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The Banking Industry in Nigeria's Economic Transformation: The Role of Professional Bankers



INSIDE

- Product Development in the Financial Services Sector
- Modernising The Payments System for Sustainable Growth
- Prerequisites for the Success of Asset Management Corporation of Nigeria (AMCON) in the Financial Services Industry



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Contents

4

The Banking Industry in Nigeria's Economic Transformation: The Role of Professional Bankers



12

Product Development in the Financial Services Sector



18

Modernising The Payments System for Sustainable Growth



27

Prerequisites for the Success of Asset Management Corporation of Nigeria (AMCON) in the Financial Services Industry



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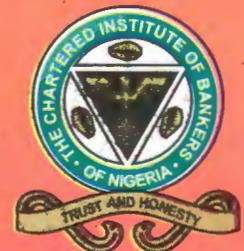
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Prerequisites for the Success of Asset Management Corporation of Nigeria (AMCON) In the Financial Services Industry

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Abstract

The steady growth of non-performing loans (NPLs) in the Nigerian banking system, with the attendant consequences on liquidity and solvency as well as the need to take proactive measures to facilitate the implementation of the current restructuring of the banking system, has made the establishment of an Asset Management Company of Nigeria (AMCON) imperative. The preponderance of NPLs in the Nigerian banking system is alarming and has necessitated the various actions taken by the CBN. There is, however, a gap in the existing NPLs management measures. The issues addressed in this paper pertain to requirements for the successful operation of Asset Management Corporation of Nigeria. The methodology is content analysis. The paper concludes, amongst others, that the success of AMCON hinges on a strong legal framework; an effective judicial process; operational autonomy and an adequate corporate governance structure.

1.0 Introduction

Asset Management Corporation of Nigeria (AMCON) came on board in 2010 at a time when some deposit money banks in the financial services industry were passing through difficult times. Some of the deposit money banks had been given up to September 2011 by the apex bank (CBN) to recapitalise or face liquidation. Asset Management Corporation of Nigeria (AMCON) was established for the purpose of acquiring the Non-Performing Loans (NPLs) of banks with a view to freeing such banks from the burden of provisioning requirements substandard, doubtful and lost accounts. The process of acquiring the NPLs involves the injection of fresh funds, thereby alleviating the liquidity and insolvency problems of the affected banks. AMCON is an interventionist initiative employed in the management of delinquent assets in the banking system. It operates as a variant of loan

acquisition companies, but has been adjudged to be more effective in the managements of NPLs (CBN 2003:41-42). Non-performing loans have been identified as a major problem of banks. The preponderance of NPLs in the Nigerian banking system is alarming and has necessitated the various actions taken by the CBN. There is, however, a gap in the existing NPLs management measures. It is therefore believed that the adoption of other measures to complement the existing options will have far-reaching effects in the resolution of NPLs' problems in the banking system.

Financial performance, especially relating to deposit money banks, is based on performance dimensions comprising: capital adequacy, asset quality, earnings and liquidity which are deeply rooted in the expectations of stakeholders which is in turn based on financial transparency. In the past, the Nigerian banking industry had been plagued with small-size banks with low capital, high cost of operations and high performance credits. This weakness inhibits bank management in the performance of its developmental roles in the economy, thus hindering the achievement of government objectives such as price stability, macroeconomic stability, provision of employment and increased output. It also affects the ability to compete effectively in the international market. Since the banking sector is the hub around which all other economic activities revolve, the health and prosperity of the bank is a major source of concern to Nigerians, especially the regulators.

The effectiveness of the financial intermediation role of banks in Nigeria is increasingly under threat as a result of soaring credit delinquency. Experience over the years shows that many credit customers of banks default in their repayment obligations. The consequence has been the deterioration in the quality of risk assets and a rise in the level of non-performing loans (NPLs) and advances with the attendant increase in the required loan

loss provision. This impacts directly on the profitability of banks. The increasing ratio of NPLs to total credits has been a source of concern to both operators and the regulatory authorities. The steady growth of non-performing loans (NPLs) in the Nigerian banking system, with the attendant consequences on liquidity and solvency, as well as the need to take proactive measures to facilitate the implementation of the current restructuring of the banking system, has made the establishment of an Asset Management Corporation of Nigeria (AMCON) imperative. The Banking Supervision Annual Report (2008:65-66) put the figures of non-performing credits and provision for bad and doubtful debts as follows:

