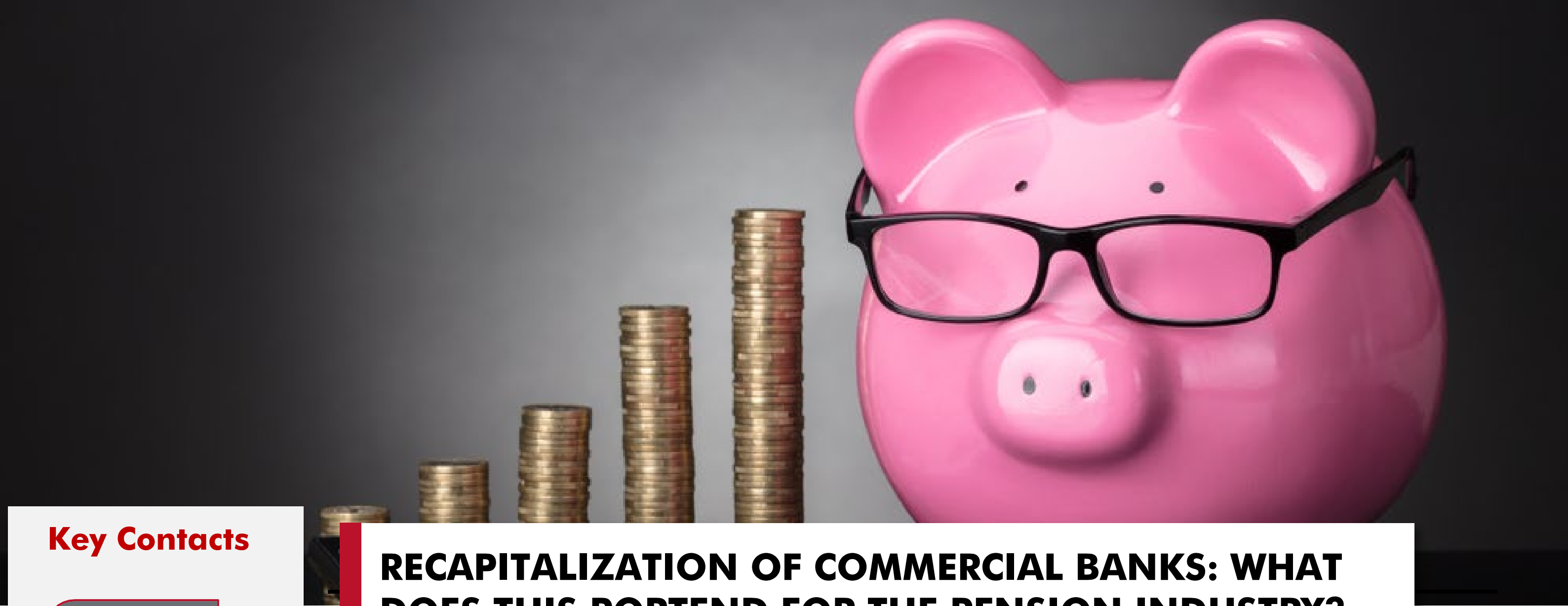

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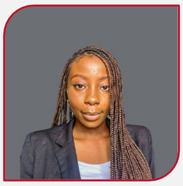

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RECAPITALIZATION OF COMMERCIAL BANKS: WHAT DOES THIS PORTEND FOR THE PENSION INDUSTRY?

Introduction

Nigeria's economic headwinds over the years have culminated in hyperinflation, macroeconomic variability, and instability in the exchange rate. As part of the approaches to tackle the economic instability bedevilling the country and bolster the country's economy to be more resilient, solvent and in tune with the aspirations of the Federal Government of Nigeria[1], the Central Bank of Nigeria ("**CBN**") issued a circular[2] mandating commercial, merchant, and non-interest banks to shore up their capital base.[3] This recapitalization exercise is backed by Section 9 of the Banks and Other Financial Institutions Act, 2020 ("**BOFIA**") which empowers the apex bank to, from time to time determine the minimum paid-up share capital requirement of each category of licensed banks operating in Nigeria.

Two decades ago, the CBN announced a significant recapitalization of the banking sector, which led to a dramatic consolidation in the industry that saw mergers and acquisitions as the most prevalent corporate restructuring option, hence, reducing the number of banks in Nigeria from 89 to 25 in 2006.[4] This latest recapitalization move intends to achieve the same objectives which the previous recapitalisations initiatives

[1] The Federal Government of Nigeria has plans to create a $1.0tn economy by 2030.
[2] The Central Bank of Nigeria released a circular to All Commercial, Merchant, Non-interest Banks; and Promoters of Proposed Banks on 28th March 2024
[3] Banks in Nigeria may require up to N4.7 trillion to meet the recapitalization benchmark before the 24 months period set by the CBN. Effectively March 31, 2026
[4] https://www.cbn.gov.ng/OUT/2012/PUBLICATIONS/REPORTS/STD/GLOBAL%20FINANCIAL%20MELTDOWN%20AND%20THE%20REFORMS%20IN%20THE%20NIGERIAN%20BANKING%20SECTOR.PDF

intended, that is, strengthening the banking sector and making it more resilient to economic shocks among other challenges.

This commentary aims to explore the potential impacts that this recapitalization policy of the CBN will have on the pension industry.

