



# BOFIA 2020: Impact on the Financial Services Industry

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KPMG Nigeria

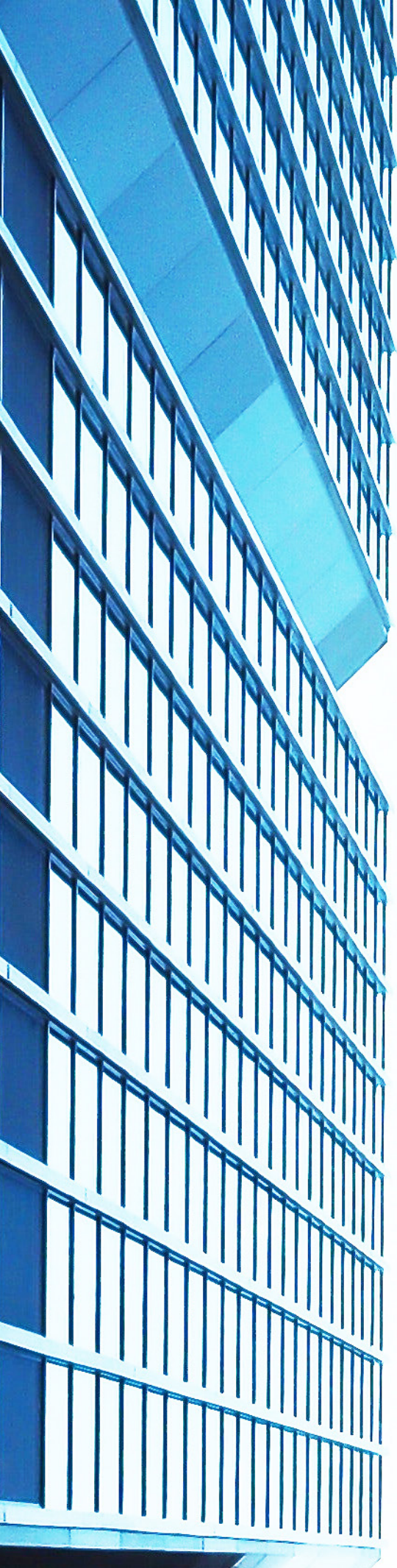
**His Excellency, President Muhammadu Buhari GCFR, on 13 November 2020 signed the amended *Banks and Other Financial Institutions Act, 2020* (“BOFIA 2020” or “the Act”) into law. The Act repeals the erstwhile BOFIA 2004 which was originally enacted in 1991 and amended in 1997, 1998, 1999 and 2002. According to a statement from the Presidency, BOFIA 2020 will strengthen the “...regulatory and supervisory framework for the financial industry”.**

The Act covers more ground than its 2004 predecessor with an expansion of the Central Bank of Nigeria (CBN)’s regulatory oversight and discretionary powers over the financial services industry. Other significant changes introduced by the Act include measures for managing failing banks and a new tribunal for the enforcement and recovery of bad bank loans. Overall, BOFIA 2020 seeks to promote a stronger, more transparent and efficient financial system in Nigeria.

The Act has 132 sections which are classified into parts under Chapters A – E as outlined below:

- Chapter A has six parts which deal with operations of commercial banks including licensing and operations, duties of banks, books and records of account, failing banks and rescue tools, general, supplemental and miscellaneous matters;
- Chapter B has a single part which enumerates licensing and compliance requirements for the establishment of specialized banks and other financial institutions;
- Chapter C also has only one part which highlights other regulatory powers of the CBN;
- Chapter D has two parts which contain several tools for resolution of issues including the introduction of a Resolution Fund and other resolution tools; and
- Chapter E establishes the Special Tribunal for the enforcement and recovery of eligible loans.

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We have summarised the key modifications introduced by the Act into broad connected areas of interest, as follows:

## 1. Banking Operations

The highlighted changes in this section were drawn from Chapters A and C of BOFIA 2020.

