UDO UDOMA & BELO-OSAGIE

AN APPRAISAL OF THE KEY PROVISIONS OF THE CENTRAL BANK OF NIGERIA'S CORPORATE GOVERNANCE GUIDELINES FOR E-BANKING INSTITUTIONS IN NIGERIA

INTRODUCTION

In 2019, the Financial Reporting Council of Nigeria ("FRCN") transformed the corporate governance landscape in Nigeria with the introduction of the Nigerian Code of Corporate Governance 2018 ("NCCG"). The NCCG supplanted all preceding sectoral codes, including the Central Bank of Nigeria's ("CBN") Code of Corporate Governance for Banks and Discount Houses, issued in 2014. The FRCN permits sector regulators to issue sector-specific guidelines on corporate governance for institutions under their regulatory purview. In view of this, the CBN adapted the principles and recommended practices of NCCG and issued the Corporate Governance Guidelines for Commercial, Merchant, Non-Interest, and Payment Service Banks in Nigeria on 13th July, 2023 ("Guidelines"). The Guidelines are designed to complement the NCCG and cater to the distinctive characteristics of each banking sub-sector in Nigeria.

The Guidelines represent a significant step forward in strengthening governance frameworks and incorporating the provisions of some extant CBN guidelines. Unlike the 'apply and explain' approach of the NCCG, the Guidelines are more specific in terms of the requirements. The Guidelines, which are issued by the CBN pursuant to Section 2(d) of the CBN Act 2007 and Sections 56(2) and 67(1) of the Banks and Other Financial Institutions Act 2020, came into effect on 1st August, 2023 ("Effective Date"). All commercial banks, merchant banks, non-interest banks and payment service banks (together "Banks") are required to comply with the requirements of the Guidelines and the recommended practices in the NCCG.

The Guidelines set out three primary objectives thus: (a) providing supplementary guidance on the principles, recommended practices and responsibilities contained in the NCCG; (b) establishing industry-specific corporate governance standards for Banks; and (c) promoting a culture of high ethical standards among banking operators while bolstering public confidence in Banks. We will explore in this article the key principles and requirements set out in the Guidelines, key changes different from the NCCG, and the impact the corporate governance principles will have on the banking industry's integrity, stability, and investor confidence.

THE CORPORATE GOVERNANCE PRINCIPLES IN THE GUIDELINES

1. Board structure and composition

Principle 2 of the NCCG requires companies to maintain an appropriate balance of skills and diversity (including experience and gender) on their boards while upholding competence, independence , and integrity. To ensure the implementation of this principle, the Guidelines make specific provisions tailored to the unique landscape of the banking sector.

To comply with this principle, the Guidelines prescribe some key requirements for the structure and composition of the boards of the Banks.

Number of directors: The Guidelines require the Board Charter to outline the process for appointing directors and specify the minimum and maximum number of directors for each board, and prescribe the minimum and maximum number of directors for the Board. Commercial, Merchant and Non-Interest Banks ("CMNIBs") are to have a minimum of seven and a maximum of fifteen directors, and Payment Service Banks ("PSBs") are to have a minimum of seven and a maximum of thirteen directors. This is a deviation from the NCCG, which states a minimum of five and a maximum of twenty directors for companies. With respect to any of the Banks that is a subsidiary of a Financial Holding Company ("FHC"), the subsidiary's representation on the FHC's board and the FHC's representation on the subsidiary's board cannot exceed thirty percent. In addition, no director of a bank can serve on the board of more than two institutions within a FHC or group structure.

Composition of boards: Similar to the NCCG, the Board is to comprise both Executive Directors and Non-Executive Directors ("NEDs"), with NEDs being the majority. The Guidelines further require that the Board must have a minimum of (a) three independent NEDs ("INEDs") for commercial banks with international and national authorisation, merchant banks, and non-interest banks ("NIBs") with national authorisation; and (b) two INEDs for PSBs, commercial banks with regional authorisation, and NIBs with regional authorisation. At least two NEDs, one of which must be an INED, should have expertise and experience in innovative financial technology, information communication technology ("ICT"), or cyber security. The requirement for two or three INEDs does not apply to Banks that are public companies, as the Companies and Allied Matters Act 2020 (as amended by the Business Facilitation Act 2023) requires public companies to have INEDs that constitute at least one-third of the total number of directors.

