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Effect of Regulatory Requirement Compliance on Non-Performing Loan of Deposit Money Banks in Nigeria

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Abstract:
In banking operations globally, granting of loans and advances remains the primary business of every bank and for this reason; loan quality is considered a primary indicator of financial soundness and health of banks. However, banks are exceeding CBN 5% threshold on non-performing loans that exposed them to huge unpaid loans due to borrower's defaults in honouring debt obligations and this may be attributed to poor adherence to regulatory requirements (credit creation, reserve requirements, statutory reserves, asset quality, and prime lending rates). The study adopted the ex-post facto *research design. The study population was 10 deposit money banks quoted on the Nigerian Stock Exchange as at 31st December 2018. Validated data were collected from the selected banks for 12 years (2007-2018), giving 120 firm years of observations. The reliability of the data was premised on the certification of the financial statements by the external auditors and data were subjected to pre-tests using descriptive statistics, correlation, unit root tests and co-integration test. Data were analysed using descriptive and inferential statistics. The result show that regulatory requirements significantly effects non-performing loan (*Adj.R2 *= 0.286,* F *(9, 96) = 5.974,* p *< 0.05) with ρ-value of F-statistics of 0.00, which is significant as it is less than the chosen significant level of 5%. The study recommended the creation of a special court that will be adjudicating on loan default and recovery matters expeditiously to discourage the accumulation of bad credit which is hindering bank performance in Nigeria.*

Keywords: *Regulations, non-performing loans, loan loss provision and bank performance*

1. Introduction

The global financial meltdown of 2008 accelerated a fundamental change in the banking industry across the globe as its impact was enormous to the extent that almost all sectors of global business were affected and with the banking sector most challenged especially due to their credit creation function having being exposed to a lot of risks of loan default and other investment risks (Harcourt (2017). Besides, by 2009, huge toxic assets had been discovered on bank balance sheets. It is only the timely and drastic banking reforms instituted by the CBN that helped rescue the industry by raising minimum capital thresholds, forcing mergers, writing off unprofitable businesses and cleaning up bad loans. The number of banks was slashed from eighty-nine to twenty-one. This is a remarkable regulatory achievement by any standards (Ajumogobia & Okeke, 2015).

The recent record of banks failure in Nigeria in 2011 when three (3) banks were acquired by AMCON while another incident of failure occurred in 2018 when the CBN revoked the operating license of Skye Bank, and a public limited company AMCON took over the sale process of the bank and a new bank emerged known as Polaris Bank (Business News, 2018). Skye Bank was liquidated because its capital had slide to a negative position due to non-performing loans thus, forcing the CBN to invest about 800 billion naira in the bank (Business News, 2018). Afrinvest (2016) has similarly stated that the key risk factor in the banking sector was weak asset quality which drove NPLs and provisioning charges higher across the industry's tiers, resulting in weaker margins and pressure on capital assets ratios (CAR) positions and this was also responsible for the reluctance of banks to extend new credit facilities. Besides this, the adverse economic impact on the borrowers and their business which had resulted to rising defaults, additional provisioning by banks and

consequent reduction in banks' capital adequacy ratio (CAR) had been blamed for financial institution's travails. Bhattarai, (2016) observed that non-performing loans could lead bank management to waste too much time and effort on recovery and beside this situation, there is also an indirect cost that the bank has to bear as a result of low asset quality hence, non-performing loans not only causes lack of interest income but also affects future profit flows in loss of income on investments.

Taiwo and Musa (2014) observed that deregulation of the economy has led to the proliferation of banks with its attendant problems whereby many banks are virtually chasing the same customers. This has made the management of banks to believe that the only option for them to survive is to take excessive risks and thus, Aregbeyen and Olufemi (2011) attributed these developments to have led to series of a banking crisis, financial shocks and distress impasse experienced in the banking sector and the entire economy (Gunu, 2009; Gunu & Olabisi, 2011).

In banking operations globally, provision of credit remains the primary business of every bank and for this reason, credit quality is considered a primary indicator of financial soundness and health of banks (Boahene, Dasah & Agyei, 2012). Also, Coyle (2014) asserted that poor credit management and administration exposes financial institutions to credit risks which occurs when a borrower defaults in honouring debt obligations on the due date or at maturity.

Sumaila (2015) and Bordeleu and Graham (2010) argues that the aftermath of the 2008 financial crises caused liquidity challenges in virtually all developed economies and corporate entities including banks. Acharya *et al*. (2009) supported this view and stated that the crises caused significant balance sheet challenges and affected banks' ability to honour previous commitments and to provide new credit.

Meanwhile, Yusuf and Ekundayo (2019) posited that banking industry in Nigeria has had its own fair share of corporate failures largely due to weak or inefficient regulatory oversight and several efforts were made to strengthen the regulatory requirements through the promulgation of the 1952 Banking Ordinance, CBN Act of 1958, Banking Decree (Act) of 1969, Bank and Other Financial Institutions Act (BOFIA) 1991, BOFIA 2004, Nigerian Deposit Insurance Corporation (NDIC) Act 2006, CBN Act 2007 among others. However, this has shown that the regulatory requirements and compliance is somewhat complex due to several legislations introduced to regulate the activities of banks but another challenge is the presence of several regulatory bodies operating independently or sometimes with overlapping functions. However, the relationship between profitability and non-performing loans is not clear; thus, objective of this paper is to analyze the effect of regulatory requirements compliance on non-performing loans (NPL) of DMBs in Nigeria.

