

## A Critique of the Legal Regime Protecting of Bank's Investors: Lesson for Nigeria in Global Financial Crisis

Nuhu Musa Idris

Lecturer

Department of Private and Commercial Law

Faculty of Law

Bayero University

Kano - Nigeria

### Abstract

*Due to its delicate position in economy, banks are the most highly regulated institutions in every jurisdiction, with very strong regulators. However, like the other players in the economy, banks as companies have their own class of stakeholders, comprising; the management team, the Board of Directors, Share holders, Depositors and the general public (supposedly the depositors). The management and the board of directors are the key players in running the day to day affairs of the banks. Share holders, on the other hand, are those who invest their money to form the bank in the first place, as without whom, there would not be any bank at all. However, due to the nature of the banking system, these investors are subject to very stringent regulations and expose to more risk than all the investors in the other sector of the economy. As mentioned earlier, the current legal regimes regulating the banking industry, do not recognize the peculiar nature of this class of investors and level of risk they are exposed to, as a result of the emerging issue of corporate governance such as; remunerations of Bank Executive on the one hand and governmental policies such as; the bailout on the other. This paper critical examines the nature and scope of the legal regimes that protect Investors in the banking sectors, as well as the impact of the global financial crisis on the banking sector of the developing countries, like Nigeria. An analysis of the legal regimes will bring to fore an interface between the protection of the investors in bank on the one hand and the emerging issues of corporate governance and some governmental policies on the other. And it will advocate whether there is the need to have a comprehensive international legal regime protecting the bank investors particularly where cross border investment is concerned, through regulating the Bank Executive Remuneration and propriety trading, and other riskier businesses carried out by bank.*

### 1. Introduction

The current trend of globalisation has turned the world into a global village, and it is the dream of every country in the world to have a sound economy. By and large economic development is premised on having a strong banking system. According to Faghohu<sup>1</sup> banks are essential in any industrial society and the role they play is vital for the rest of the economy, not only do banks play a key role in the distribution of financial resources to the rest of the economy, they also act as repositories for the public's saving. The financial sector is one of the most important sectors of the economy. A disruption in this sector can have serious ripple effects and damage other, initially healthy sectors, too.

Due to this central position played by the banks in the economic development of country, the banking sector is a highly regulated industry with detailed and focused regulators, and the nature of the banking regulation varies from one country to another.<sup>2</sup>

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<sup>1</sup> Faghohu, I. (1994) Crisis in the financial sector: Legal perspective, a paper presented at the Annual conference of National Association of law Teachers, Lagos.

<sup>2</sup> Because, while some countries; like Nigeria are using single banking regulatory system others such as the USA are using dual system of banking regulation; whereby both federal and state legislatures can make laws relating to certain areas of banking operation. As fully explain by Scott. K. E. The Dual Banking System: A Model of Competition in Regulation, *Stanford Law Review* 30 no. I, 1977, 1-49 and Wilmarth, A.E. The expansion of State Bank powers, the Federal Response and the case for preserving the Dual Banking System, *Fordham Law Review* 58 NO. 6 1990 1132

Governments all over the world have established regulatory frameworks; by careful issuance of licence, constant monitoring of banking activities, resolution of distress and eventual liquidation of the failed banks.

In most countries, this regulatory framework was initially administered through the central banking system, whereby a Central Bank will be established and charged with the responsibility of implementing various policies in respect of banking operation. Most of the legal and institutional arrangements were made purposely to protect bank depositors, without paying much attention to protect the bank investors (without whom there would have been no bank at all) against some challenges foist on them by governmental policies preventing bank failure; such bailouts and some current issues relating to corporate governance, such as Bank Executive's Remuneration,

Whereas, as every regulation or policy is often premised on the attainment of certain objectives, the common objectives of banking regulation is to enhance the confidence of not only the bank depositors but that of the investors as well. Bank investors have some peculiarity different and distinct from other investors in ordinary companies. The peculiarity is related to the fact that the banking sector is highly regulated industry and operates under the closed supervisions and regulations of several Regulators, who possess the power to terminate the business of the bank, thereby destroying the investor's investment. Investors in other sector of the economy do not face such challenges.

In particular some of the issues that have emerged out of current global financial crises and that are bedevilling the banking industry border on corporate governance in the banking sector, like; remunerations of Bank Executive<sup>3</sup> on the one hand and governmental policies such as; the bailout<sup>4</sup> These have exposed bank investors to certain degree of risk of losing their investment, thereby, eroding the confidence of the investors in the banking sector.

In view of this glaring problem this paper seeks to addresses the Bailout policies and highlights some corporate governance issues inherent in bank executives' remuneration, and their impact on the legal regime protecting bank investors in the era of global financial crisis. The paper will commence with analysis of the level of protection which the bank investors enjoy from the Nigerian legal regime. It will also look at the current governmental policy of bailout and corporate governance issues like; executive remuneration affects the investors' protection vis-a-vis the Current global financial crisis.