"Non-performing credits increased from N0.4 trillion in 2007 to 0.5 trillion in 2008. The ratio of non-performing credits to total credits of 6.26 per cent during the review period was far below the trigger level of 35 per cent for setting up a Crisis Management Unit as stipulated in the Contingency Planning Framework for Systemic Distress. The ratio was lower than 21.6 per cent, 18.12 per cent, 8.77 per cent and 8.44 per cent in 2004, 2005, 2006 and 2007 respectively. Provision for bad and doubtful debts grew from N0.2 trillion in 2004 to N0.4 trillion in 2008. The ratio of bad debt provision to total credits was 22.6 percent in 2004, 19.1 percent in 2005, 6.3 per cent in 2006, 8.1 per cent in 2007 and 6.1 per cent in 2008."

Therefore, the rationale for the establishment of Asset Management Corporation of Nigeria (AMCON) is timely. Specifically, AMCON is expected to achieve the following objectives:

- (i) Promote financial recovery by addressing the debt overhang of banks occasioned by NPLs;
- (ii) Acquire, restructure, manage and/or dispose NPLs in the banking system;
- (iii) Recover and sell off collaterals for NPLs as quickly as possible; and
- (iv) Maximise recovery value to reduce public cost.

The CBN has responded by taking measures to strengthen the administration of credits in the banking system and prevent contagion. In the face of the inadequacy of existing measures to stem the increasing incidence of NPLs, the exploration of complementary NPLs management measures has become imperative in order to stave off systemic distress in the financial system. The remaining part of the paper will take an overview of literature review, methodology, types of Asset Management Corporation and Methods of asset transfer/funding; prerequisites for the successful operation of an asset management corporation and end with conclusion.

2.0 Literature Review

According to the Governor of Central Bank of Nigeria cited in Egene (2009:31), of the 10 banks audited so far as at August 2009, the balance sheets of five banks (Union Bank Plc, Finbank Plc, Oceanic Bank Plc, Afribank Plc and Intercontinental Bank) had shrunken, shareholders' funds impaired and they now had liquidity problems. Their huge exposure to non-performing loans (margin loans) had affected the banks. These five banks had spent a length of time at the expanded discount window (EDW) introduced in September 2008 by the apex bank, accounting for 90% of transactions at the EDW. The remaining banks accounted for the rest 10%. According to the apex bank, these banks took money from the inter-bank to repay their exposure to the discount window, an indication that their balance sheets had shrunk. The management teams had acted in a manner that was detrimental to the interest of their depositors and creditors. According to the apex bank, the temporary capital injection of N420 billion into the banks in the form of Convertible Tier 11 Debt, was expected to be repaid to the CBN once the banks were recapitalised. Considering the fact that ownership of banks has moved from family to private, existing shareholders have not been informed how these funds would be converted when the bailout fund is fully repaid.

The measure adopted by the CBN to bail out the banks is adjudged as misuse of taxpayers' money and may eventually displace existing shareholders.

According to Ajekigbe (2009: 2-8), from the classical and historical perspective, "Several factors led to the failure of banks between 1977 and early 2000. Some of the reasons advanced are poor asset quality, under capitalisation, inexperienced personnel, illiquidity, inconsistent regulatory policies and supervision". Non-performing accounts and the evolving competition in the banking industry as a result of globalisation has made it difficult for deposit money banks to play their major role of financing economic activities arising from inadequate capital. Inadequate bank capital has led to a crisis of confidence in the banks to the extent that the original functions which are: to support the volume, type and character of a bank's business, to provide for the possibilities of losses that may arise therefrom, and to enable the bank to meet a reasonable credit need of the community, have been eroded. Losses suffered by banks as a result of non-performing accounts led to bank failure, especially in the areas of lending. The soundness, safety and profitability of a bank affect the quality of its loan portfolio. The last few years have been both traumatic and revolutionary for the Nigerian banking system.

According to Eke (1999:1-14):

"Since the introduction of structural adjustment programme (SAP) in 1986 and the deregulation of the nation's financial system, banking business has raised a variety of performance questions. Although insured banks had recorded an appreciable increase in the volume of assets and deposits, their overall financial condition had deteriorated tremendously"...

