The new Credit Risk Protection Clause for Nigerian Commercial Banks: Efficacy and Limitations

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Exordium

A major challenge which has continuously bedeviled Nigerian banks is the burden of non-performing loans (NPLs). Data from the Nigerian Bureau of Statistics reveal that NPLs stood at ₦1.44 trillion at the end of the second quarter of 2019. This was about 9.3% of total loans in the banking sector and the first time in 40 months that NPL ratio would be in single digit. Despite rising NPLs, lack of access to credit has remained the bane of most businesses in Nigeria. In recent times, the Central Bank of Nigeria (CBN) has initiated measures aimed at improving credit culture as well as credit risk management. One of such initiatives was the resolve of CBN and Bankers' Committee at the Committee's 345th to introduce a credit risk protection clause in loan agreements. This discourse examines the efficacy and limitations of this initiative.

The Credit Risk Protection Clause

First, the obligor covenants to repay the loan when due. In the event of a default, Last August, CBN issued an *Implementation Guideline* in relation to the credit risk protection clause. CBN's sample clause encapsulates two covenants and a waiver. The obligor acknowledges the lending bank's right to request CBN to direct other banks to set-off the obligor's indebtedness from any money or financial asset held by the banks for the obligor's benefit. Second, the obligor covenants and "warrants" that the lending bank shall have the power to set-off its indebtedness from financial assets and monies standing to the obligor's benefit/credit in other banks. Third, the obligor waives its/his right of confidentiality and irrevocably agrees not to argue to the contrary before a court or any judicial or quasi-judicial authority.

Loan agreements are henceforth required to contain bank verification and/or tax identification numbers of obligors. This is for ease of identification of other deposits of the obligors across the banking industry.

The clause is prima facie enforceable and may provide succor to lending banks in some instances. The enforceability of the clause may be hinged on at least two legal principles. First, on banker/customer relationship. Second, on the law of assignment. In a banker/customer contractual relationship, the banker has an obligation not to pay out money in the customer's account except to the customer's order or by his instructions: **FBN Ltd v African Petroleum Ltd** (1996) 4 NWLR (Pt. 443) 438 at 444H, 445E. The credit protection clause may be viewed as a customer/obligor's order to its banker to pay money held to the customer's credit to a lending bank. Alternatively, it is settled law that money deposited in a banker by its customer is a loan to the banker: **Joachimson v Swiss Bank Corporation** (1921) 3 KB 110 at 127. Consequently, a banker/customer relationship is that of debtor and creditor: **UBN Plc v Ifeoluwa (Nigeria) Ltd** [2007] 7 NWLR (Pt 1032) 71 at 83C-D. The credit risk protection clause thus constitutes an *assignment* by the customer/obligor to the lending bank of a debt owed by the customer/obligor's banker.

The clause may not, and is certainly not meant to, provide foolproof protection. First, the clause will be unhelpful where the obligor has no deposits in other banks. Second, the clause will be of limited help where the obligor does not have substantial deposits in other banks. Third, its enforceability may be impaired by a number of factors. This poses the biggest threat to the efficacy of the credit risk protection clause.

A Banker's set-off right

A banker's right to set-off or combine accounts is a well-established legal principle which is generally implied in banker/customer relationships. In the absence of an express agreement to the contrary, a banker is entitled to combine accounts of a customer which has two or more accounts with the banker: **National Westminster Bank Ltd v Halesowen Presswork & Assemblies Ltd** [1972] AC 785 at 819F. A banker may use money paid into one current account to cover missed payments on other accounts: **FBN Ltd v Osunsedo** [1997] 11 NWLR (Pt 527) 132 at142F-G.

A banker's right to combine accounts will have priority over a credit risk protection clause. A banker would logically ensure that a customer's accounts are properly settled before making any payment to another bank pursuant to a credit risk protection clause. **Fidelity Bank Plc v Okwuowulu** (2012) LPELR-8497 which relates to garnishee proceedings illustrates this point. In that case, the court held that the garnishee/banker had properly merged the customer/judgment-debtor's accounts for the purpose of "settling accounts" between the customer/judgment-debtor and the garnishee/banker. The court stated that the garnishee order nisi was subordinate to the garnishee/banker's interest in the merged accounts by operation of law and equity and the garnishee/banker was "perfectly right" to protect its right to sums in the customer/judgment-debtor's account which was in credit.