1. **Pension Fund Investments:** Commercial banks are significant holders of pension fund assets with a considerable portion of pension funds invested in bank deposits, bonds, and other financial instruments.[5] The recapitalization may lead to changes in the risk profile of these investments potentially affecting the returns and performance of pension funds. Furthermore, the current capitalization of some

banks is not sufficient to meet the new capitalization threshold set by the CBN. Expectedly this would compel the banks to explore corporate restructuring options such as mergers and acquisitions, public offerings, private placement and other means to raise funds from the capital market. Depending on the viability of the securities of each bank, pension assets are invested in approved securities which have the potential of improving the fortunes of beneficiaries of the funds upon an

[5] Olatunji, L. A., & Akinlo, A. E. (2018). Pension fund assets and economic growth in Nigeria. Cogent Economics & Finance, 6(1), 1-14

appreciation in the value of the investments, and vice versa, where the securities perform badly. As such, it is conceivable that there might be an increase in the demand for the investment of pension assets into securities floated by the banks given that PFAs are traditionally, attractive institutional investors in the capital market.

2. Potential Decline of the Competitive Landscape of the Pension Industry: The increased capital requirements may lead to corporate restructuring within the banking sector, with smaller banks potentially merging or being acquired by larger institutions[6]. This could result in changes in the distribution of pension fund assets among the merged entities. This will potentially affect the market share and influence on individual PFAs, particularly where the merger involves financial institutions that own or are affiliated to Pension Fund Custodians ("**PFCs**").
3. Consolidation of Pension Fund Custodians: Where banks involved in mergers or acquisitions own or are affiliated to PFCs, there could be a ripple effect leading to consolidation and/or mergers within the PFC sector as well. Mergers among PFCs may be driven by the need to streamline operations and enhance efficiency in custody and safekeeping of pension assets. Consolidation among PFCs would result in fewer but larger and more robust PFCs and potentially lead to improved service standards, increased efficiency, and better risk management practices. Notwithstanding, a consolidation induced by recapitalization would require careful monitoring and regulation by the National Pension Commission (the "**Commission**") to ensure compliance with market standards in order to preserve the interests of pension contributors.
4. Change in the Regulatory Environment of the Pension Industry: The Commission as the regulatory body for the pension industry in Nigeria may need to review and potentially adjust its policies and guidelines to address the changing dynamics within the financial services sector.[7] This could include revisions to investment guidelines, risk management frameworks, and reporting requirements for PFAs and or PFCs. As banks undergo recapitalization, regulatory frameworks may

[6] Adegbite, E. O., & Machethe, C. L. (2020). Bridging the financial inclusion gap in Nigeria: Issues and policy options. Acta Universitatis Danubius. Œconomica, 16(2), 16-32.
[7] Okafor, F. O., & Anyanwu, J. C. (2019). Pension fund administration in Nigeria: Issues and challenges. International Journal of Business and Management, 14(6), 1-15.

evolve to ensure the financial services sector's soundness. Pension industry regulations might also be adjusted to align with the changing landscape post-recapitalization.

Potential for Recapitalization in the Pension Industry:

In Nigeria generally, the business paraphernalia in the pension industry is clearly undertaken by the PFAs and the PFCs. While the PFAs are saddled with the responsibility of administering and investing the pension funds, the PFCs are responsible for custody of the pension funds. As an integral part of the country's financial sector, any reform in other industries within the financial sector of the country's economy will directly or remotely impact the pension industry. More so, the recent recapitalization in the banking sector is not unrelated to the expansion which the country has registered as a macroeconomy which requires a depth in the reserve basin to accommodate the country's economic growth and resilience to risk.

The expansion and growth in the country's economy is a function of good performances in different sectors of the economy, which the pension industry is a critical part of. In the light of the foregoing, it is conceivable that there might be calls in the near future for an upward review of the capital requirements of both PFAs and PFCs to ensure that their risk profile is robust enough to absorb any economic shocks.

This call for recapitalization in the pension industry is not unrelated to the fact that PFCs, are affiliated to commercial banks. Meanwhile, as stipulated by the Pension Reform Act 2014(the "Act") [8], the requirement for a person to carry on business as a PFC is that: -

(i) the applicant must be a limited liability company incorporated under the Companies and Allied Matters Act by a licensed financial institution with sole object of keeping custody of pension fund and retirement benefits assets;

(ii) the applicant must have a minimum paid capital of such sum that may be prescribed by the commission from time to time and is wholly owned by a licensed financial institution with net worth of a minimum of N25,000,000,000 or as may be prescribed from time to time;

[8] Section 62(b)

The above capital threshold of N25,000,000,000 (Twenty-Five Billion Naira) as stipulated in the Act was tailored along the prevailing minimum capital threshold of commercial banks at the time the Act was enacted. It is now exigent that the industry's performance has grown beyond the capped threshold and there is now a need for a review by the Commission to align with the current realities which the CBN has set for banks.

Conclusion

The recapitalization of banks presents both challenges and opportunities for the pension industry. Having highlighted the immediate implications, posed by the recapitalization of Commercial Banks, Merchant Banks and Non-interest Banks, players in the pension space are urged to stay informed about regulatory developments, and proactively adjusting investment strategies. We believe that by keeping tabs on regulatory developments, PFAs and PFCs can weather the changes and continue to fulfil their long-term financial objectives. It would be advisable for stakeholders within the pension industry, to adapt to regulatory changes, and explore diversified investment options to safeguard pension funds and optimize returns in a shifting financial environment.

Based on the foregoing, an effective collaboration and coordination between the banking and pension sectors will be crucial in navigating these changes and ensuring the continued stability and growth of the Nigerian pension industry.

Please do not treat the foregoing as legal advice as it only represents the public commentary views of the authors. All enquiries on this should please be directed at the key contacts