### **1.1. Removal of Requirement to Consult with Minister of Finance in Granting New Banking Licences**

Section 3(3) of BOFIA 2020 now empowers the CBN Governor to grant new banking licences with the approval of the CBN's Board of Directors which is chaired by the CBN Governor. This provision replaces the requirement for the Minister of Finance ('MoF') to approve new banking licences under BOFIA 2004.

The removal of the MoF's approval further reinforces the autonomy of the CBN and should speed up the licence application process by eliminating the additional layer of approval by the MoF.

### **1.2. Prohibition of Certain Foreign Banks/Entities from Operating in Nigeria**

Section 3(5) of the Act prohibits foreign banks and other entities *from operating in Nigeria*, if they do not have physical presence or a licence to operate in their country of incorporation and are not affiliated to any financial services group that is subject to effective consolidated supervision. It also precludes Nigerian banks from transacting with such foreign banks and entities. The effect of this new directive is that interaction of Nigerian banks with foreign financial technology companies ('FinTechs') and other online and digital banks which provide disruptive banking solutions and services may become limited.

Although this measure is aimed at preserving the integrity of the financial system, it may be counter-productive as it could potentially exclude Nigerian banks from effectively participating in this emerging disruptive space. This is because these FinTechs may deploy technology solutions that can by-pass the banks and traditional banking system and provide services directly to customers. Therefore, the CBN may consider an alternative measure that ensures that the activities of foreign FinTechs in Nigeria are adequately monitored and regulated. For instance, the CBN has an existing framework that regulates the licensing and operations of local FinTechs and, with the advent of Open Banking Regulatory Framework, a more pragmatic solution should be to modify the existing framework to include foreign FinTechs that provide digital solutions to Nigerian customers rather than an outright restriction.

It is hoped that the CBN will revisit this regulatory restriction, carefully re-evaluate its potential risks and, thereafter, develop a more robust framework that addresses the operations of foreign FinTechs in Nigeria, rather than preclude them.

### **1.3. Banks' Restructuring and Divestment from Subsidiaries**

Section 6(3) provides that the CBN may direct banks to divest from their subsidiaries in order to minimize the risks which may jeopardize the financial stability of such banks.

Further, Section 7 of the Act reiterates the obligation of banks to obtain the CBN's prior consent before embarking on any type of structural or strategic change, and/ or divestment including change in control; transfer of significant shareholding in the bank; sale, disposal or transfer of the whole or any part of the business of the bank; amalgamation or merger with other person, restructuring, reconstruction or re-organisation of the bank; and transfer of the whole or any part of the bank to any agent. Failure to obtain the consent of the CBN will result in penalties, upon conviction, and such transactions will be rendered void and ineffectual unless subsequently ratified by the CBN.



#### **1.4. Revocation of Banking Licences and Related Matters**

Section 12 of BOFIA 2020 introduces additional circumstances under which banking licences may be revoked, and significantly expands the CBN's discretion in exercising such powers. Also, the Act prohibits the Federal High Court (FHC) from restoring any bank's licence where the CBN has revoked such licence. However, an aggrieved party can only be granted monetary compensation, which would not be more than the value of paid-up capital held in the bank.

The expanded circumstances for licence revocation should safeguard the system by curbing any reckless tendency by any bank and ensure stability of the Nigerian financial institutions. However, the cap placed on reliefs which the FHC may grant to aggrieved parties when there is a licence revocation may be viewed negatively by the court itself. Generally, courts do not take kindly to provisions which seek to restrict their judicial powers. Consequently, the FHC may ignore the limitation and grant other reliefs by relying on its general powers under the Constitution.

Relatedly, where foreign investors are involved, the cap on monetary compensation payable to parties could potentially contradict the sovereign guarantee provided by the Federal Government to foreign investors in Section 25 of the Nigerian Investment Promotion Commission Act (NIPC Act). This may need to be revisited so as not to discourage foreign direct investment in Nigeria's financial services sector.

