



The work ahead at the Central Bank

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The Governor of the Central Bank of Nigeria has done something that not even his American counterparts have been able to accomplish to date; he has fired five of those who he believes are responsible for some of the most egregious and unproductive financial policies and procedures in recent memory.

The injection of \$2.8 billion into the banking system represents 14% of the estimated capital base of all the banks, half of which is estimated to be impaired. Therefore, there is still considerable work ahead, prior to presenting promising banks with attractive balance sheets to international investors. To do so, the CBN should consider the following next steps:

Step 1: Strategic recovery team The CBN should classify non-performing loans into the following two buckets, Physical Recovery Loans and Workout Loans. Physical Recovery Loans are the loans that were provided to business owners for specific or general corporate purposes, but were diverted to an opulent lifestyle. These are crimes for the EFCC to investigate and to perform physical asset recovery.

Workout Loans are completely different.

These loans were used for the intended corporate purposes, but the terms coupled the high cost of production juxtaposed with the current downturn made payment economically unfeasible. Borrowers of such loans didn't seek to defraud the lenders. The loan workout process for such credits is better left to distressed investment professionals as this is a matter of analysis and business judgement, not policing. CBN should create a Strategic Recovery Team to ascertain what can be recovered, worked out, or written-off, and a frank assessment of the gaps in each bank's balance sheet.



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Step 2: Devise a strategy for the findings of the recovery teams The Physical Recovery team should produce quick and straightforward results-property seizure for the culprits. Those physical assets could be allocated to the creditors based on seniority to achieve some recovery, perhaps through a public auction of such assets.

The results from the Workout team will take more time to obtain and will undoubtedly be more complicated. For instance, there's no surefire approach for a basket of manufacturing companies that all owe money to any of the troubled banks. Some of these borrowers will have a good chance at achieving feasibility through a comprehensive restructuring process and some will not. One approach would be to classify each credit (company) as strong, stable or weak.

Once the classification process is complete, what to do with these credits is the next question. The answer is that the banks should keep strong and stable credits on their balance sheets, consider selling non-core strong and relatively stable assets such as hotels and luxury apartment buildings to commercial real estate investors to help cushion the balance sheet against the ensuing purge as the weaker assets will have to go. Go where?

Step 3: Create a resolution trust corporation (rtc)-like vehicle Banks saddled with bad balance sheets aren't likely to lend money to the real or imaginary sector anytime soon; and are certainly unattractive to investors, local or international. The way to address the bad asset problem is by creating a Resolution Trust Corporation-like vehicle. The employment of this relatively straightforward vehicle has been avoided by the CBN's international counterparts during this crisis for a couple of reasons. The public resistance to making "vultures" rich again in such a blatant way is palpable.

The size of the hole such write-offs would leave in the financial system would be too large for governments to fill without further piling on to existing fiscal shortfalls. The Public Private Investment Program created

by the Treasury Department of the United States was designed as an end-around to the public resistance, which it isn't; it also doesn't resolve the write-down issue. So, the least convoluted way out is to revert to what worked during the Savings and Loans Crisis-the RTC vehicle, which can work here for a few reasons.

International investors will be unwilling to accept legacy bad debt in addition to the other investment specific issues. If they are presented with such debt, they will ask the CBN for a put contract (think Long-Term Credit in Japan). If exercised, such puts will place the bag right back at the Central Bank. Avoiding step 4 will make negotiations less favorable for the CBN. The election in two years will place power supply, corruption, unemployment, infrastructure and electoral reform on the front-burner. Avoiding the addition of a prolonged banking reorganisation from that list could prove helpful during the campaign. Lastly, the public would be amenable to the use of public funds for what over the long-term will be to their benefit.

Step 4: The great sale of rejuvenated banks This will be the result of the CBN dutifully executing steps 1 through 4. . . .

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