Diversity: In line with the NCCG principles on diversity, no Board shall consist of only one gender. Banks are required to adopt practical measures towards empowering women economically in accordance with principle 4 of the Nigerian Sustainable Banking Principles.

Family Members: A Board can only have a maximum of two members belonging to the same extended family. This is a deviation from the NCCG, which states that an INED shall not be a close family member of the company's directors. In addition, only one member from an extended family can hold the positions of Managing Director/Chief Executive Officer (MD/CEO), Chairman, or Executive Director at any given time. The term 'extended family' encompasses the director's spouse, parents, children, siblings, cousins, uncles, aunts, nephews, nieces, in-laws, and any other relationship deemed appropriate by the CBN.

Eligibility: To be eligible to be appointed to the Board, the track record of members must meet the standards for integrity and past performance outlined in the extant guidelines on competency and fit and proper persons for the Nigerian banking industry. Similar to the NCCG, prospective and current directors must disclose any existing or potential board memberships with other institutions. The Guidelines require the approval of the CBN for directors and prohibit the role of Executive Chairman or Vice Chairman in a bank's Board structure.

Resignation: A director intending to resign must submit a written notice of resignation to the Chairman of the Board at least ninety days before the effective resignation date. If an INED resigns and the resignation results in non-compliance with the minimum required number of INEDs, the Board must appoint a replacement within the ninety-day notice period. If a director resigns due to unresolved concerns pertaining to the running of the bank, the director must submit a written statement to the Chairman of the Board and forward a copy of the statement to the CBN within seven days of the notice of resignation. If a NED resigns and it results in NEDs not being in the majority, the Board must appoint a replacement within ninety days. Lastly, if the Chairman resigns, he must submit a written notice to the Board Nomination and Governance Committee, who shall circulate the notice to Board members and the CBN within seven days of the receipt of the notice.

Others: If a merger, acquisition, take-over, or any other type of business combination occurs and a director from the legacy institution is appointed, their length of service will be calculated to include both pre and post-combination periods. The Guidelines require, in the case of NIBs, that members of the Advisory Committee of Experts ("ACE") and Financial Regulation Advisory Council of Experts ("FRACE") are not permitted to be on the Board, senior management, or staff of any NIFI under the regulatory purview of the CBN.

2. Roles and responsibilities of the Board

In addition to the roles of the Board under the NCCG and CAMA, the Guidelines provide for additional roles and responsibilities of the Board. First, the governing charters, as approved by the CBN, shall be reviewed by the Board at least once every three years. Upon carrying out any such review, the Board-approved copies shall be submitted to the CBN for its "No Objection" within thirty days of approval by the Board and prior to its implementation. Secondly, the Board shall ensure a review of the investment policies and strategies of the bank at least once every three years, and submit a copy to the Director of the Banking Supervision Department of the CBN.

Thirdly, the Board shall supervise the bank's policies and procedures related to Anti-Money Laundering/Combating the Financing of Terrorism and Countering Proliferation Financing and approve an Enterprise Risk Management (ERM) Framework and Information Technology Framework for the bank including a Business Continuity plan.

The Guidelines now requires the Board to designate an Executive Director as the Executive Compliance Officer and inform the CBN of this appointment. The Board must approve all insider credit applications, regardless of the amount, based on the recommendation of the Board Credit Committee.

