UPDATES TO CODE OF CORPORATE GOVERNANCE FOR BANKS AND DISCOUNT HOUSES.

The Financial Policy and Regulation Department of the Central Bank of Nigeria (CBN) recently published a circular on the revised code of Corporate Governance for Banks and Discount Houses in Nigeria.

The revised code, which supersedes the previous code issued in March 2006 amends certain sections of the previous code of corporate governance in order to align with current realities and leading practices.

The objective of this newsletter is to highlight the amendments and additions to the code and our views on them.

1. Effective date of the revised code of corporate governance for banks and discount houses.

The revised code is effective October 1, 2014. According to the circular, the CBN would begin to monitor full implementation of the revised code from the end of the last quarter of 2014 as banks and discount houses are required to submit quarterly returns on their compliance with the provisions of the code. The returns are required to reach the Director, Financial Policy and Regulation Department, CBN not later than 7 days after the end of each quarter. In addition, external auditors of banks are required to report annually to the CBN, the extent of the bank’s compliance with the provisions of this Code. The timeline of the submission of the report by the external auditor was not mentioned. Based on Section 8 of the BOFIA, which provides the timeline of provision of information by banks, our view is that it should be submitted alongside the audited financial statements due in March 2015.

2. Highlights of the amendments and additions to the Code.

2.1 Amendments to the Code

(a) Size of the Board (Section 2.2.1)

This section now includes a requirement for a minimum size of 5 people for the Board of any Bank or Discount house in addition to the required maximum size of 20 people. The number of directors on the board (or board size), is a critical factor that influences their performance. The complexity and effectiveness of the decision making process requires a critical mass which has been reflected in the minimum number of directors stipulated by the guideline. This requirement has resolved the lingering issue on the minimum number of the board members for the discount houses.

(b) Composition of the Board of Directors (Section 2.2.4)

Going forward, every discount house must have at least one (1) Non-Executive Director as an independent director separate from the minimum number of 2 already stipulated for Banks. The independence of the members of the board critically determines their ability to significantly impact the Board performance.

(c) Eligibility for the Chairman, MD/CEO or ED position (Section 2.3.3):

This section stipulates that where a bank is a member of a holding company, no two members of the same extended family shall occupy the positions of Chairman and MD/CEO or Executive Director of the bank and Chairman or MD/CEO of a bank’s
2.2 Additions to the Code:

The additional provisions to the code covered areas such as Compliance, Board structure, Remuneration, Disclosures for reporting, Appointment/Removal of the Chief Compliance Officer, Whistle Blowing Policy, Risk Management, Composition of Board Risk Management Committee, Establishment of Code of Conduct and Conflict of Interest. The details are summarized below:

(a) Compliance Report by external auditors (Sections 2.4.6, 5.2.10 and 6.1.9)

This section stipulates that external auditors of banks shall report annually to the CBN, the extent of the bank’s compliance with the regulatory directives, the bank’s risk management practices and internal controls. The auditor must be duly approved by the CBN and must have adequate experience/knowledge and competence to assess the governance systems in banks and discount houses. This is separate from the requirement to engage an external consultant to conduct board appraisal as required by section 2.8.3.

The implication of this additional provision is that Nigerian banks and discount houses would need to proactively engage with their external auditors to understand the scope of the assurance service required by the Central Bank of Nigeria which is in addition to the statutory audit of the financial statements.

(b) Board structure (Sections 2.4.6, 2.5.2. and 2.6.3)

Going forward, no Director, either executive or Non-executive, would be allowed to serve on the Board of a bank and a holding company within a Group at the same time. Furthermore, every board committee must obtain a charter specifying its terms of reference duly approved by CBN. Also, in order to qualify for re-election, a Director must have attended at least two-thirds of all Board and Board Committee meetings in the year under review.

These amendments on directorship and attendance at meetings would make for increased accountability and responsibility on the part of the directors and is expected to increase board effectiveness.

(c) Remuneration (sections 2.7.3 and 2.7.10)

Where the remuneration is linked to performance, it shall be designed in such a manner as to prevent excessive risk taking. Also, a Director cannot exercise his/her right over share options until one year after the expiration of his/her tenure.

