



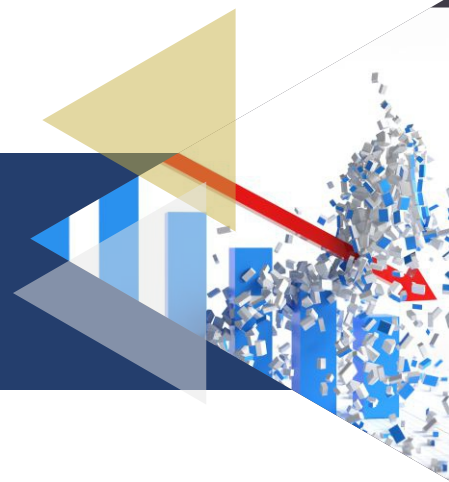
TOPE ADEBAYO LP

# BANK FAILURES IN NIGERIA:

IMPLICATIONS FOR STAKEHOLDERS –  
A CASE STUDY OF HERITAGE BANK



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## INTRODUCTION

On the 3<sup>rd</sup> day of June, 2024, The Central Bank of Nigeria (CBN) revoked Heritage Bank's license, raising significant concerns among depositors, investors, and other stakeholders.

Banks operate in a complex and sensitive environment, therefore, they are under various regulatory frameworks including the maintenance of certain capital reserves and adherence to Capital Adequacy Ratio (CAR) to ensure stability. However, despite these safeguards, bank failures are a reality. In Nigeria, a failing bank calls for the intervention of the Central Bank of Nigeria (CBN) as the primary regulator of the Banking Sector. Depending on the circumstances, such intervention may vary from changing the bank's management to revoking the license of the bank to the liquidation of the bank. This article will examine circumstances under which the CBN may revoke a bank's license, the implications of such an action, and what stakeholders can expect moving forward.

## UNDERSTANDING BANK FAILURES AND THEIR CAUSES

A bank failure occurs when a bank is unable to fulfill its financial commitments to its creditors and depositors. This inability can stem from two primary causes: insolvency or illiquidity. Insolvency arises when a bank's liabilities surpass its assets. In this scenario, the bank simply lacks the financial resources to cover its debts. On the other hand, illiquidity occurs when a bank, despite being technically solvent, does not possess enough liquid assets, such as cash or easily convertible assets, to meet the immediate withdrawal demands of its depositors. This can trigger a bank run, a chaotic situation where depositors rush to withdraw their funds, intensifying the bank's liquidity crisis.

Several factors can contribute to a bank's descent into failure. Poor risk management practices, such as making high-risk loans, investing in volatile assets, or neglecting to



# BANK FAILURES IN NIGERIA: IMPLICATIONS FOR STAKEHOLDERS – A CASE STUDY OF HERITAGE BANK



diversify the bank's investment portfolio, can expose the institution to significant financial vulnerabilities. Economic downturns, like recessions or other financial crises, can lead to a surge in loan defaults and a decrease in profitability. Fraudulent activities or mismanagement by bank executives can rapidly erode a bank's capital base. Non-compliance with regulatory requirements can also result in hefty fines or penalties, further weakening the bank's financial standing.

## IN WHAT CIRCUMSTANCES CAN THE CBN REVOKE THE LICENSE OF A BANK?

According to the CBN, the revocation of the Heritage Bank's license was hinged on its breach of Section 12(1) of the Banks and Other Financial Institutions Act (BOFIA 2020).

Section 12(1) of the BOFIA 2020 provides that the Central Bank of Nigeria (CBN) may revoke the license of a bank under the following circumstances:<sup>1</sup>

1. The bank ceases to conduct its licensed banking business in Nigeria for six continuous months or for an aggregate period of six months within a 12-month period.
2. The bank undergoes liquidation, winding up, or dissolution proceedings.
3. The bank fails to meet the conditions stipulated in its license or violates provisions of the BOFIA, the CBN Act, or related regulations.
4. The bank's assets are insufficient to cover its liabilities, rendering it financially unstable.

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<sup>1</sup>Section 12 (1) of the BOFIA 2020

## BANK FAILURES IN NIGERIA: IMPLICATIONS FOR STAKEHOLDERS – A CASE STUDY OF HERITAGE BANK

5. The bank conducts its business in an unsound manner, or its directors engage in unsafe practices that could jeopardize the bank's stability.
6. The bank's situation, actions, or inactions pose a threat to the overall stability of the financial system.
7. The bank fails to adhere to obligations imposed by the Banks and Other Financial Institutions Act, the CBN Act, or any other applicable rules, regulations, guidelines, or directives.
8. The bank's capital adequacy ratio falls below the minimum prudential requirement, or any other ratio prescribed by the CBN.
9. The bank fails to commence banking operations within 12 months of being granted a license.
10. The bank fails to maintain the minimum paid-up share capital requirement for its category as prescribed by the CBN.<sup>2</sup>
11. The bank fails to maintain capital funds unimpaired by losses at the ratio to assets or liabilities as specified by the CBN.<sup>3</sup>

The CBN's press release cited Heritage Bank's breach of Section 12(1) of the BOFIA 2020 and the bank's inability to improve its

financial performance resulting in threatened financial instability. While the specific details of Heritage Bank's failure were not provided by CBN, the reasons lean towards items 4 and 6 as listed above.

