemma.”* For crisis cases, external sustainability could only be assured if foreign banks remained engaged in the countries in which their subsidiaries work.
- *Commitments were upheld.* Parent banks maintained the agreed exposure limits. This was critical particularly as the crisis proved to be worse and the recovery took longer than expected. Subsidiaries were also recapitalized according to stress-testing results.
- *Over time consultations allowed for “controlled” deleveraging.* During regular reviews exposure commitments were reduced on a country-by-country basis. This permitted banks to increase room to manage liquidity internationally while still supporting external sustainability.
- *The Vienna Initiative informed as well as supported policy decisions in both home and host countries.* For example, banking sector support packages of home country authorities were allowed for use in the subsidiaries of bank groups; monetary policy tools in host countries such as reserve requirements could be loosened to address weak demand with the assurances that additional liquidity will not be used for capital flight, creating pressure on the exchange rate.
- *The Vienna Initiative was also used to examine issues that benefit from joint private-public sector assessments.* The first two subjects were the development of local currency and capital markets and the role banks can play in helping with the absorption of EU structural funds.

Applicability to other regions:

The unique public-private sector coordination framework of the Vienna Initiative can be applied to other regions where collective action problems are significant and where coordinated action by the private and public sectors can bring additional benefits, in particular:

- An initiative of this kind captures a specific geographical area, with countries with common risks, common private sector actors, and different regulatory and supervisory frameworks.
- Financial policy challenges can return to a specific region, and with such initiative in place, it would be easier to coordinate and mitigate risks and emerging problems.

An Initiative of this kind can also enhance the effectiveness of international financial institution involvement in the region.

REFERENCES

- European Bank for Reconstruction and Development, 2012, "[Vienna Initiative – Moving to a New Phase](#)," London: EBRD.
- De Haas, R., Y. Korniyenko, E. Loukoianova, and A. Pivovarsky, 2012, "Foreign Banks and Vienna Initiative: Turning Sinners into Saints?" IMF Working Paper, WP/12/117.
- International Monetary Fund, 2010, "Resolution of Cross-Border Banks – A Proposed Framework for Enhanced Coordination," pp.23-25, on www.imf.org.