## **2.1 The Legal Regime Protecting Bank Investors in Nigeria**

In view of the fragile nature of the banking industry, there is the need to maintain the confidence of both the Depositors and Investors in banks. When such confidence is absent, then banking crisis is inevitable.<sup>5</sup> Hence, the need to have stringent regulations in the industry, therefore, discussion on the legal regime protecting bank cannot be complete without highlighting the nature of Banking Regulations.

### **2.1.1 Nature of Banking Regulation**

The banking industry is a highly regulated industry with detailed and focused regulators, and the nature of the banking regulation varies from one country to another.<sup>6</sup> The examination of the nature of banking regulations, can be better approached by way of exploring the general principles of banking regulation, that serve as the platform under which all the regulatory frameworks in the banking system all over that world are primarily based.

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<sup>3</sup> Whereby, the management either with or without the knowledge of the Board of Directors engage themselves into to some sharp practices that could lead to the failure of the bank, thereby destroying the whole investment of the said investors.

<sup>4</sup> Where a government could inject money into to the banking industry with a view to save it from being collapsed, but in process the interest of the investors may be affected. For example in 2011, Nigerian government decided to bailout three commercial banks, but the government Nationalized the affected banks with total disregard of the investors' interest therein and the available legal regime in Nigeria does not provide any protection to them.

<sup>5</sup> Wadsley, J. and Penn, G.A. (2000) Penn & Shea: The Law of Domestic Banking, 2<sup>nd</sup> ed, London, p. 3

<sup>6</sup> Because, while some countries; like Nigeria are using single banking regulatory system others such as the USA are using dual system of banking regulation; whereby both federal and state legislatures can make laws relating to certain areas of banking operation. As fully explain by Scott. K. E. The Dual Banking System: A Model of Competition in Regulation, *Stanford Law Review* 30 no. I, 1977, 1-49 and Wilmarth, A.E. The expansion of State Bank powers, the Federal Response and the case for preserving the Dual Banking System, *Fordham Law Review* 58 NO. 6 1990 1132

However, the international body<sup>7</sup> that profound and implement such general principles need to be highlighted before embarking on the discussion of such general principles. This body is called the Bank for International Settlement.<sup>8</sup>

The Bank of International Settlement established certain standards that qualified to be the General Principles of Banking Regulation, due to the frequent usage by the international community. Despite the fact that, banking regulations can vary widely across nations and jurisdictions. In discussing such general principles, reference will be made to Nigerian legislations in order to show the extent to which Nigerian banking regulations complies with the said principle. According to Singh S.K.<sup>9</sup> these general principles include:

- Minimum Capital requirement;
- Reserve requirement;
- Corporate Governance;
- Supervisory review;
- Credit rating requirement;
- Large exposure restriction;
- Financial reporting and disclosure requirement;

It should be noted that, out of the above general principles, only three are relevant to this paper; that is Large Exposure Restriction,<sup>10</sup> Supervisory Review and Corporate Governance, which are the main issues that have link with the protection of bank investors in Nigeria, and this paper may make reference them at the appropriate time.

### 2.1.2 The Legal Regime for Bank Investors Protection

Structurally, bank under Nigerian law<sup>11</sup>, is undoubtedly, prima facie a company which could be governed by the ordinary company law principles. Therefore, the existing legal framework equates the Bank Investors with the investors in ordinary companies. However, In view of its delicate position in the economy; bank is highly regulated with very strong Regulators and it possesses a very unique feature different from that of the ordinary companies. That is to say, the banking structure includes; the Executive, the Board of Directors, the Share holders (investors) and the Depositors.

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<sup>7</sup> Whenever a body that regulates the banking system is mentioned, the first thing that readily comes to mind is the Central Banking System. At international level, the body that perform the functions of a Central Bank is the Bank of International Settlement whereas, almost all countries in world have their own Central Bank, which normally operate within the framework set up by the Bank of International Settlement.

<sup>8</sup> The Bank for International Settlements was established in 1930 as the principal centre for international central bank cooperation. It was established for the purpose of handling the issue of the reparation payments imposed on Germany by the Treaty of Versailles following the First World War. The Bank's name is derived from this original role. The BIS was also created to promote central bank cooperation in general. It should be noted also that, the reparations issue quickly faded, focusing the Bank's activities entirely on cooperation among Central Banks in pursuit of monetary and financial stability. This is because since 1930, central bank cooperation at the BIS has taken place through the regular meetings in Basel of Central Bank Governors and experts from central banks and other agencies. According to James C. Baker in his book, 2002 *The Bank for International Settlements: Evolution and Evaluation*, (Quorum,), p. 20 The Bank of International Settlement was formed with funding by the Central Banks of six nations, Belgium, France, Germany, Italy, Japan, and the United Kingdom. In addition, three private international banks from the United States also assisted in financing the establishment of the BIS

<sup>9</sup> Singh, S.K., *General Principles of Bank Regulation*, discovery publishing house PVT. Ltd, S New Delhi. **See also** Malloy M. P. (2007) *Principles of Bank Regulation*, *Journal of Banking Regulation*, 11 2007, made a Comprehensive, yet intelligible treatment of the basic rules, principles, statutes, and issues governing the law of bank regulation. Examines the rapid pace of development in depository institution regulation, and how federal statutes governing banking have been subject to constant amendment in recent years. Detailed sections discuss the regulated environment of banking, entry rules, branching, control transactions, transactional rules, holding company activities, securities regulation, resolution of institution failures, international banking, and bank regulation and social policy.