The entry of new generation banks from 1989 witnessed competition amongst banks. New generation banks introduced aggressive marketing for deposits, new technology, etc. Between 1977 when rural banking was

introduced and now the deposit money banks have opened branches across the rural areas and cities of Nigeria. This was facilitated and enhanced by the liberalisation of banking licence and changes in the capital structure of Nigerian banks by the regulatory authority (apex bank); the most being the recapitalisation of Nigerian deposit money banks to N25 billion in 2005. Despite the change in capital structure, the financial health of some of the deposit money banks is yet to improve. With the presence of Asset Management Corporation of Nigeria (AMCON), we still have merger and acquisition plans in the Nigerian banking industry, such as the Finbank and FCMB merger plan, and the proposal by Diamond bank is making effort to acquire Oceanic Bank, etc. What then is the essence of Asset Management Corporation of Nigeria?

Madubueze (2008:10-11) opined that banking is bedrocked on risks; hence, the acceptance and management of financial risk remains an integral part of the business. Risk management, as commonly perceived does not mean minimising risk; rather, the goal of risk management is to optimise risk-reward trade-off. Notwithstanding the fact that banks are in the business of taking risk, it needs to be recognised that a banking institution should neither engage in any business in a manner that unnecessarily imposes risk upon it, nor absorb risks that can be transferred to other parties... It should rather accept those risks that are uniquely part of the array of bank services. Zero tolerance of risk is certainly not good banking business just as one hundred per cent tolerance is also not good banking. A banker must lend in order to make money and, in lending, he must strike a healthy balance between the risk that he is willing to accept and the returns he wants to make, and that should be within the regulatory framework.

Professor Chukwuma Soludo initiated the setting up of Asset Management Corporation of Nigeria (AMCON) to mop up the toxic assets in the balance sheets of rescued banks in preparation for

their takeover by new investors. In 2010, Sanusi, as CBN Governor, went further to actualise the vision of Soludo by bringing AMCON to fruition. AMCON is an entity established for the purpose of acquiring, managing, restructuring and disposing of NPLs. Some of the banks' problems actually started when most of them used their capital market subsidiaries to engage in share price manipulation and other sharp practices. The then Governor of the Central Bank of Nigeria, Professor Chukwuma Soludo, in 2004 identified the fact that as a result of the international nature of finance, size had become an important ingredient for success in the globalised world. He noted that large-scale Merger & Acquisition (M&A) were sweeping through Europe, America, Asia and South Africa, while the Nigerian banking system remained marginal relative to its potentials and in comparison to other countries. It was on this premise that he considered consolidation in the Nigeria banking system imperative. He specifically stated that M&A in the Nigerian banking system would result in:

- (i) Cost-savings due to economies of scale;
- (ii) more efficient allocation of resources;
- (iii) risk reduction arising from improved management;
- (iv) disincentive to engage in sharp practices; and
- (v) better financial intermediation by the banking system.

According to Sanusi, cited in Ogbonna (2010:34), AMCON with an authorised capital of N10 billion would not be able to soak the industry's huge standing bad loans, estimated at over N2.8 trillion. He explained: "Of a total loan portfolio of N2.8 trillion, margin loans accounted for N456 billion, and oil and gas loans made up N487 billion; aggregate non-performing loans totalled N1.143 trillion, or 40.81 per cent of total loans". The broad objective of AMCON is to assume the Non-Performing Loans (NPLs) in the banking system, thereby injecting fresh funds into the banks and, in the process, freeing the banks of the loan provisioning requirements, which

depress their earnings/capital.

AMCON, in November 2010, announced a firm commitment to start buying Non-Performing Loans (NPLs) from rescued banks in December 2010. It also announced that it would buy the share-backed loans of the non-performing portfolio of the rescued banks at 60% premium on the 60-day average closing price, as of November 15, 2010. The announcement has raised the confidence of investors that a resolution of the challenges of the rescued banks is now in sight. According to Osaë-Brown (2010: 1-4) in *BusinessDay*, the returns on the Exchange in November were dominated by the rescued banks, led by Oceanic Bank Plc with an average monthly return in November of 80.94%, Wema Bank Plc; Finbank Plc; Intercontinental Bank Plc and Afribank Plc followed with gains of 64.7%, 63.95, 59.65 and 57.6% respectively.

3.0 Methodology

The methodology of the research is the content analysis. Although it is defined in various ways, in this research, content analysis will be seen as "a research technique for the objective, systematic and quantitative description of the manifest content of communication" (Selltize 1977: 335). To this end, the research will involve a review of existing secondary sources in books, journals, magazines and newspapers.

4.0 AMC by Ownership/ Methods of Asset Transfer and Funding

From the Central Bank of Nigeria Banking Supervision Annual Report (2004), there are three main types of AMCs. These are private, government and jointly owned AMCs.