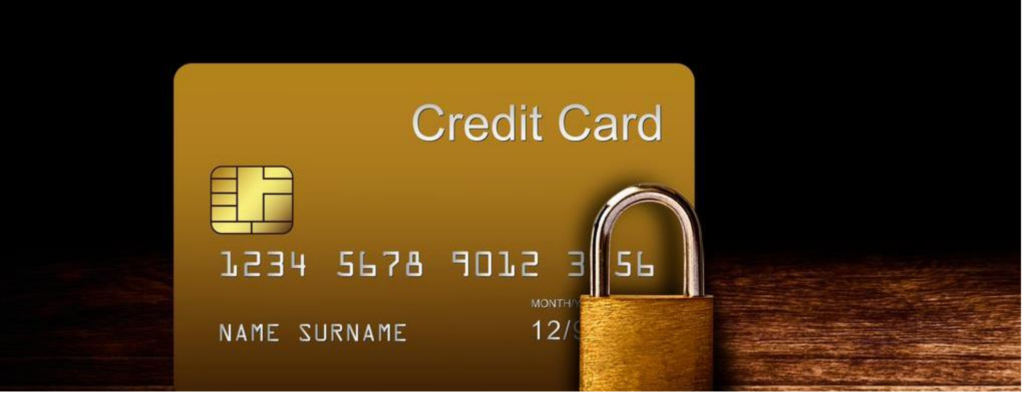
3. Key Officers of the Board

Chairman: The Guidelines require the Chairman to hold a formal meeting with the NEDs once a year. If the Bank is a member of a FHC, the Chairman of the Bank cannot serve on the FHC's Board and the Chairman of the FHC's Board cannot also serve on the Bank's Board.

Tenure: The Guidelines specify that the tenure of the MD/CEO and Deputy Managing Director ("DMD")/Executive Directors of a Bank is as stated in the terms of engagement with the bank but subject to a maximum period of twelve years. If an ED becomes a DMD, the cumulative tenure of twelve years will still apply and cannot be extended. If a DMD/ED becomes the MD/CEO of the same bank, the previous tenure as DMD/ED will not be counted towards the tenure as MD/CEO. All EDs, DMDs and MDs/CEOs are subject to a cumulative tenure limit of twenty-four years from the date of first appointment to the bank's board.

NEDs: NEDs can access all corporate info from top-level executives and control function heads reporting to the Board. Their access to other senior management will be through the MD/CEO. NEDs (except INEDs) can serve up to twelve years in a bank, divided into three terms of four years each. A NED must not be employed by a financial institution except where the NED is representing the interest of a financial institution that promotes the bank. For commercial banks with a NIB window, at least one NED must be knowledgeable or have experience in the field of Islamic finance or Islamic commercial jurisprudence.

INEDs: The Guidelines stipulate that INEDs are limited to serving for two terms of four years each. EDs, NEDs, and members of ACE are prohibited from being appointed as an INED within the same bank or group structure. In addition, an INED cannot transition to any other role within the same bank or group structure. It is mandatory for INEDs to conduct a formal meeting at least once a year without other directors present. Furthermore, the Guidelines introduce more stringent requirements for INEDs.



For instance, an INED is not allowed to have: (a) previously served as a director or an employee in a senior management role in the bank or below the senior management level in the bank in the last five years; (b) an immediate family member who is currently employed in a senior management position in the bank or served at the senior management level in the bank in the preceding five years; (c) provided financial, legal, or consulting services to the bank or its subsidiaries/affiliates within the last five years; (d) borrowed funds from the bank, its officers, subsidiaries, and affiliates; (e) been part of the governing body of any institution, charitable or otherwise, supported by the bank; (f) previously served on the Board of its FHC, subsidiary, or related entity within the banking group.

Company secretary: Banks are prohibited from outsourcing the role of the company secretary. In the case of CMNIBs, the role of the company secretary cannot be merged with that of the head legal/legal adviser without the consent of the CBN.

4. Meetings of the Board and its Committees

The Guidelines require that, in order to oversee management's performance, the Board and its Committees must meet at least once every quarter. The membership of the Board Committee shall be reviewed and refreshed at least once every three years. The schedules for meetings must be approved by the Board each financial year. The Chairman shall not be in attendance at any of the meetings of the Committees Meetings can be physical or virtual. The Guidelines prohibit the establishment of sub-committees of Committees.