Bank accounts subject to security interests

Where a debtor's bank account is subject to a security interest, a credit risk protection clause may be incapable of enforcement in relation to that account. The credit protection clause does not confer any security interest on the lending bank. It is simply a contractual right.

Security interest over bank accounts and deposits may now be created and perfected by virtue of the Secured Transactions in Moveable Assets Act 2017 (STMAA). Assuming lending banks sought for additional layer of protection by ingeniously procuring obligors to pledge not to encumber their accounts in other banks, such "negative pledge" will not affect the validity/effectiveness of a subsequent security interest created over the bank accounts: section 4(3) STMAA. Further, assuming lending banks were to create (and perfect) security over such bank accounts, a banker's right to set-off will still have priority over such perfected security interest: section 29(1) STMAA.

A security agreement may be expressed to cover all monies subsequently deposited in an account. In such a case, monies paid by the obligor into the account would be subject to the security without the obligor's consent or any further security agreement: section 3(2) STMAA. A perfected security interest has the same priority in relation to all secured obligations whether present or future: section 24(2) STMAA.

Where deposits in bank accounts are traceable proceeds of the sale of a moveable asset which was subject to a perfected security interest, the security interest continues to such monies/deposits: section 7(1) STMAA. In addition, the security interest in such deposits/monies will be automatically perfected: section 9(1)(b) STMAA.

Formal Insolvency proceedings

Upon commencement of formal insolvency proceedings for an obligor, a lending bank with a credit risk protection clause would be a mere unsecured creditor. Taking the deposit of the insolvent obligor from another bank after the commencement of formal insolvency proceedings will be void unless a court orders otherwise: section 213 of Companies and Allied Matters Act, 1990 (CAMA). Where the deposit is taken within three months prior to the commencement of formal insolvency proceedings, an officeholder may challenge same as constituting a fraudulent preference: section 495 of CAMA and section 46 of the Bankruptcy Act, 1979.

Accounts not in obligor's own right

The credit risk protection clause may only be enforced against accounts in other banks with monies standing to the obligor's benefit/credit. It may not be enforced against deposits held in trust, joint accounts, business accounts etc. In relation to a banker's right to set-off or combine accounts, it is trite law that when a banker opens two accounts for a customer, one in the customer's name and the other in a business name, in the absence of any express agreement to the contrary, there is an implied agreement that the accounts are to be kept separate: **Asman Mechanical Ltd v Spring Bank Ltd** [2012] All FWLR (Pt 613) 1824 at 1864.

In **British & French Bank Ltd v Opaleye** [1962] 1 All NLR 26, the respondent had two bank accounts with the bank. One was in his name (*Opaleye Rafiu Afolabi Bello)* and the other was in the name of his business (*Fekemo Brothers)*. Money was paid into the personal account which was in credit while the business account was overdrawn. The bank, without the respondent's notice or consent, used the personal account's credit to reduce the overdraft in the business account and prevented the respondent from drawing on the personal account. Bairamian FJJ held that in the absence of any express agreement to the contrary, there was an implied agreement that the accounts were to be kept distinct and separate. This decision was followed in **Adejuwon v Co-op Bank Ltd** [1992] 3 NWLR (Pt 228) 251 where the name of one account was *"Ositelu Brothers Ltd"* while the second account was named after the first appellant, "*Oloyede Adejuwon*".

Where a debtor maintains a joint account in a bank, the credit risk protection clause may not be used in clawing deposits from such jointly-held account. This is plainly due to the third party interest. Monies which are subject to trust cannot be claimed pursuant to a credit risk protection clause. In **FBN Ltd v Osunsedo** [1997] 11 NWLR (Pt 527) 132 at 142E which was in relation to a banker's right to combine accounts, the customer's contention that an account was a trust account was discountenance based on the peculiar facts of that case. The court found that the customers had not informed the banker had at the time of opening the account that the deposit was remittance to the children of the account holders for studying abroad.