<sup>10</sup> Banks may be restricted from having imprudently large exposures to individual counterparties or groups of connected counterparties. This may be expressed as a proportion of the bank's assets or equity, and different limits may apply depending on the security held and/or the credit rating of the counterparty. In compliance with this principle, banks in Nigeria are restricted from granting any advances, loan or credit facility or give any financial guarantee the total value of which is more than 20% of the shareholders fund<sup>10</sup> which is money Deposited with the CBN pursuant to section 13 of the BOFIA as the minimum capital ratio which is one of the condition for advertising or accepting new deposits; granting credit or paying cash dividend to share holders, except in respect of inter banks transactions, as provided by Section 20 (1) of the Bank and Other Financial Institution Act

<sup>11</sup> Section 2 and 3 of the Bank and Other Financial Institution Act Cap B3 LFN 2004

The management and the board of directors are the key players in running the day to day affairs of the banks. Share holders, on the other hand, are those who invest their money to form the bank in the first place, as without whom, there would not be any bank at all. However, due to the nature of the banking system, these investors are subject to very stringent regulations and expose to more risk than all the investors in the other sector of the economy. More so, a healthy and strong banking environment is dependent upon adequate investment (which could be either local or Foreign Direct and/or Portfolio Investment<sup>12</sup>) in the banks. Therefore, the bank investor deserves a special adequate protection different from all other class of investors. As the theme of this paper suggests, bank investors will be its central focus.

The legal regime that generally protects the investors and invariably Bank Investors comprised of:

- a) Investment and Securities Act
- b) Companies and Allied Matters Act, Cap C20 LFN 2004
- c) Nigerian Investment Promotion Council Act
- d) Bank and Other Financial Institution Act Cap B3 LFN 2004
- e) Central Bank of Nigeria Act 2007

Relevant provisions of these laws will be analyses in the light of investors' protection in Nigeria.

## 2.2 Investment and Securities Act

This Act under Section established the Securities and Exchange Commission<sup>13</sup> (SEC) as the body empowered to be the regulatory and supervisory body to securities dealers and market operators in the Nigeria. It is authorized to inter alia; regulate investments and securities business in Nigeria, register and regulate securities exchanges, capital trade points, futures options and derivatives, exchanges and commodity exchanges<sup>14</sup> and also to register securities to be offered for subscription or sale to the public, as no shares or any form of security can be offered to public for or transfer unless it has been registered with and approved by SEC.<sup>15</sup>

One of the most significant protections given to the investors by the Act, is the introduction of the concept of investors protection fund and established the Investment and Securities Tribunal. Under section 197(1) of the Act, it is provided that:

*“a securities exchange or capital trade point shall establish and maintain a fund to be known as the investors protection fund which shall be administered by its governing board(herein after referred to as the “Board”) on its behalf.”*

Furthermore subsection (2) of the same section 197 of the Act provides that:

*“the assets of the investors protection fund shall be the property of the securities exchange or capital trade point but shall be kept separate from all other property and shall be held in trust for the purpose set out in this part of the Act.”*

However, it is only under section 204 of the Act that it was made clearer as to how to apply the investors' protection fund. Under the said section, it states that investors fund shall be held and applied for the purpose of compensating persons who suffer pecuniary loss from any defalcation committed by a member company or any of its directors or employee in relation to any money or other property which was entrusted or received by a member company or any of its directors or employees in relation to any money or other property which was entrusted or received by a member company or any of its directors or employees whether before or after the commencement of this Act in the course of or in connection with the business of that company.

<sup>12</sup> An Investment is considered as Direct when the investor's share of ownership is sufficient to allow control of the company, while investment that provides the investors with a return, but not control over the company, generally is considered portfolio investment. UNCTAD, Scope and Definition, series in Issues in International Investment Agreement, UNCTAD/ITE/IIT/11(Vol.II), 8

<sup>13</sup> Section 1 of Investment and Securities Act, (ISA) 2007

<sup>14</sup> Ibid section 13

<sup>15</sup> Ibid

However, section 203 of the Act stipulates that all monies that form the investors' protection fund shall be kept in a separate account in any part of Nigeria pending such period that there would be need or desire for the use or application of such funds. The reason behind this legislation is to ensure that investors' funds are seen to be in safe hands so as to ginger great confidence and trust from various investors as far as their protection is concerned.

