CODE OF CORPORATE GOVERNANCE FOR MICROFINANCE BANKS IN NIGERIA

The Central Bank of Nigeria ("CBN") in October 2018 introduced a new Code of Corporate Governance (the "Code") which applies to all licensed Microfinance Banks ("MFBs") in Nigeria. The Code covers issues ranging from the board to shareholders and stakeholders of MFBs.

The objectives of the Code are to define minimum acceptable corporate governance standards for all licensed MFBs in Nigeria, promote high ethical standards among operators, and enhance public confidence in MFBs in Nigeria.

Salient Provisions of the Code

A summary of certain considered provisions of the Code which are the focus of this paper are reproduced below:[1]

Enforcement and Timeline

The Code takes effect from December 1, 2018 while the full implementation of the Code is to become effective from April 1, 2019. On this note, MFBs are generally advised to commence compliance procedures as soon as possible. The Code imposes strict sanctions and penalties for non-compliance.

Board of Directors and Management of MFBs[2]

The Code imposes important responsibilities on the board of MFBs and essentially holds the board accountable for the general affairs and performance of the MFB. Specifically, members of the board are severally and jointly liable for the activities of the MFB.

Whilst the Code empowers the board to act in the interest of the shareholders and other stakeholders towards the attainment of set goals of the MFB, the board is required to ensure strict adherence to the Code of Conduct for Directors of Banks and Other Financial Institutions in Nigeria. Interestingly, the Code also makes mandatory provisions in relation to the composition and size of the board, rights of stakeholders and risk management, amongst others.

Composition and Size of the Board[3]

The Code provides that members of the board shall be persons of proven integrity and are to meet the requirements of the Revised Assessment Criteria for Approved Persons' Regime for financial institutions. In addition, at least two (2) members of the board of directors other than the executive directors are required to have banking or related financial industry experience.

The composition and size of the board is a critical requirement for MFBs in the Code. This is because the board of directors is considered the highest decision-making body of any bank or corporate entity in Nigeria. As mentioned earlier, members of the board are accountable for the activities of the MFB, thus it behoves the board members and the management of an MFB in general to ensure that the Code is adhered to.

Pursuant to the Code, the minimum and maximum number of directors on the boards of MFBs shall be five (5) and seven (7) for Unit MFBs respectively; five (5) and nine (9) for State MFBs respectively; and seven (7) and twelve (12) for National MFBs, respectively. Additionally, every Unit MFB is to ensure that the MD/CEO is the only executive director of the bank. The Code further provides that the board is to consist of executive and non-executive directors. The number of non-executive directors shall be more than that of executive directors.

1 The provisions of the Code highlighted in this paper are not exhaustive.

2 Section 2.1 of the Code details the responsibilities of the Board of MFBs.

3 Section 2.2 of the Code.

4 Section 2.3 of the Code.

5 Section 2.4 of the Code

6 Section 2.5 of the Code

7 Section 3.2.1 of the Code

8 Section 5.0 of the Code.

9 Section 8.1 of the Code.

The board of MFBs is to consist of a minimum of one (1) Independent Non-Executive Director ("INED") for Unit MFBs and State MFBs and two (2) for National MFBs. On the other hand, a State MFB with a board size of more than Seven (7) members is required to have a minimum of two (2) INEDs.

In the interest of curtailing insider trading, abuse of powers and conflict of interest, it is instructive to note that non-executive directors appointed to the board of MFBs are not to be existing employees of any bank or other financial institutions. However, such a proposed director may be appointed to the board of the bank where the MFB is promoted by the bank or other financial institution and the proposed director is representing the interest of such an institution.

Separation of Powers[4]

The positions of the board chairman and the MD/CEO are to be separate and should not run concurrently. No executive vice chairman is to be allowed in the board structure. Not more than two members of a family (inclusive of extended relatives) shall be on the board of an MFB at the same time.

The Code provides that not more than two family members are allowed to serve on the boards of a MFB and its holding company, where the MFB is a member of such holding company. Also, no two members of a family are to occupy the positions of chairman and MD/CEO or executive director of the MFB and chairman or MD/CEO of an MFB's subsidiary at the same time.

Appointment and Tenure[5]

Members of the board are to be appointed by the shareholders and approved by the CBN. Such appointment is to be in accordance with extant regulations issued by the CBN from time to time. Non-executive directors of MFBs are to serve for a maximum of three (3) terms of four (4) years each. For an Independent Director, there is the requirement for a 4-year single term and a maximum of eight (8) years of two consecutive terms if re-elected upon the expiration of the first term.