The provision on remuneration would ensure that the operations of banks and discount houses are carried out in a manner that is devoid of bias, financial recklessness or undue influence on executive management.

(d) Mandatory disclosures for reporting (Section 5.1.2)

The code now defines the minimum disclosure in the annual report to include the details of directors, corporate governance, and contingency planning framework amongst others.

At the heart of high quality reporting is full disclosure of relevant information as required by the regulatory authorities. This is important to the users of the financial statements and improves overall quality of reporting and disclosures.

(e) Appointment/Removal of the Chief Compliance Officer (Section 5.2.7)

The Board shall be responsible for the approval and removal of the Chief Compliance Officer/Head of Internal Audit subject to CBN’s ratification. CBN must be notified of any change and reason thereof within 14 days of such change. This requires that board members are expected to act responsibly in the removal of these officers. This will avoid undue influence on these officers in the discharge of their responsibilities.

(f) Whistle Blowing Policy (Section 5.3)

Section 5.3 requires that every bank shall have a whistle blowing policy
duly communicated to the employees and shareholders. This policy shall contain mechanism that encourages all stakeholders to report any unethical activity to the Bank or the CBN. A separate whistle blowing policy guideline has been designed by the CBN to ensure and measure compliance.

By implementing this, Banks will promote transparent, structured, effective and clear communication across the organization. Clear communication is important to building an organization where employees feel comfortable raising their concerns and have channels to anonymously report untoward practices.

(g) **Risk Management (Sections 6.1.6 and 6.1.7)**
The code defines the responsibility for preparing the bank’s risk management framework as that of the Board. The Board also has oversight responsibility over its effective implementation. It shall also review the effectiveness of the implementation of the risk management and control system at least annually.

This role of the board cannot be overemphasized, it has improved the perception to risk, enhanced analysis of corporate risks and disclosures in financial reporting.

(h) **Composition of Board Risk Management Committee (BRMC) (Section 6.1.8)**
Section 6.1.8 requires that the composition of the BRMC shall include at least 2 non-EDs and the executive Director in charge of risk management. The committee must be chaired by a non-ED. This guidance would make for uniformity in the approach to setting up BRMCs by banks within the industry.

(i) **Establishment of Code of Conduct (Section 7.1.2 and 7.1)**
All banks are required to establish a code of conduct that contains a summary of practices necessary to maintain confidence and integrity and investigating reports of unethical practices amongst others. This code must be developed in collaboration with management and employees, be sufficiently detailed as to give clear guidance to the users and must be reviewed regularly and updated where necessary.

It is expected that the Bank, its board and management (and employees) would be committed to the highest standards of professional behavior, business and sustainable business practices.

(j) **Establishment of Bank’s securities trading policy (Section 7.1.4)**
The establishment of a policy concerning trading in the bank’s securities by Directors, senior executives and employees has become mandatory for Banks. This policy must contain appropriate compliance standards to ensure that it is appropriately implemented. There shall also be an internal review mechanism to assess compliance and effectiveness. The implementation of this would curtail insider or related party trades based on material non-public information which is considered a criminal offence and could result in a civil liability.

(k) **Conflict of interest (Section 7.2.1)**
Finally, it is expected that all Banks adopt a policy to guide all conflict of interest situations. The board shall be responsible for managing conflict of interest. Directors are expected to raise any real, potential or perceived conflict of interest for clarification either with the Director concerned or with the Chairman of the board.

3. **Conclusion**
The updates and revisions to the code of corporate governance for Nigerian banks and discount houses would result in more robust corporate governance practices and disclosures in the annual reports. It would also align the code with current realities and global best practices and eliminate perceived ambiguities. Compliance with the code is mandatory for all banks and discount houses as they are required to submit the returns on corporate governance for the quarter ending 31 December 2014 to the CBN.

In addition, effective financial year ending 2014, external auditors will be required to report to CBN on an annual basis the extent of the bank’s compliance with the provisions of the Code. The implication of this guideline is that Nigerian banks and discount houses would need to proactively engage with their external auditors to agree scope of this assurance report based on section 17 and 18 of International Standards on Related Services (ISRS) 4400. This would be in addition to the engagement of an external consultant to conduct board appraisal as stipulated in section 2.8.3.