#### **1.5. Minimum Capital Ratio**

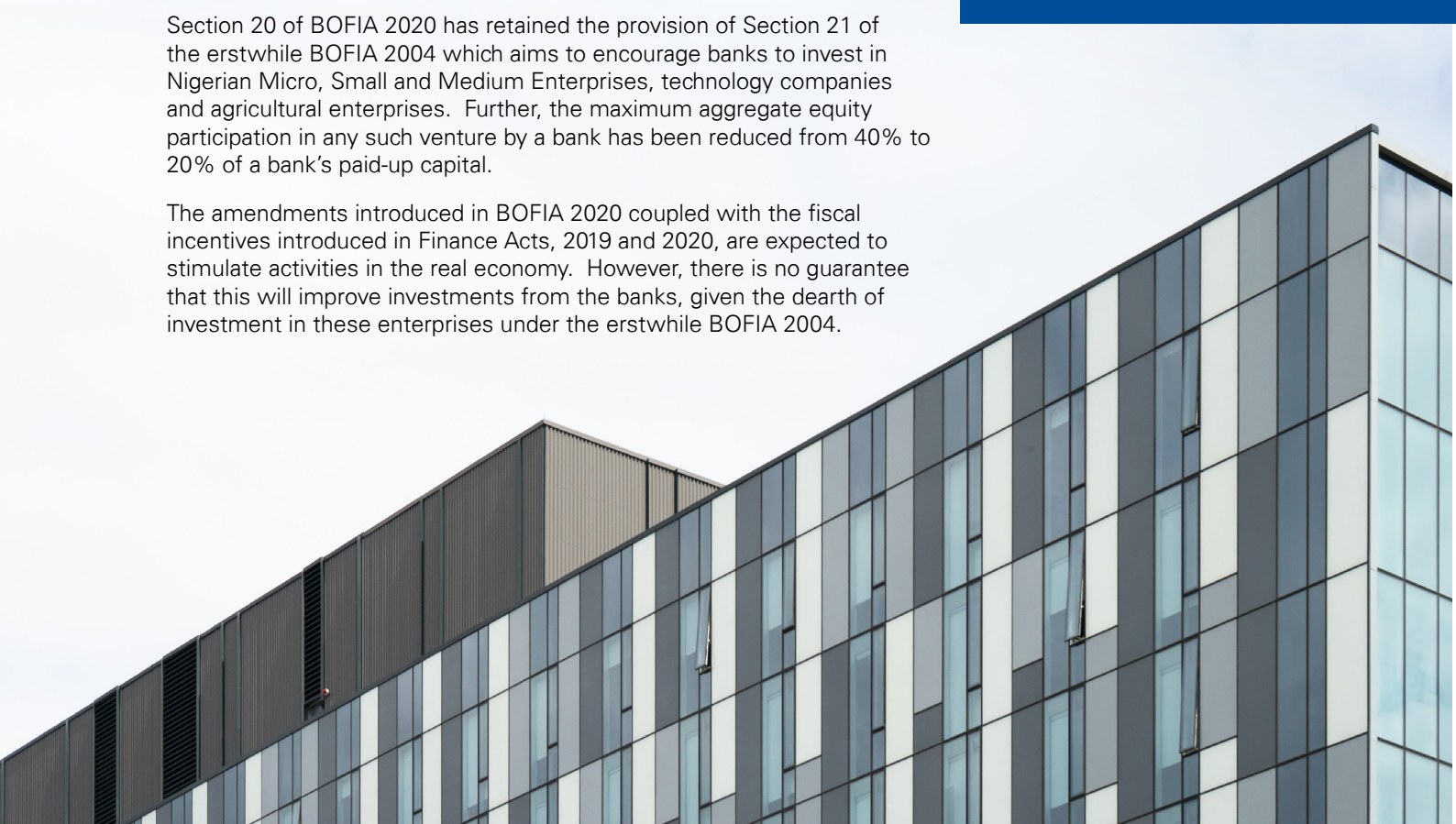
Section 13 of the Act provides that the CBN may prescribe a different Minimum Capital Ratio (MCR) for any category of banks and require such banks to maintain additional capital in order to mitigate risk peculiar to them. Also, the CBN's power to sanction erring banks for inadequate MCR has been extended to include banning its directors from receiving bonuses and imposing any other measure as the CBN deems fit. The CBN's power to prescribe specific MCRs for different banks/categories of banks will go a long way to preserve the stability of the Nigerian financial system and improve the effectiveness of CBN's oversight.