This does not however mean that investors protection cannot be utilized for any developmental purposes as the "Board") on its behalf in the interest of the investors concerned. This is why section 211 of the Act provides inter alia that:

*"any monies in an investors protection fund which are not immediately required for its purposes may be invested by the board in any manner in which the trustee are for the time being authorized by the Trustee Investment Act to invest trust funds."*

Apart from Investors' Protection Fund, the Act also establishes an Investment Tribunal<sup>16</sup> and clothed with exclusive jurisdiction to hear and determine questions of law or disputes arising from the exercise of the Securities and Exchange Commission's powers under the Act, more particularly matters involving inter alia; investors and the Securities and Exchange commission, capital market operators inter se and between capital market operators and their client.<sup>17</sup> However, What is not clear is to what extent this provisions will apply to banks vis-à-vis the powers of the Central Bank of Nigeria under the Central Bank Act,<sup>18</sup> Bank and Other Financial Institution Act<sup>19</sup> and Nigerian Deposit Insurance Corporation Act<sup>20</sup>?

### **2.3 Companies and Allied Matters Act (CAMA)**

This Act provides a framework for investors and their protection. Under the Act, Investor is synonymous to a member of company; and a person can become a member of every company if he subscribed to the Memorandum and Article of Association or he (after the formation of the company) agrees in writing to become a member of the company.<sup>21</sup> Also, the Memorandum and Article of Association have the effect of a contract under seal between the Company, its members and officer (including directors) and between the members and the officers (including Directors) themselves.<sup>22</sup> Once a person becomes a member of Company, the law views his rights and liabilities in terms of the types of shares he hold, as usually spell out by the provision of the Companies and Allied Matters Act as well as the Article of Association of the company.<sup>23</sup> On the Investors right, the Supreme Court of Nigeria stated that, the Act imposes some liabilities on the investors in the same way it confers some rights them.<sup>24</sup>

The investor's liability is determined, at first instance by the type of company in which he has invested his resources i.e. whether the company is limited by shares, guarantee or unlimited. Where the company is limited by shares, the liability of the investor is limited to the amount unpaid on his shares which may be called up at any time whether or not the company is in the process of being wound up.<sup>25</sup> Where the company is limited by guarantee, the liability of an investor is limited to the sum which he has entered into an undertaking to contribute to the assets of the company in the event of its being wound up.<sup>26</sup> The Act also recognized right of the investors to rectify and benefit from all pre-incorporation contracts entered into, as if such contracts were made by their consent<sup>27</sup>, and if the contract happens to be harmful to investors Act empowers them to reject them.<sup>28</sup>

### **2.4 Nigerian Investment Promotion Commission ACT (NIPC)**

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<sup>16</sup> Section 274 of the Investment and Securities Act

<sup>17</sup> Ibid Section 284

<sup>18</sup> 2007

<sup>19</sup> Cap B3 LFN 2004

<sup>20</sup> Act NO. 16 of 2006

<sup>21</sup> Section 79 (2) & (3) of the Companies and Allied Matters Act C20 LFN 2004 (CAMA)

<sup>22</sup> Ibid at section 41(1)

<sup>23</sup> Ibid as section 81

<sup>24</sup> Kotoye Vs. Saraki (1994) 7 NWLR (pt 357) 41 at 467

<sup>25</sup> Section 21 (1) (a) and Section 133 of CAMA

<sup>26</sup> Ibid at section 21 (1) (b)

<sup>27</sup> Ibid at section 71 (1)

<sup>28</sup> Ibid at section 71 (2)

This Act regulates foreign investment in Nigeria. It established a commission<sup>29</sup>, charged with the responsibility of encouraging, promoting and coordinating investment in Nigeria, also to enhance the investment climate in Nigeria for both Nigerian and non-Nigerian investor.<sup>30</sup>

The protect the investors against nationalization and expropriation by any government and no person who owns share in any company shall be compelled to surrender his interest in the said share.<sup>31</sup>

## **2.5 Bank and Other Financial Institution Act (BOFIA)**

The BOFIA provides the regulatory framework for the establishment and management of banks and other related financial institutions. Under the Act, no person shall carry on any banking business in Nigeria except it is a company duly incorporated in Nigeria and hold a valid banking licence issued under this Act.<sup>32</sup> Therefore, a bank may also hold or acquire share capital of any business subject to the approval of the Central Bank of Nigeria.<sup>33</sup> In order enhance the protection bank investors; this Act empowers the Central Bank of Nigeria to grant a licence to any bank in Nigeria to undertake off-shore banking business.<sup>34</sup>

However, this Act introduced one fundamental restriction on one of the rights of investor recognised under CAMA,<sup>35</sup> that is, the right to received dividend. Under BOFIA, No bank shall pay dividend on its shares until all its preliminary expenses, organisational expenses, shares selling commission, brokerage, adequate provisions have been made to the satisfaction of the Bank for actual and contingent losses on risk assets, liabilities, off balance sheet commitments and such unearned incomes as are derivable there from; Or that the bank has complied with any capital ratio requirement as specified by the Central Bank of Nigeria.<sup>36</sup>

From the cited provisions of the above laws, it seem that they all provide for the protection of the investors generally without recognising the peculiarity of the bank investors.