The tenure of the MD/CEO of the MFB shall be in accordance with the terms of engagement subject to a maximum period of ten (10) years. Such tenure is to be broken down into periods not exceeding five (5) years at a time. Any person who has served as MD/CEO for the maximum tenure (of ten years) in an MFB will not qualify for appointment in any capacity in the same MFB or its subsidiaries until after a period of three (3) years after the expiration of his tenure as MD/CEO.

Board Committees[6]

The board shall at the minimum, establish the following Committees:

i) Risk Management Committee;

ii) Audit Committee;

iii) Board Governance and Nominations Committee; and

iv) Board Credit Committee.

To effectively perform its oversight functions and monitor management's performance, the board and each of the board committees is to meet at least once every quarter.
Every director is required to attend all meetings of the board, and board committees in which he is a member. In order to qualify for re-election, a director must have attended at least two-thirds of all board and board committee meetings in each financial year.

The board/board committee meetings will be deemed to be duly constituted where two-thirds of members are present, provided that a majority of directors at the meeting are non-executive directors' (NEDs).

Equity Ownership[7]

Except where prior approval of the CBN is granted, individuals, group of individuals, their proxies or corporate entities and/or their subsidiaries are not permitted to own controlling interest in more than one (1) MFB under the Code. In order to discourage government from having majority shareholding in MFBs, government direct and indirect equity holding in any MFB is required to be divested to private investors within a maximum period of five (5) years from the date of investment and limited to 10%. For existing investment above five years, the MFB is required to comply with this provision within two (2) years from the commencement of this Code.

Transparency[8]

MFBs are encouraged to make timely, accurate and robust disclosures beyond the statutory requirements stipulated under other applicable laws, regulations and standards. The management of MFBs are directed under the Code, to follow laid down standards in annual financial reports. Specifically, MFBs are required to have a structure which independently verifies and safeguards the integrity of their financial reporting at all times.

Compliance[9]

All MFBs are mandated to comply with the provisions of the Code. All external auditors of MFBs are required to submit a report to the CBN annually, taking into consideration, the extent of the MFB's compliance with the provisions of the Code. Returns on the status of each institution's compliance with the code is to be rendered to the CBN semi-annually (30th June and 31st December every year) or as may be specified by the CBN from time to time. The returns are to be addressed and submitted to the director, other financial institutions supervision department not later than 2 weeks after the end of the relevant reporting period.

Issues Arising

As mentioned earlier, the Code prohibits the appointment of a non-executive director who is an existing employee of a bank or other financial institution to the board of an MFB, except where the MFB is promoted by the bank or other financial institution and the proposed director is representing the interest of such an institution. On the face of it, the above provision of the Code begs the question as to whether the prohibition placed on the appointment of non-executive directors in this context does not contradict the Code itself, which also provides that at least two (2) members of the board of directors other than the executive directors are required to have banking or related financial industry experience.

The pertinent question that then arises is, how does one identify a director with the required banking and/or financial experience if such a proposed director is not an employee or member of management of another bank or related financial institution. What identifies as experience for a proposed director who is no longer in the active practice of banking and/or a related field within the financial industry? The above restriction could also have the effect of pressurizing proposed directors to resign from their current positions of employment or in the alternative, turning down prospective offers of appointment to directorship from MFBs. MFBs in turn may be left with no choice than to appoint prospective directors who are willing to resign from their current positions.

The attendant risk is that such persons who are willing to resign will most likely not be of the ilk or have the requisite experience for the role of director.

Conversely, it can be argued that the rationale behind the restriction imposed on MFBs by the CBN is to curtail abuse of power, insider trading and conflict of interest by the board members. For instance, an employee of an existing bank or financial institution who is also a director in an MFB may be faced with the conflict of revealing trade secrets and competition strategies of the MFB to the bank/financial institution where he/she is a current employee.

Banks and financial institutions operate related businesses, hence, there is the need to strictly comply with non-disclosure principles and transparency standards expected of the management and board of MFBs to avoid a breach of the cardinal fiduciary principles of duty of loyalty and duty of care to the MFBs.

Conclusion

We applaud the CBN for taking time to formulate such robust rules for corporate governance. While we acknowledge that on the face of it, the provisions of the Code may seem demanding, there is no doubt that the overall policy objective of the Code is well received by stakeholders and the general public. It is important to note that the Code is not directional as there are strict sanctions imposed on defaulters, such as suspension of banking license in addition to payment of fines.

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