#### **1.6. Investment in Medium, Small and Micro Enterprises**

Section 20 of BOFIA 2020 has retained the provision of Section 21 of the erstwhile BOFIA 2004 which aims to encourage banks to invest in Nigerian Micro, Small and Medium Enterprises, technology companies and agricultural enterprises. Further, the maximum aggregate equity participation in any such venture by a bank has been reduced from 40% to 20% of a bank's paid-up capital.

The amendments introduced in BOFIA 2020 coupled with the fiscal incentives introduced in Finance Acts, 2019 and 2020, are expected to stimulate activities in the real economy. However, there is no guarantee that this will improve investments from the banks, given the dearth of investment in these enterprises under the erstwhile BOFIA 2004.

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### **1.7. Management Staff and Personal Liability for all Banking Officers**

Under Section 48 of the erstwhile BOFIA 2004, banks were only required to obtain the CBN's approval prior to appointing a chief executive officer or members of the Board of Directors. However, Section 47 of BOFIA 2020 has now expanded this requirement to include the appointment of management staff of banks, thereby codifying into law the CBN's 2015 Circular on the issue - *"Revised Assessment Criteria for Approved Persons' Regime for Financial Institutions"*.

This is a welcome development given the role that such senior staff play in the banks, and in the overall financial system. However, the CBN should be sensitive to the fact that the relationships of management staff with the banks are contractual *employer-employee* arrangements. Therefore, the rights of banks to employ management staff who have passed through their selection process should not be unduly constrained except on ethical grounds that due diligence by the banks did not expose.

Further, personal liability for official actions have been extended to all officers of a bank instead of just the directors and managers. This amendment should curb the reckless actions by bank staff and promote integrity and professionalism in the industry.

### **1.8. Dormant Bank Accounts**

Section 72 of BOFIA 2020 provides that account balances in banks which have not been operated for a year or period specified by CBN should be transferred to a special register in a bank. Where such funds remain unclaimed after 10 years, they are to be transferred to the CBN. However, the banks are required to try to notify the account holder by various means, including placing an advert in two national newspapers, before transferring the funds to the CBN.

Interestingly, the duration stipulated in BOFIA 2020 differs from that of a similar provision introduced by Finance Act, 2020 establishing the Unclaimed Funds Trust Fund ('the Trust Fund') which will be supervised by the Debt Management Office (DMO) and governed by a Council co-headed by the MoF and a private sector co-chair. Under Finance Act, 2020, dormant funds are to be transferred to the Trust Fund after 6 years. Given that Finance Act, 2020 was enacted after BOFIA 2020, it may be safe to assume that the *"later in time"* rule would apply and, consequently, dormant funds would be transferred to the Trust Fund, after 6 years of dormancy as provided in Finance Act, 2020. However, it is important to explicitly resolve the discrepancies between the two laws to avoid confusion as banks are obliged to comply with BOFIA, being the primary law regulating their industry.

In summary, the new amendments introduced in BOFIA 2020 have expanded the CBN's discretion and consolidated its supervisory role over the banking operations of players in the financial system from what obtained under BOFIA 2004. These changes should, therefore, strengthen the financial services industry and promote transparency and integrity in the industry.