### WHAT HAPPENS WHEN THE LICENSE OF A BANK IS REVOKED?

For depositors of the bank, the revocation of the bank's license may have significant implications. Depositors may lose access to their bank accounts held at the bank. Banking services, such as ATM access, online banking, and branch operations, may be suspended or disrupted.

More specifically, in Nigeria, the following happens when the license of a bank is revoked;

1. The CBN immediately appoints the Nigeria Deposit Insurance Corporation (NDIC), or the NDIC automatically steps in as the liquidator of the bank.<sup>4</sup> The NDIC is an independent agency that insures deposits held by commercial banks, merchant banks, and deposit-taking microfinance banks licensed in Nigeria up to a specified coverage limit. The NDIC also acts as a receiver and liquidator of failed insured banks and financial institutions.
2. The NDIC will do a publication through advertisements in print and electronic media inviting depositors

<sup>2</sup>Section 9 of the BOFIA 2020

<sup>3</sup>Section 13 of the BOFIA 2020

<sup>4</sup>Section 12 (2) of the BOFIA 2020, Section 55(a) of the NDIC Act 2023

## BANK FAILURES IN NIGERIA: IMPLICATIONS FOR STAKEHOLDERS – A CASE STUDY OF HERITAGE BANK

to formally submit their claims for deposit reimbursement. The NDIC has the authority to request proof of claims from depositors. This is a verification step to ensure that only valid claims are processed and paid out.<sup>5</sup>

3. The NDIC will make payments to depositors within thirty (30) days of being appointed the liquidator of the bank. The NDIC guarantees the payment of insured deposits up to the maximum limits specified in the Act (₦500,000 for non-microfinance banks and ₦200,000 for microfinance banks).<sup>6</sup> However the NDIC has the power to increase the amount that a depositor can receive.<sup>7</sup> It is important to note that the NDIC will prioritize deposit liabilities over all other liabilities of the bank. This means that depositors will be paid first from the available assets of the bank, followed by other creditors.<sup>8</sup>

Following CBN's press release, the NDIC commenced the liquidation of Heritage Bank Plc with immediate verification and payment of insured deposits to the bank depositors. The NDIC, exercising its power to increase the amount that a depositor can receive, has announced that it would pay each depositor a maximum limit of ₦5 million, although the statutory insured limit is ₦500,000. Using each depositor's

BVN, the NDIC will transfer the funds directly into the depositor's alternate account with any other commercial bank in Nigeria. While depositors with funds in excess of ₦5 million will be paid liquidation dividends upon realisation of the bank's assets and recovery of debts owed to the bank.

4. For clarity, for deposits exceeding the insured limits, in addition to the initial (maximum of N5,000,000) sum paid to them, depositors will also be entitled to liquidation dividend upon realization of the bank's assets and recovery of debts owed to the bank.<sup>9</sup> This means that depositors have the opportunity to recover as much of their money as possible, even beyond the initial insured amount.

### WHAT HAPPENS TO THE SHAREHOLDERS AND DIRECTORS OF THE BANK?

In the event of a bank's license revocation, the NDIC can enforce the personal liability of significant shareholders and directors if their actions or inactions contributed to the bank's failure.<sup>10</sup> This means that directors, significant shareholders, officers, employees, and other parties involved with the bank can be held personally liable for monetary damages if their actions or inactions contributed to the bank's failure. This liability extends to damages resulting from the misuse or improper investment of the institution's assets, including principal

<sup>5</sup>Section 28(2) of the NDIC Act 2023

<sup>6</sup>Section 25(1) of the NDIC Act, 2023

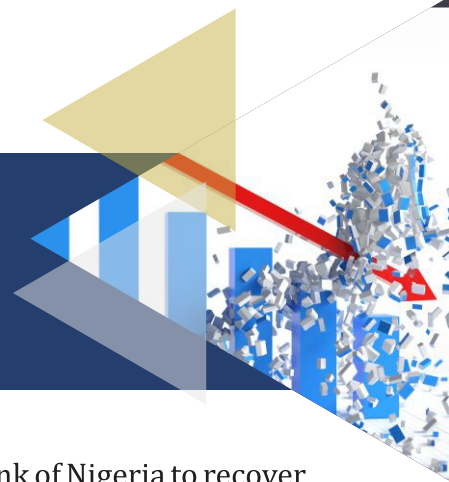
<sup>7</sup>Section 28 of the NDIC Act, 2023

<sup>8</sup>Section 72 of the NDIC Act, 2023

<sup>9</sup>Section 25(4) of the NDIC Act, Section 31(1) of the NDIC Act.