- (i) Private AMCs: These are AMCs that are established by private persons with the objective of acquiring NPLs of banks to re-sell or realize. Debt-factoring companies may be said to be private AMCs. However, large privately owned AMCs are rare in practice because of the



difficulty in finding private investors willing to assume ownership, without requiring far-reaching state guarantees covering the future value of the asset portfolio, especially where a substantial amount of bad loans and assets are involved.

- ii. Government-Owned AMCs: These are AMCs that are established, wholly funded and run by government or its agencies. Government may be in a more favourable position to own AMCs since it has the capacity to fund and put in place an adequate machinery for the smooth operation of an AMC.
- iii. Jointly-Owned AMCs: An AMC under this category could bring in stakeholders from the non-bank private sector, government, banking sector and regulatory/supervisory authorities. It could engage competent and qualified professionals and permit the



consolidation of skills and resources as well as improved prospects for orderly and sustainable macroeconomic growth and development. This type of AMC can be given special legal powers to expedite loan recovery and bank restructuring.

AMCON has the features of (i) and (ii). Considering the limited life-span of the AMC, its ability to take over assets will be limited. Options for asset transfer include:

- i. One-time transfer of targeted assets;
- ii. A defined number of transfers in tranches; or
- iii. Transfers within a given time-frame.

Individual loans transferred to an AMC should not exceed 5 per cent of the capital base of the AMC. The aggregate portfolio of assets of a particular bank should not exceed 25 per cent of the AMC's capital, at any point in time. The AMC will purchase outright, loans that have adequate underwriting documentation and collateral, while

other categories of loans would be purchased with recourse. In the case of banks that meet the new capital base requirement, the AMC would act in an agency capacity to recover the NPLs for a fee. In view of the fact that a significant proportion of the assets to be acquired by the AMC will be NPLs, which were created by the affected banks, the AMC would need to acquire such assets at market value. The AMC is allowed to raise funds from other sources as required. A working capital to be provided by the owners in the same proportion of ownership is recommended. The fund could be in the form of a credit. The AMC could also attract other commercial loans. Its ability to attract these loans would be market-determined, as it would be required to show capacity to repay such loans.

5.0 Prerequisite for the Successful Operation of an Asset Management Corporation (AMCON)

AMCON is one of the NPLs complementary management options

for integration into existing policy measures. The prudential Guidelines regulate income recognition and credit classification in the banking system. Its provisions have been potentially used in the administration and review of credits in the system. We also have debt factoring and loan acquisition companies. Debt factoring is a private sector initiative that involves the sale of a bank's NPLs to individuals/companies for recovery. Loan acquisition is an arrangement in which an array of institutional loan buyers acquire the NPLs of a bank. Such acquisitions may be by way of sale with recourse or without recourse. In the case of sale with recourse, the bank's balance sheet still reflects the quantum of NPLs offered for sale while in the latter, the balance sheet value of the credit is reduced by the amount of delinquent credit sold, whether or not recovery by the buyer is successful. Drawing from the experiences of the past and the reports of the CBN, there are certain requirements for the successful operation of an AMC in Nigeria. These are mentioned hereunder:

- a. **Legal Framework:** To operate legally, the AMCON must be properly created. This can be by way of incorporation as a limited liability company with perpetual succession or by legislation, through an Act of the National Assembly. The CBN and the NDIC can, under the combined effect of sections 27(1) (i) of the CBN Act and Sections 5 (10), 9b & 28 (1) of the NDIC Act, legitimately incorporate an AMC. Every documentation and procedure required for the setting up of AMCON should be followed to the letter. This is to avert an aggrieved person taking legal action against the body in future. The body should also be given maximum powers to seize assets of debtors, guarantors and directors of companies, including those in the custody of third parties, by taking physical possession of personal properties and sealing-off of real properties whether used as collateral or not.

- b. Recovery through Effective Judicial Process: The current judicial process of NPLs by banks through debt recovery action at the high court, under the Failed Banks Act or through winding-up proceedings at the Federal High Court (FHC) is protracted and ineffective. AMCON should be able to initiate and institute debt recovery proceedings at the Federal High Court (FHC) under special rules of procedure. For instance, special courts can be created to try debtors as was done through the failed banks' tribunal under the late Maximum ruler; Gen. Sanni Abacha.
- c. Operational Autonomy: To ensure success of this body, AMCON should be given full operational

on a good governance culture. Therefore, a code of corporate governance should be put in place by the management to address corporate governance issues in the organisation.