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## 2. Rescue of Failing Banks

Chapters A and C of BOFIA 2020 have significantly expanded the powers and tools available to the CBN to prevent banks from failing. Specifically, when a bank is distressed, the CBN may:

- Suspend its payment or delivery obligations;
- Require its third-party service providers to continue providing services to such bank for a period that the CBN may stipulate;
- Transfer the bank or any part of it to private third-party buyer;
- Issue a bail-in-certificate to cancel, modify, convert or change the form of any eligible instrument issued by the failing bank;
- Suspend the right of the counterparty to a failing bank to terminate a contract ordinarily determinable due to the bank's insolvency;
- Transfer the distressed bank's viable assets to a private asset management vehicle ("good bank") to maximize the value of such assets in an eventual sale or measured winding up; and
- Employ any other intervention tool that the CBN deems fit.

Also, BOFIA 2020 recognizes that some banks are more important to the stability of the Nigerian financial system and empowers the CBN to designate such banks if they meet its prescribed criteria. Consequently, the CBN may direct such designated banks to comply with additional regulatory obligations which it deems necessary to sustain their status. This validates the *"Framework for Regulation and Supervision of Domestic Systematically Important Banks"* issued by the CBN and Nigeria Deposit Insurance Corporation (NDIC) in 2014.

Further, Section 36 of BOFIA 2004, which requires the CBN to turn over control of a distressed bank to the NDIC has now been deleted, thereby recognising the CBN as the appropriate regulator to resolve the issues of distressed banks. The Act also empowers the CBN to solicit the assistance and cooperation of other government parastatals to avert a potential systemic crisis.

Clearly, BOFIA 2020 prioritizes the prevention of banks from getting distressed, over rescuing them, which is very commendable. The expansion of the CBN's powers and the creation of some of the new tools introduced by the Act should help to prevent bank failures and other systemic issues. However, it is doubtful if the CBN can realistically enforce some of the listed measures. For instance, it may be unrealistic to compel third party service providers to continue rendering services to an illiquid bank. Such arrangements are contractual and the CBN may have to offer affected vendors some guarantee of receiving payment for their services. Another tool available to the CBN is the option to transfer a bank or any part of it to private third party buyers (which expressly contradicts the constitutional prohibitions against expropriation of private property), and to employ any other intervention method the CBN deems fit. While these are far-reaching measures, it is expected that the CBN will judiciously exercise its powers to sustain investors' confidence in our financial system regulation.

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### 3. Enforceability of Netting Arrangements

Section 54 of BOFIA 2020 recognizes the legal enforceability of netting arrangements by banks, and limits to the powers of liquidators to unravel such transactions. Prior to BOFIA 2020, there was no Act which clearly recognized the enforceability of netting transactions in Nigeria’s national payment system. Rather, the legal rules on netting relied on the CBN’s generic payment system oversight powers pursuant to the CBN Act. Due to this, there had been some payment system risk because of the absence of clear statutory provisions on netting arrangements and other payment concepts. The recently enacted Companies’ Allied Matters Act, 2020 also included provisions on netting arrangements to mitigate credit and settlement risks.

This amendment ensures that netting arrangements have a clear basis in the law and gives legal certainty to parties to such transactions. Also, the amendment would strengthen the payment system and protect it from settlement risk. Currently, Nigeria does not have a dedicated payment system law, and this is a gap that needs to be addressed. However, the amendment stipulated under section 54 of the BOFIA, in addition to CBN’s generic power to oversee the payment system pursuant to the CBN Act, should act as effective stop-gap measure in the meantime.

### 4. Specialized Banking and Other Financial Service Providers

Section 57 of BOFIA 2020 now recognizes the CBN as a regulator of all entities providing financial services in Nigeria. The section also lists the types of entities overseen by the CBN and leaves the list open-ended to ensure flexibility. Some of the specified financial service institutions include discount houses, bureaux de change, credit bureaux, finance companies or money brokerage firms, international money transfer service firms, mortgage refinance companies, mortgage guarantee companies, credit guarantee firms, financial holding companies or payment services providers. Further, the section provides that the CBN would oversee any company whose objects in its Memorandum of Association include equipment leasing, factoring, project financing, debt administration, investment management, private ledger services, export finance, and any other company that the CBN may designate in future.