## **3.1 Emerging Issues That Affect the Interest of the Banks' Investors in Nigeria**

There is no doubt that the above legal regime were meant to give adequate protection to investors generally. However, due to the nature of the banking system, these investors are subject to very stringent regulations and expose to more risk than all the investors in the other sector of the economy. As mentioned earlier, the current legal regimes protecting investors do not recognize the peculiar nature of this class of investors and level of risk they are exposed to, as a result of inter alia, governmental policies such as; the bailout on one hand and emerging issue of corporate governance such as; remunerations of Bank Executive on the other hand.

These two, out of many other issues (that is Bailout and Executive Remuneration) usually break the protective shell provided for the investors by the current legal regime. Compounding the vulnerability of the bank investors, one of the various governmental policies; such as bailout, that aim at rescuing the banking sector, do not take into cognisance the fact that, within the banking structure, the investors do not usually involve into the technical banking decisions that could lead to the bank failure, as that remains the prerogative of the Bank Executives, who enjoy the aforesaid practices. For example, in 2011, the Nigerian Government (through the CBN) cited some of these practices as the reason why it introduced a bailout policy that led to the nationalisation of three banks<sup>37</sup>; that is to say, the government took over the ownership and control of these banks out rightly<sup>38</sup>, without considering the fate of the innocents investors in such banks. The bank investors in this regard, were punished for the misconduct which was admitted to have been committed by the bank executives.

<sup>29</sup> Nigerian Investment and Security Commission , Section 1 of the Act

<sup>30</sup> Ibid at section 4

<sup>31</sup> Ibid at section 25

<sup>32</sup> Section 2 of the BOFIA

<sup>33</sup> Ibid at 21 (1) and (2)

<sup>34</sup> Ibid at section 8 (2)

<sup>35</sup> Section 81 CAMA

<sup>36</sup> Section 17 (1) BOFIA

<sup>37</sup> Afribank, Spring Bank and Bank PHB

<sup>38</sup> By establishing three bridge banks; Enterprise Bank, Mainstream Bank and Keystone Bank

The investors do not have any remedy within the existing legal regime. This is because, after the nationalisation of such banks, none of the existing statutory bodies, such as; Central bank of Nigeria<sup>39</sup> (CBN), Security and Exchange Commission (SEC), Nigerian Investment Promotion Council (NIPC) and the Corporate Affairs Commission (CAC) that are charged with responsibility of protecting the interest of the investors, made any move to rescue the innocent bank investors in that circumstance. The current legal regime does not provide any room for them to intervene and they even supported the action of the Bank Regulators. On these issues the Governor of Central Bank of Nigeria is reported to have said:

*“...the owners of the banks are depositors and creditors not the shareholders and bank CEOs who have been abusing me for taking their banks what they do not know is that if CBN had not intervened at all they would not have had anything to own.”*

In the circumstances, there is need to discuss both the Bailout and Executive Remuneration syndrome separately.

### **3.1.1 The Bank Bailout**

During the financial panic of 2008, governments around the world decided to use taxpayer funds to rescue their most important financial institutions rather than allow them to be liquidated at fire-sale prices. Policymakers have developed measures to make future failures less likely or severe. If failures nevertheless occur, however, regulators will want to resolve systemically important institutions (known as "Too Big to Fail") in a way that provides a credible alternative to taxpayer-funded bailouts. Bailout is an act of giving capital to an entity, be it, a company, a country or an individual, that is in danger of failing, in an attempt to prevent the eventual failure. In banking regulation, it refers to governmental policy that provides financial help to a bank or other financial institution that otherwise would be on the brink of collapse.<sup>40</sup> It can be in form of a direct transfer of capital, or it may indirectly occur through low or no interest loans and subsidies.<sup>41</sup>

In some of the developed countries like, USA, the implementation of the Government bailout policies were followed by populist outcries of never again. Because they viewed the bailouts as expensive, unjust, and unpopular, and they usually represent dramatic deviations from the rule of law. Sequel to such revolt against bailout policy by the Americans, the US government enacted two different legislations, that is; “Dodd Frank Act<sup>42</sup>” and “jumpstart Our Business Startups Act<sup>43</sup>” in order to cushion the impact of the bailout. For instance, SEC. 911 of the Dodd Frank Act established Investor Advisory Committee to inter alia advise and consult with the Securities and Exchange Commission on regulatory priorities of the Commission and initiatives to protect and promote investors’ confidence and interest.

In reaction to the enactment of these two legislation, many theories are being conversed in order to create a balance between maintenance of banking stability in banks, especially for the “Too Big to Fail” financial institutions on one hand and the resultant effect of preventing the failure of such banks; bailout.