- e. Restricted Government Ownership and Private Sector Participation: There should be minimum interference from government and the involvement of the CBN and the NDIC. However, government commitment through, support and the provision of adequate funding is required on a sustainable basis. AMCON is a joint ownership venture between the government and the private sectors (including the deposit money banks). However, we should not expect the government to starve the body of

manage and/or dispose NPLs in the banking system; to recover and sell off collaterals for NPLs as quickly as possible and maximise recovery value to reduce public cost.

- g. Co-operation of All Relevant Regulatory and Government Agencies: The operation of AMCON would, of necessity, require the full co-operation of the judiciary, money and capital markets and other agencies. With the Freedom of Information (FoI) bill already passed by the National Assembly, individuals can now give information freely and voluntarily without harassment from the police. This will certainly facilitate and help the judiciary, money and capital markets and other agencies.

- h. Transparent and Realistic Asset Pricing: There is no doubt that some banks have contributed directly or indirectly to the delinquency of non-performing accounts/loans through fraudulent practices and insider abuses; the pricing and acquisition of non-performing loans must be separated, transparent and realistic.

- i. Development of a Secondary Market for the Sale of Loans: The need to create a secondary market where loans can be traded cannot be overstressed. AMCON should be able to take up the non-performing loans of banks and also undertake asset securitisation (bonds) and debt factoring, for the purpose of enhancing the quality of the balance sheet of banks and improving their liquidity. Before taking up non-performing accounts of banks they should be thoroughly investigated to ensure that they are genuine and valid debts. Knowing the fraudulent tendencies of Nigerians as a people, the fear is that bank staff are capable of faking accounts of customers as debts because they will be taken over by AMCON.

- j. Training and Development:

autonomy within the context of the banking sector and the legal system, while guaranteeing maximum professionalism in its operations. There should be limited interference from the executive arm of government.

- d. Adequate Corporate Governance Structure: The board and management of AMCON must comprise of persons of tested, and proven integrity and experience, driven by the desire to serve, and who are transparent, committed to achieving the objectives of the company within the set time frame. Whereas a high degree of transparency would foster market discipline in AMCON, the reverse would be the case. The safety and soundness of an institution depend

funds, especially when it fails to dance to the water's tune as we have noticed in other bodies like the Economic and Financial Crimes Commission (EFCC), the Independent Corrupt Practices Commission (ICPC), the Code of Conduct Bureau, the Police, the Judiciary, etc.

- f. Sound Macro-Economic Environment: A strong economy that is growing at a reasonable and sustainable rate (e.g. price stability, stable exchange rate, single-digit inflation, etc.) would provide a better environment for the timely realisation of the goals of AMCON which are: to promote financial recovery by addressing the debt overhang of banks occasioned by NPLs; to acquire, restructure,

“

The safety and soundness of an institution depend on a good governance culture. Therefore, a code of corporate governance should be put in place by the management to address corporate governance issues in the organisation.

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Competent and experience staff should be employed in AMCON. The management should place emphasis on continuous training and development of employees to match the ever-increasing challenges in the Nigerian financial system. Induction course will not be out of place for newly recruited staff while domestic and international courses should be organised for existing staff to update their knowledge on the dynamics of the Nigeria financial services sector.

6.0 Conclusion

Banks' regular risk monitoring activities are imperative as they offer the advantage of quick detection and correction of deficiencies in policies, processes and procedures for managing risks. Promptly detecting and addressing identified deficiencies can substantially reduce the potential frequency and severity of a loss. Regular reviews should be carried out by the internal audit in conjunction with staff of AMCON to analyse the control environment and test the effectiveness of implementing controls thereby ensuring that business operations are conducted in a controlled manner. Bank inspectors and AMCON staff should be properly focused on the significant risk as identified by management as well in auditing the risk management process across the banks. Employees should be properly sensitised to report systematically and promptly to senior management any perceived new risk or failure of existing control measures across the entire bank.

As stated earlier in section 5, the existing legal framework should be strengthened; an effective judicial process established; operational autonomy truly upheld, and an adequate corporate governance structure put in place to ensure the success of AMCON. Government is not a good manager of business. With this in mind, there should be restricted government ownership. Private sector participation should be of utmost

priority in AMCON. A sound macroeconomic environment; co-operation of all relevant regulatory and governmental agencies; transparent and realistic asset pricing; development of a secondary market for the sale of loans and training and development of employees are tools that can be used to ensure the success of AMCON.

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