5. Board evaluation

While the requirement for Board evaluation exists under the NCCG, the Guidelines introduce additional requirements. NIBs are required to have an annual appraisal of the ACE covering all aspects of its responsibilities, processes, meetings and overall functions. The appraisal shall be conducted by an independent external consultant. The Board evaluation shall, at a minimum, cover the scope described in the extant CBN Guidelines for Annual Board Evaluation by External Consultants of Banks and Other Financial Institutions in Nigeria. Banks are required to forward the report of the annual evaluation of the Board and ACE to the Director of the Financial Policy and Regulation Department of the CBN latest by 31st May following the end of every financial year or before the Annual General Meeting.

6. Cool-off period

Any Executive Director who leaves a Bank's Board must wait for two years before being considered for a NED role in the same bank. A NED that leaves office must also wait for two years before being considered for an executive role in the same bank. A cooling-off period of two years applies when an Executive Director is appointed to the Board of the Bank's FHC. Any member of FRACE that leaves office must wait for three years before becoming eligible for appointment as a director or member of an ACE in any NIFI supervised by the CBN.

A bank's auditors can serve up to ten consecutive years, subject to the rotation of audit engagement partners once every five years. A cooling-off period of ten years is required before an audit firm is eligible to be reappointed by the same bank. Lastly, the Governor and Deputy Governors of the CBN, the MD/CEO and Executive Directors of the Nigeria Deposit Insurance Corporation ("NDIC") and the departmental directors of the CBN and the NDIC must observe a cooling-off period prescribed by their respective governing board before being eligible for any appointment in a bank.

7. Compliance

In line with the CBN's desire to ensure strict compliance with laws and regulations, the Guidelines require Banks to have an Executive Compliance Officer ("ECO") and Chief Compliance Officer ("CCO"). The duties of the ECO include communicating regulatory requirements to the appropriate parties and reporting any violations to the Board. The ECO cannot combine these duties with any income-generating activity. Furthermore, all Banks are required to have a CCO who holds a position not less than that of a General Manager (for commercial and non-interest banks with national and international authorisation) or an Assistant General Manager (for merchant banks and commercial and non-interest banks with regional authorisation). The CCO is responsible for monitoring and coordinating the implementation of regulatory requirements and reports to the Board through the ECO.

NIBs are required to establish a Shariah Review/Compliance ("SRC") function that regularly assesses the compliance of their operations and activities with Shariah requirements. The Internal Shariah Compliance Officer ("ISCO") is responsible for identifying, measuring, monitoring, and reporting on Shariah Non-Compliance Risks ("SNCR") in the NIB's operations on a daily basis. The ISCO must review all financing requests before disbursement to avoid SNCR and report directly to the CCO and indirectly to the ACE. The ISCO must hold at least the rank of Manager or a lower rank in the case of a commercial bank with a NIB window. The Board, in consultation with the ACE, is responsible for appointing and removing the ISCO subject to CBN's ratification.

7. Treatment of shareholders

The Guidelines regulate the ownership and acquisition of shares in Banks. No individual, group, proxy, or corporate entity can own a controlling interest in more than one bank without the prior approval of the CBN. Before acquiring shares in a bank that will result in a five percent or higher equity holding, investors must obtain CBN's prior approval and No Objection. If the CBN objects to the acquisition, the bank must notify the investor(s) within forty-eight hours of receiving the objection. Any government's equity holding in a Bank, whether direct or indirect, must not exceed ten per cent and should be divested to private investors within a maximum of five years from the date of investment. Existing investments beyond five years must comply with this requirement within two years from the Effective Date.

8. Risk management function

The Bank's ERM Framework is required to clearly outline the responsibilities and roles of the Board and other relevant officials/committees of the bank. The Board is responsible for ensuring that an ED oversees the risk management function. For NIBs with regional authorisation and PSBs, a senior management officer may head the risk management function. The Board must conduct a review of the ERM Framework every three years and undertake annual reviews of the effectiveness of risk management policies and procedures.

9. Audit

Although the NCCG contains recommended practices for internal and external audits, the Guidelines make provision for additional requirements and state that Banks are to be guided by the following internal and external audit principles:

(a) A bank must have an in-house internal audit and compliance function headed by a qualified person approved by the Board and CBN and must undertake an independent external assessment of the effectiveness of the internal audit function annually. A report on this must be submitted to the Banking Supervision Department by 31st, May of the next accounting year.