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<sup>39</sup> The comment made by the Governor Central Bank of Nigeria on the fate of the banks investors is not encouraging – Sanusi L. Sanusi was quoted to have said that, “...the owners of the

<sup>40</sup> Definition found at [www.investors.com](http://www.investors.com) last visited 24/12/2012

<sup>41</sup> Guynn, R.D., (2012) Are Bailouts Inevitable, 29 Yale J. on Reg. 121 2012, Hein online

<sup>42</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act 2010 - To promote the financial stability of the United States by improving accountability and transparency in the financial system, to end “too big to fail”, to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes.

<sup>43</sup> Jumpstart Our Business Start-ups Act 2012 To increase American job creation and economic growth by improving access to the public capital markets for emerging growth companies.

Notable among the theories "Elective Shareholder Liability"<sup>44</sup> as corollary to this, Templin, B. A.<sup>45</sup> Opined that the Bailout initiatives to protect the private sector of the economy through the legal framework enshrined in the Emergency Economic Stabilization Act 2008, indicated the shift of developed countries like USA, from a predominantly neo-liberal model to one that embodies elements of state capitalism.

Unlike what is obtainable in other jurisdiction, like United States of America, where bailout is considered as a huge cost to tax payers, because government uses money from its account to bailout failing banks, under Nigerian style of bailout, the Central Bank of Nigeria (CBN), in exercising its power under section 32 and 42<sup>46</sup> of the CBN Act, has entered into an agreement with all the 24 banks in Nigeria to fund distressed banks in the future, such fund is called 'Banking Sector Resolution Cost Fund'<sup>47</sup> and is to be jointly financed by the CBN, the Asset Management Corporation<sup>48</sup> and all the 24 banks in Nigeria. Under the agreement, the CBN is to contribute N50 billion annually while, the each of the 24 banks in Nigeria to contribute 0.3% of the value of its total assets annually, for the period of ten years.

Despite all this adjustment of the bailout policy that introduction of the 'Banking Sector Resolution Cost Fund' seek to achieve, the investors still consider it as another way of tempering with their investment. The Banking Sector Resolution Cost Fund, requires that each bank must pay 0.3% of its total assets into the fund, they view this as an attempt to forcefully take away their investment without any return. They investors cited the reduction of dividend in bank as the result of such fund. From the CBN records, by the year ending First Bank and UBA paid N81 million and N5.9 billion respectively into the fund.<sup>49</sup> This policy is invariably going to erode the investment of bank investors and as well as expose them to more risk of losing their investment.

### 3.1.2 Bank Executive Remuneration

Corporate governance as one of the General Principle of Banking of Regulation<sup>50</sup> presupposes that the management team, as employees of banks are entitle to certain remuneration for their services, that "the Executive Remuneration". However, imposes an obligation on to disclose any interest they in respect of any transaction in which their interest conflict with that of the bank.<sup>51</sup> Since by the banking structure, they are the ones to decide what to take as remuneration.

Over the years, this remuneration has come under intense scrutiny around the world. Under the current legal regimes, the bank executives determine their own remunerations, and in the course of discharging their functions, the bank executives use to engage themselves in certain businesses that are not for the benefit of the investors, such type of business is called 'Propriety Trading'<sup>52</sup>.

<sup>44</sup> Conti-Brown, P (2012) Elective Shareholder Liability, 64 Stan. L. Rev. 409 2012 Hein online, Which allows bank shareholders two options; They must either change their bank's capital structure to include dramatically less debt, consistent with the consensus recommendation of leading economists; or alternatively, they must add a bailout exception to their bank's limited shareholder- liability status, thus requiring shareholders-not taxpayers-to cover the ultimate costs of the bank's failure. This liability would be structured as a governmental collection, similar to a tax assessment, for the recoupment of all bailout costs against the shareholders on a pro rata basis. It would also include an up-front stay on collections to ensure that there are, in fact, taxpayer losses to be recouped and to mitigate government incentives for over bailout, political manipulation, and crisis exacerbation.

<sup>45</sup> Templin, B.A. (2009) State Entrepreneurism, TJSJL Legal Studies Research Paper No. 1428108, July 2009

<sup>46</sup> Central Bank Act 2007

<sup>47</sup> Which is now a Bill before the National Assembly to amend section 46(2) and 61 of the Asset Management Corporation Act 2011, in order to establish a 'Banking Sector Resolution Cost Fund'

<sup>48</sup> A body establish under section 1 of the Assets Management Corporation Act 2010 for the purpose of resolving all non-performing Loan Assets of Banks in Nigeria, as spelt out under section, 5, 6, 24 and 25 of Act.

<sup>49</sup> Punch Newspaper, 9 June, 2012

<sup>50</sup> Supra Note 10

<sup>51</sup> See section 18 of the BOFIA

<sup>52</sup> Presently, there are heated debate as to the legality or otherwise of such type of trading, which to some of the developed countries like; US and UK tried to regulate, then to what extent this trading affect the interest of the investors and how the developing countries approach.