The institutions outlined above are required to be licensed by the CBN, even if their activities are carried out only digitally, virtually or electronically. Also, BOFIA 2020 gives unlicensed existing businesses three months to obtain a licence from the CBN. This clear listing of the firms under the CBN’s regulatory oversight is a marked improvement over BOFIA 2004, where the wider description of “*other financial institutions*” seemed to have been hidden away in its interpretation section. With this amendment, the entire value chain in the financial services industry may now be construed to be under the regulatory supervision of the CBN.

However, a concern may be the issue of over-regulation of some of the other financial service providers, such as the FinTechs. Currently, the CBN regulates FinTechs that undertake payments and other financial services, while the Security Exchange Commission (SEC)’s FinTech and Innovation Office (FINO) seeks to regulate FinTechs at large. Given the collaborative and dynamic working relationship between the CBN and SEC, the two regulators should jointly determine which of them would be best to exercise primary oversight over any class of firms, and to cede ground to the other where necessary. This is important to ensure that the administrative costs and regulatory compliance burdens of these companies do not increase so much as to stunt their growth.





## 5. Competition Issues

Competition and anti-trust issues are relatively new to Nigeria's regulatory landscape and BOFIA 2004 did not address such matters. However, Chapter C of BOFIA 2020 has corrected this by addressing some of the following competition issues:

### 5.1 Suspension of the Federal Competition and Consumer Protection Act (FCCPA)

Section 65 of the Act removes products and services in the financial services sector from the purview of anti-trust rules set in the FCCPA. This means that the Federal Competition and Consumer Protection Commission (FCCPC), going forward, will no longer oversee any function, act, financial products and services provided by banks and other entities licensed by the CBN.

Interestingly, BOFIA 2020 provides that mergers and acquisitions and any other forms of business re-organizations by banks and other organizations regulated by the CBN, are to be conducted in accordance with the FCCPA. However, it is the CBN that is to exercise regulatory oversight over the process, instead of the FCCPC. This ensures that the CBN has total oversight over banks and their operations.

### 5.2 Provision for Other Merger Procedures

In addition to its supervisory role, the CBN may provide additional guidelines on business combinations within the financial services sector.

The change introduced by BOFIA 2020 that the CBN should have total oversight over business re-organization and competition issues in the financial services sector is commendable. However, the suspension of anti-trust rules on financial products and services may influence the wider Nigerian economy. Competition rules were put in place to remove monopolistic tendencies which are harmful to consumers and, ultimately, the Nigerian economy. It is the FCCPC that has the specialized skills required to oversee competition issues, mergers and other such transactions. Thus, the CBN is encouraged to lean on the FCCPC's expertise in preventing and curtailing anti-competitive tendencies in the financial services sector.

## 6. Establishment of Resolution Fund

Section 74 of BOFIA 2020 introduced the Banking Sector Resolution Fund ('the Fund'). This will provide liquidity to the CBN's resolution measures by providing overdrafts or credit facilities and funding bridge banks, among others. The Fund is to complement Asset Management Corporation of Nigeria (AMCON)'s activities, but it is not intended to replace AMCON. The Fund is to be domiciled with the CBN and managed by a Board of Trustees. The Governor of the CBN, with the approval of the CBN's Board, is to determine the commencement date of the Fund.

The contributors to the Fund are the CBN, NDIC, the banks and other financial institutions. Initial commitments of ₦10 billion and ₦4 billion, respectively, are expected from the CBN and the NDIC. Annually, the banks and other financial entities are to be surcharged with a levy payable by 30 April of each subsequent year which are tax deductible. Any bank or entity which fails to make its contribution to the Fund would be prohibited from paying out dividends to its shareholders or bonuses to its employees.