(b) NIBs must establish an internal Shariah audit function led by an Internal Shariah Auditor ("ISA") at or above the rank of Assistant General Manager. commercial banks with a NIB window must appoint a head of the internal shariah audit function with a rank not lower than a manager.

(c) The Board has the power to appoint (subject to confirmation at an AGM) and remove the external auditor subject to CBN's approval. The external auditor must report on the bank's compliance with NCCG and the Guidelines in the annual financial statements. In addition, the external auditor must report on risk management, internal controls, and regulatory compliance to the Director of the BSD of the CBN. For NIBs, the report must cover NPI disposal, PSIAH treatment, and income smoothing. The external auditor of an NIB must also review compliance with ACE and FRACE decisions and ISA and ISCO work. The report and management letter on audited financial statements must be sent to the Director of Banking Supervision Department by March 31st.

10. Other requirements

Evaluation: The Board, Committees, etc, must have an annual evaluation covering their structure, responsibilities, processes, and relationships. NIBs must appraise the ACE annually. The evaluations will be conducted by an independent external consultant with experience in corporate governance and performance management and the report submitted to the CBN by 31st May each year. Poor performance of directors may lead to non-renewal of tenure, if any.

Whistle-blowing and Sustainability: Banks are required to adhere to both Recommended Practice 19 of the NCCG and the existing CBN Guidelines for Whistleblowing in Nigeria's financial institutions. Banks are to comply with the provisions of Recommended Practice 26 of NCCG and the requirements of the Nigerian Sustainable Banking Principles.

Business integrity and insider trading: To ensure trust in their integrity, Banks are required to create a Code of Business Conduct and Ethics which shall include legal obligations, stakeholder expectations, and individual accountability. The code should be reviewed at least every three years. Banks are required to establish a policy concerning insider trading and related party transactions by directors, senior executives, and employees. A summary of the policy is required to publish on their website.

Conflicts of interest and non-performing loans: Banks shall develop and adopt a policy to guide the Board and individual directors in conflict-of-interest situations. Directors with non-performing facilities for over a year will be removed from a bank's board and blacklisted from other financial institutions overseen by the CBN. The CBN's prior approval is required for any write-off of director-related loans or interest.

The Guidelines provide for principles for related parties' transactions in the case of PSB and non-compliance with these fair competition clauses by any PSB may result in the revocation of its licence. All services between the parent company and its PSB must adhere to a Service Level Agreement ("SLA") or shared services arrangements pursuant to the CBN Guidelines for Shared Services Arrangements for Banks and Other Financial Institutions. Prior to implementation of a SLA, a PSB must submit the SLAs to the CBN for approval.

Effect of non-compliance: Where a bank fails to comply with the requirements of the Guidelines and NCCG, or if false, misleading or incomplete information is provided, that will be a regulatory breach. The bank and responsible individuals may face sanctions. These sanctions could include penalties, suspension or removal from the Board for repeated offences.

NEXT STEPS

As you would have seen above, the Guidelines has far-reaching provisions which would require non-compliant banks to take immediate steps to comply with. Banks are, therefore, advised to initiate a thorough review of their current corporate governance practices and structures to assess their alignment with the Guidelines. Based on the review findings, non-compliant Banks should develop a detailed roadmap outlining the steps and timelines required to achieve full compliance with the Guidelines and continuously monitor their progress in implementing the Guidelines, making necessary adjustments as they move forward.

CONCLUSION

By providing governance requirements tailored to different banking models, the Guidelines are expected to promote a more robust and adaptable framework for the industry. It will be instrumental in ensuring the stability, sustainability, effective gorvervance, and trustworthiness of these institutions. As the Nigerian banking sector continues to evolve, Banks need to be more open, responsible, and careful in their decision-making. These Guidelines will, hopefully, result in that.

This update has been provided by Yinka Edu, Joseph Eimunjeze, Abolanle Ayoola, Tomisin Taiwo and Iheoma Sylvia Njoku of the Banking and Finance team at Udo Udoma & Belo-Osagie. For more information about our Tax practice group offerings, please visit our website at www.uubo.org or email us at uubo@uubo.org.