These two practices<sup>53</sup>; ‘executive remuneration’ and the ‘propriety trading’ are now raising serious Corporate Governance issues in the banking industry that directly affect the bank investors, as they are some of the factors identified to be the cause of the bank failures in the developing countries, due to lack of adequate legal regime regulating protecting the bank investors against the practices. This issue of Executive Remuneration raised a serious tension between the bank executives and the investors, which raised some legal questions which the current legal regime failed to address, such as; what aspect of the remuneration ought to be regulated? - Is it the salary, allowances or bonuses? And Why do we need to regulate the remuneration?

On the first question, is it the monthly salary, bonuses, short-term or long-term incentives? Conyon<sup>54</sup> noted that the problem with most of the executive remuneration is usually not with the overall pay level, but the composition mix with various elements<sup>55</sup>, therefore, it is confusing as to what aspect of the remuneration to regulate. One the second question, gauging the executives’ remuneration from the perspective of their performance, inter alia, then there is the need to regulate the remuneration.

This is because, the executive continue to receive the same generous pay packages (and in some cases, higher than before) even when prices are falling and investors are receiving little or no returns on their investments.<sup>56</sup>

It should be noted that, corporate governance in banks differs considerably from general corporate governance. For banks, the scope of corporate governance goes beyond the shareholders (equity governance) to include debt holders (debt governance).<sup>57</sup> From the perspective of bank supervision debt governance is the primary governance concern. Equity governance and debt governance face partly parallel and partly divergent interests of management, shareholders, debt holders, and regulators. Failures in the corporate governance of banks contributed to the financial crisis.<sup>58</sup>

More so, the current legal regime does not vest much power on the investors in terms of checking the activities of the bank executives. The legal regime places the responsibility for managing a company (bank inclusive) in the collective hands of members of the Board of Directors (not the investors). The said board does not run the company on a day – to – day basis; that is the role of the management team (the executive).<sup>59</sup>

#### 4.1 Bank Investors Protection and Global Financial Crisis

According to Sanusi<sup>60</sup> stated from 2002 to early 2007, the decline in volatility in the global economy and financial markets was reflected in lower measures of market risk, which encouraged firms to increase their risk-taking. However, in September 2008, the economic downturn particularly in the United States and a number of industrialized economies signaled the beginning of a recession triggered by the credit crunch that resulted from the crisis. It is clear, therefore, that when the global crisis eventually hit Nigeria, the banking sector was ill-equipped to weather the storm

In view of the fact that, the aforementioned corporate governance problems as well as the recurrent governmental policies in the banking sector, have not been envisaged by the existing general legal framework for protection of Investors, especially the need to enhance the protective measures that can be able to improve investors’ confidence in the banking system vis-a-vis the current financial crisis.

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<sup>53</sup> This paper restricts itself to executive remuneration only.

<sup>54</sup> Conyon, M. (2006) Executive Compensation and Incentives, Academy of Management Perspective, 25

<sup>55</sup> He cited an example of two executive directors from two different companies, their total annual pay is let say, N160 million, for one of them, 50% of this amount may be in the form of long-term equity plan, and another 20% from an annual bonus plan. In contrast, 90% of the other executive director’s remuneration package comprises of basic salary and other benefits. From this example, the two executives obviously have different remuneration

<sup>56</sup> In US under its Dodd Frank Act, Banks are required to disclosed to the SEC in detail the link between their executive remuneration and their performance

<sup>57</sup> E. Wymeersch, K. Hopt, G. Ferrarini, eds., (2012) *FINANCIAL REGULATION AND SUPERVISION - A POST CRISIS ANALYSIS*, (Oxford University Press) Forthcoming [ECGI - Law Working Paper No. 181/2011](#)

<sup>58</sup> Conyon, M. (2006) Executive Compensation and Incentives, Academy of Management Perspective, 25

<sup>59</sup> Section 63 (3) CAMA

<sup>60</sup> Sanusi, L.S. (2010) Global Financial Meltdown and the Reforms in the Nigerian Banking sector, paper a Public Lecture delivered at the Convocation Square, Abubakar Tafawa Balewa University, Bauchi - Nigeria, Friday, December 10, 2010

Beside, most of the healthiest banks in the developing countries have large presence of foreign investors especially from the developed countries, which immensely augment the capital based of such banks. Therefore, with these problems of corporate governance and the governmental policies in the era of Global financial crisis, the foreign banks' investors may tend to withdraw their investment and reinvest same in their respective countries, thereby, exposing the local investors and the whole banking system of the developing countries into a serious danger of collapsing<sup>61</sup>. On this issue, Sornarajah, M.<sup>62</sup> examined the protection of foreign investment and the problems associated with such protection and explores treaty-based methods, and examines several bilateral and regional investment treaties. Moloney N.<sup>63</sup> on the other hand, He explores why the retail investor should be protected, whether retail investor engagement with the markets should be encouraged and how investor protection laws should be designed, particularly in light of the financial crisis.