<sup>10</sup>Section 57(2)b of the NDIC Act 2023, Section 76 of the NDIC Act, 2023.

# BANK FAILURES IN NIGERIA: IMPLICATIONS FOR STAKEHOLDERS – A CASE STUDY OF HERITAGE BANK



losses and appropriate interest. The liability of directors for granting unauthorized credit facilities is unlimited and personal. Directors and the shareholders may be liable even if their actions occurred before the institution was declared failing or failed.

It is worth noting that a bank whose license has been revoked may challenge the revocation of its license by filing an action with the Federal High Court of Nigeria within thirty (30) days from the date of the revocation. However, the court cannot restore the license already revoked but may award monetary compensation not exceeding the bank's paid-up capital at the time the license was revoked.<sup>11</sup>

## WHAT HAPPENS TO THE DEBTORS OF THE BANK?

As a liquidator, NDIC can take several actions against debtors (borrowers) of a bank whose license has been revoked. These actions aim to recover the debts owed to the failed bank and protect the interests of depositors and creditors. NDIC can;

1. set off a loan owed by a debtor against the debtor's deposits held in the failed bank or any other failed bank under liquidation. This means the NDIC can use the debtor's deposits to partially or fully repay the loan.<sup>12</sup>
2. Utilize the Global Standing Instruction (GSI) scheme operated by

the Central Bank of Nigeria to recover debts. This scheme allows the NDIC to access the debtor's accounts in other banks and use the funds to settle the outstanding loan. The NDIC can obtain information about the debtor's accounts and investments from other insured institutions. This helps the NDIC track the debtor's assets and financial activities to recover the debt.<sup>13</sup>

3. Appoint a receiver to manage the debtor's assets if they fail to repay the loan. The receiver can take possession of the debtor's property, manage it, and sell it to recover the debt owed to the failed bank. It will be immaterial that the assets were not pledged or mortgaged as security for the loan.<sup>14</sup>
4. Pending the determination of a debt related suit, apply to the court to freeze the account of the debtor if the NDIC has reason to believe that a debtor has funds in an account with another insured institution. This prevents the debtor from accessing the funds until the debt recovery process is completed.<sup>15</sup>
5. Where a debtor fails to comply with a written demand from the NDIC to settle his debts with the failed bank within 90 days, the NDIC can initiate bankruptcy proceedings against the debtor and the court may adjudge

<sup>11</sup>Section 12 (4), (5), and (6) of BOFIA

<sup>12</sup>Section 26 of the NDIC Act, 2023

<sup>13</sup>Section 27 of the NDIC Act, 2023

<sup>14</sup>Section 62(1) of the NDIC Act, 2023

<sup>15</sup>Section 64 of the NDIC Act, 2023

## BANK FAILURES IN NIGERIA: IMPLICATIONS FOR STAKEHOLDERS – A CASE STUDY OF HERITAGE BANK

that the debtor is bankrupt notwithstanding that the debtor had not committed any act of bankruptcy.<sup>16</sup> This allows the NDIC to take control of the debtor's assets and distribute them among creditors, including the failed bank.

6. Where a body corporate who is a debtor to a bank whose license has been revoked does not comply with a written demand from the NDIC to settle its debt to the bank within 30 days, apply to the court for a winding up order and the entity may be wound up by the court.<sup>17</sup>
7. Publish the names of debtors of a failed bank in the media. This public disclosure can put pressure on debtors to repay their loans and help the NDIC recover the debts.<sup>18</sup>

Beyond the immediate impact, this incident will likely prompt increased regulatory scrutiny and a reassessment of risk management practices within the banking sector. While the NDIC has stepped in to manage the liquidation process, the long-term consequences for Nigeria's financial stability and economic confidence remain to be seen. It is a stark reminder of the importance of robust regulation and proactive measures to safeguard the interests of depositors and maintain trust in the banking system.

### WHAT NEXT?

The revocation of Heritage Bank's license significantly impacts various stakeholders, including depositors, employees, shareholders, directors and others with ties to the bank. The process of liquidation and deposit insurance payouts will unfold imminently. For the investors and depositors with deposits in excess of ₦5,000,000, the settlement process may span several months if not years depending on how long the debt recovery and asset liquidation process takes.

<sup>16</sup>Section 65 of the NDIC Act, 2023

<sup>17</sup>Section 68 of the NDIC Act, 2023

<sup>18</sup>Section 62(1)n of the NDIC Act, 2023

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