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INTRODUCTION OF A NEW DEFAULT CLAUSE IN CREDIT FACILITY AGREEMENTS



ARTICLE SERIES

The Central Bank of Nigeria (CBN) has been vocal about implementing regulatory measures aimed at ensuring banking stability while improving credit growth in the Nigerian economy. In line with this initiative, the CBN released a circular on 26 August 2019 titled: New Offer Letter Clause for Credit Facilities (“the Circular”). The Circular is pursuant to the CBN Bankers Committee’s decision to grant banks access to the deposits in other banks of their defaulting customers to repay non-performing loans (NPL).

THE CIRCULAR

The Circular gives banks, who have extended facilities to customers, the right to access and utilise deposits of the NPL’s customer across the banking industry in the event of a payment default. As such, a bank loan can be repaid, upon default on repayment of either the principal or interest or both, with funds in any bank account belonging to the customer. A bank can exercise this right by reporting the defaulting loan and customer to the CBN, who would in turn direct other banks and financial institutions it regulates to pay over and set off the outstanding indebtedness with bank deposits and financial assets in the name of the defaulting customer. The Circular also provides for the template clause to be included in loan agreements effective from 26 August 2019 as follows:



By signing this offer letter/loan agreement and by drawing on the loan, I covenant to repay the loan as and when due. In the event that I fail to repay the loan as agreed and the loan becomes delinquent, the bank shall have the right to report the delinquent loan to the CBN through the Credit Risk Management System (CRMS) or by any other means and request the CBN exercise its regulatory power to direct all banks and other financial institutions under its regulatory purview to set-off my indebtedness from any money standing to my credit in any bank account and from any other financial assets they may be holding for my benefit.

I covenant and warrant that the bank shall have power to set off my indebtedness under this loan agreement from all such monies and funds standing to my credit/benefit in any and all such accounts or from any other financial assets belonging to me and in the custody of any such bank.

I hereby waive any right of confidentiality whether arising under common law or statute or in any other manner whatsoever and irrevocably agree that I shall not argue to the contrary before any court of law, tribunal, administrative authority or any other body acting in any judicial or quasi-judicial capacity.

The Circular does not limit the inclusion of the clause laid out above, so this would likely apply to all types of loans ranging from credit lines on a bank account to syndicated loans. This would change the risk position of domestic banks in a syndicate of lenders to a Nigerian borrower which may impact the other provisions of a facility agreement; for example, the interest rate that may be charged on the loan. Presumably, the Circular would also apply to any refinancing agreements or loan restructuring agreements to be executed after 26 August 2019.

The Circular also mandates that the Bank Verification Numbers (“BVN”) of the customer and any obligors/guarantors of the loan must be included in the loan documentation. With respect to loans to corporate entities, the BVN of the directors and the Tax Identification Number of the entity must also be included in the loan documentation for easy identification of other bank accounts maintained by the customer.

THOUGHTS

Since the 2014 recession, financial institutions have been reluctant to extend credit facilities.

In particular, the commercial banks adopted a conservative approach to increasing their credit exposures. Banks’ portfolio of NPLs saw a steady increase as more customers/borrowers defaulted on their debt service payments and facility repayments. For instance, in February 2019, the National Bureau of Statistics reported that the NPLs in Nigeria were valued at about N2.4trillion as at fourth quarter of 2017 with gross loans valued at about N15.9trillion. This had reduced to about N1.79trillion as at the fourth quarter of 2018 against gross loans valued at about N15.4 trillion. Therefore, the Circular is part of the CBN’s policies targeted at fostering the risk appetite of domestic banks.

The rationale behind the Circular is commendable considering it is meant to bolster banks’ willingness to extend lines of credit to the customers, particularly the SMEs and retail businesses, who would benefit the most from a financial market with a robust credit appetite. However, the implementation of this default clause in practice might come into question especially as banks in Nigeria are very competitive with customer patronage. The effectiveness of the Circular relies heavily on co-operation amongst the banks to pay over any deposits or



financial assets in their possession belonging to the defaulting customer. Realistically, banks may be unwilling to do this as it takes away money from those banks and they run the risk of losing the patronage of that customer.

On the flipside, bank customers also have to note this additional risk if they decide to take loans from banks in Nigeria. This may discourage them from applying for facilities from domestic banks and customers who can afford to look to foreign financial institutions to finance their transactions which may negatively impact the domestic financial market.

In addition, it is important for the CBN to issue further guidelines on the measure, particularly with regards to the sanctions that maybe imposed on banks who fail to report defaulting customers to CBN and banks who fail to pay over bank deposits and financial assets that they hold on behalf of the defaulting customer for set off of the outstanding amounts.

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