The United Nations report<sup>64</sup> on Global Financial Crisis indicates that Nigeria is seriously impacted, the stock market has witnessed sharp decline since March 2008, with Nigeria All Share Index losing more than 60 percent of its value.

The correction (from very high price/earnings ratios) was triggered inter alia by foreign investor withdrawal, and led to margin calls and increases in required collateral, precipitating further declines. The decline in the Nigerian stock market is of particular concern to banks in Nigeria, as it will lead to increases in non-performing loans, as banks have undertaken lending for stock purchases and raises the cost of issuing new capital.<sup>3</sup> At the same time the Naira exchange rate has depreciated by 20 percent from its level in July 2008 reflecting the drop in oil revenues. In the same vein, Muhammed, S.<sup>65</sup> and Seeta, P.<sup>66</sup> Also examined the impact of the Global Financial Crisis on Developing countries with particular reference to South Africa and India respectively and revealed similar position to that of Nigeria

Therefore, the legal regime in Nigeria must be seen to have adequately protect the bank investors, as the absence of the strong investors protection mechanism in developing countries<sup>67</sup>, especially Nigeria, could serious undermine the development in the banking sector of the economy. Hence, most of the reforms introduced in order to have sound and vibrant banking industry will be jeopardise.

## 5.1 Conclusion

In the light of the above analysis, it is glaring that our current legal regime does not consider the peculiar nature of the bank investors, let alone addressing all the issues that hinder his protection. These problems could scare away not only the local investors, but even their foreign counterpart. This lack of adequate protection of bank investors could seriously affects the banking environment. More so, the impact global financial crisis on developing countries has been more wide-spread than what one would expect based on the level of globalisation of these economies. This is because, most of the foreign investors in the developing countries tend to withdraw their investment (especially in the banking sector) and take it back to their respective countries that are now in need of such investment.<sup>68</sup> This attitude of withdrawal phenomenon could be seen from the attitude of foreign banks in terms of lending to their subsidiaries in the developing countries during the financial crisis.<sup>69</sup> Such withdrawal (which could be triggered by the lack of adequate legal protection of the banking investors) could among other thing exposes the banking sector to the risk of being collapsed.

<sup>61</sup> The Impact of the Global Financial Crisis on Financial Markets in Sub-Saharan Africa, April, 2009 *Finance & Private Sector Development Africa Region, The World Bank*

<sup>62</sup> M. Sornarajah, (2004) *The International Law on Foreign Investment*, National University of Singapore

<sup>63</sup> Moloney N., (2010) *How to Protect Investors: Lessons from the EC and the UK*, Cambridge University Press,

<sup>64</sup> The Impact of the Global Financial Crisis on Financial Markets in Sub-Saharan Africa: *Highlights of selected countries cases* Finance & Private Sector Development Africa Region, The World Bank April, 2009

<sup>65</sup> Muhammed, S. (2009) *The Impact of the Global Economic Crisis on the South African Economy, paper presented at UNRISD conference on Social and Political Dimensions of the Global Crisis: Implications for Developing Countries, Geneva*

<sup>66</sup> Seeta, P. (2009) *Restructuring Development during Global Financial Crisis: Lessons from India being a paper presented at UNRISD conference on Social and Political Dimensions of the Global Crisis: Implications for Developing Countries, Geneva*

<sup>67</sup> Mugabe, J (2005) *Governing Foreign Direct Investment in Sub-Sahara Africa: Policies and Practices Reconsidered in* Lyuba, Z (ed) *International Investment for Sustainable Development: Balancing Rights and Rewards.*

<sup>68</sup> Claessens et al (2012), *Foreign Bank: Trends, Impact and Financial Stability* IMF Working paper 12/10

<sup>69</sup> De Haas et al (2011) *Running for the Exist: International Bank and Crisis Transmission*, DBN Working paper, No. 279

The twin problems addressed by this paper; bailout and executive remuneration are seriously undermining the protection of the bank investor. More so the issue of remuneration, being one of the corporate governance issues that affect the interest of the investors, and ultimately lead to bailout. Therefore, the proper alternative to bailout is the adjustment of the executive power to pay themselves remuneration out of the bank's fund. The legal framework need to be changed so that the executive will see themselves as ordinary employee of the bank rather than the present position, where they consider themselves as owners of the bank to the detriment of the investors. It is that notion that makes them to engage into some sharp practices that adversely affect the interest of the bank investors.

### **6.1 Recommendations**

- The need to consider the link between the executive pay and their performance in deciding the amount payable
- to empower investor and better align the composition of the board to the interests of all the owners of the corporation
- the investors, especially bank investor should utilise the available provision of CAMA to exercise an oversight function over the board of directors.
- There is need for legal regime akin to the US Dodd- Frank Wall Street Consumer Protection Act, which address all the issues highlighted above for the United States banking sector, more particularly the bank investors' protection.