The introduction of the Fund and its corporate governance measures are commendable. Also, the Fund will provide the CBN with another tool to resolve issues of any distressed bank. The funding arrangements should also reduce taxpayers' cost in rescuing ailing banks over the long run. However, the annual contributions required from the banks and other entities will increase their cost of doing business, strain their resources and cash flows, and increase their administrative compliance burdens. This point is important as banks are already levied to the Banking Sector Resolution Cost Fund, pursuant to the AMCON Amendment Act 2015 ('AMCON Fund'). The AMCON Fund was due to lapse in 2020, but it is liable to be extended by the National Assembly for another 5 years. Given the similarity of the names, it appears that BOFIA 2020 has come to give more permanence to the previously tenured AMCON Fund.

A consolation to the banks may be that the higher costs is a collective pain necessary to preserve the integrity of the system, which would protect them and the larger public over the long term.

## 7. Special Tribunal for Enforcement and Recovery of Loans

Chapter E of BOFIA 2020 establishes a special tribunal ('the Tribunal') to serve as an arbiter for the enforcement and recovery of loans. This is an innovation that was not in the erstwhile BOFIA 2004. The Tribunal will consist of eleven (11) legal practitioners who are to be appointed by the President. The members of the Tribunal are to be assisted in their adjudication by a Panel of Experts, with experience in banking, credit or capital market matters.

The Tribunal will have Divisions across the country, and a single member of the Tribunal may preside over its proceedings. Interestingly, the income of the members of the Tribunal and the administrative staff are to be benchmarked against those applicable at the FHC. Appeals against decisions of the Tribunal are to be made to the Court of Appeal, and thereafter to the Supreme Court.

The introduction of the Tribunal is a welcome development, because the Tribunal will complement other recovery protocols presently in place and enhance speedy resolution of banking debt claims. This will complement the effectiveness of the recent Global Standard Instruction Guidelines issued by the CBN to facilitate proactive repayment culture and reduce the worrisome cases of non-performing loans within the system.

Nonetheless, there may be legal issues regarding the activities of the Tribunal given the powers vested in it by the BOFIA 2020. There is a risk that the Tribunal may be construed as a court, rather than an administrative adjudication set-up to resolve debt recovery issues. Further, the FHC has authority to resolve banking issues under the 1999 Constitution.

Therefore, the Tribunal may be deemed as an unconstitutional mechanism which may impact the effectiveness of its decisions. Taking a view that the Tribunal is not a court and it does not oversee banking matters, should make it safe from any constitutional breach.

Another practical issue is that case fees at the Tribunal are pegged at 0.5% of claims. The flat rate, irrespective of the size of the claims, may discourage litigants from approaching the Tribunal. In contrast, other adjudicatory bodies, such as the FHC, State High Courts, National Industrial Court and others, adopt rates based on a graduating scale. It is hoped that the President of the Tribunal would adopt this approach in the Rules which they are empowered to publish, to ensure effective discharge of the Tribunal's mandate. This will in no small way reduce the risk of bad loans to banks and assist financial institutions to have a more seamless recovery procedure on defaulting loans.



## Conclusion

BOFIA 2020 re-enactment should strengthen the Nigerian financial system by making new regulatory tools available to the CBN and significantly expanding the discretionary powers of the CBN and its Governor. However, this may be a double-edged sword.

The Act seems to have addressed the existing legal gaps in Nigeria's payment system law by providing for the enforceability of netting arrangements in the industry. This amendment, along with the CBN's existing payments oversight powers granted under the CBN Act, should act as effective stop-gaps pending the enactment of the Payment System Act by the National Assembly.

Further, BOFIA 2020 has significantly revised the penalties applicable for breaching its provisions upwards, typically by 1000%. Banks and other financial institutions should do well to avoid incurring such fines as Finance Act, 2020 specifically disallows the deductibility of any fine prescribed in any statute of the National Assembly or State House of Assembly in their tax returns.

Notwithstanding the positive changes noted, the Act has some contentious provisions, such as the wider discretionary powers of the CBN and its Governor; immunity clause from legal proceedings against the CBN and its agents; restriction of interactions with foreign FinTechs; cost of filings at the Tribunal, amongst others. It is hoped that the CBN would continue to exercise the restraint it has been noted for, in enforcing the wide-ranging powers it has been granted under BOFIA 2020.



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