1.1. Statement of the Problems

According to Rauch, (2011), non-repayment of loans or loan default by borrowers in Nigeria has gained cultural acceptance or worse as it has become the norm hence, Nigeria has a primary problem with subsidized State credit sometimes called 'Cold Money' which is regarded by borrowers as government money that does not need to be repaid as they perceived it to be a 'grant' rather than a loan. Thus Offiong and Egbuka (2017) posits that some bank customers misconstrue the loans and advances availed them by banks as national cake, hence, they deliberately shy away from repayment leaving the banks an enormous amount of doubtful and bad loans hence, the task of bad debts management is becoming an issue of serious concern in the banking system. Abubakar (2018) posited that there is a need for banks to engage professionals and banking experts that can handle credits appraisal better at the level which it can maintain its assets to optimize and achieve lending objectives. Similarly, Ibrahim (2018) posits that many banks do not have the right industry knowledge needed to properly appraise loans applications and the dilemma of that bad loan experienced today by banks are mainly due to their large exposure to oil and gas, power and telecom sectors have exposed themselves to the sector without the right industry knowledge which created huge NPLs. The main objective of the study is to investigate the effect of regulatory requirements compliance and non-performing loans in deposit money banks in Nigeria.

2. Review of Literature

The rule and compliance approach place reliance on transaction testing, such as evaluating the adequacy of the credit administration process, assessing the quality of loans and ensuring the adequacy of provisioning for loan losses (CBN, 2014). Risk control and compliance functions should also provide strong guidance in the process of designing and reviewing NPL-related policies, especially to incorporate best practices to address issues identified in the past. At the very minimum, these functions should review the policies before they are approved by the management body (ECB, 2017). The primary regulatory concern of the CBN was with ensuring compliance with the allocative controls, such as the sectoral lending guidelines, rather than the prudential controls. The allocative controls weakened loan portfolio quality by diverting loans towards non-viable borrowers (Jimoh 1994). The introduction of asset management companies (AMCON) was saddled with the responsibility of mopping up the toxic assets of banks to relieve them of non-performing loans to improve their liquidity; enhance credit allocation to the private sector, access to credit and strengthen banks' capital base to absorb both internal and external shocks as well as engender an increase in shareholders' wealth and the reduction of the social costs of bank failure to the economy (Igbinosa, Ogbeide, & Babatunde 2017).

Banking Compliance issues include direct and indirect laws resulting from inadequacy of internal processes, people and systems or from external event. Credit Inspection through file and field level area deals with all matters relating to credit inspection, ensuring compliance of BBL policy towards credit granting process, corporate portfolio review and physical inspection of client's premise and files (Lalong, 2015). Also, CBN Act, Section 3.9 on the risk management provisions gave minimum conditions, which must be met before granting exposures. Item (d) of sec.3.9 is of relevance to credit information reporting and it states that all banks must obtain credit report from at least two (2) credit bureaus before granting any facility to their customers (CBN, 2014).

2.1. Credit Creation

Tetteh (2012) sound credit creation is one of the most essential principles which strengthen financial institutions as sound credit creation system establishes credit limits and credit approval process for new credits. Credit plays a very vital part of the economic growth and development of a country. Similarly, Kargi (2011) defines credit creation as a major source of income to the banks and therefore postulates that credit risk management must be seen as critical for the survival banks and the nation's economy. Mohammed, Ali and Mahshid (2015) posited that banks lend to facilitate the flow process of transferring funds from lenders to borrowers. Explaining further Akani and Onyema (2017) posit that credit represents the supply side of financial intermediation and has the great extent to which it affects the economy. Increase in bank credit has the capacity of raising aggregate demand and also have the capacity of rising inflation. These pro-cyclical effects of commercial banks credit require that the monetary authorities formulate policies to ensure equilibrium credit level in the economy. Solomon, (2012); Agu and Nwankwo, (2019) opined that DMBs invest customer deposits in the various short term and long-term investment outlets; however, the core of such deposits is used for loans to generate profits. The more loans and advances they extend to borrowers, the more the profit they make. Akani and Onyema, (2017) asserted that credit expansion is the steady increase in the volume of credit in the economy, it is determined by monetary policy, macroeconomic and international variables.

2.2. Reserves Requirements (RR)

The CBN (2015) defined reserve requirement as the proportion of total deposit liabilities which the deposit money banks are expected to keep as cash in vaults and deposits with the CBN who controls the money stock by varying the requirement as desirable as banks usually keep reserves over and above the legal requirement to ensure the safety of depositors' fund, hence the cash ratio requires the deposit banks to keep a certain proportion of their total deposit liabilities as cash balances with the CBN, while the liquidity ratio stipulates the proportion of total deposits to be kept in specified liquid assets, mainly to safeguard the ability of banks to meet depositors' cash withdrawals and ensure confidence in the banking system. Similarly, Osadume R. and Obialom V. (2018) stated that reserve instruments are used by the central bank to influence the level of bank reserves and hence, their ability to grant loans. It can be lowered to free reserves for banks to grant loans and thereby increase the money supply in the economy. On the other hand, they are raised to reduce the capacity of banks to provide loans thereby reducing money supply in the economy. The reserve requirements are the cash reserve ratio (CRR) and the Liquidity Ratio (LR), while the former is defined as a proportion of the total demand, savings and time deposits which banks are expected to keep as deposits with the CBN, the latter refers to the proportion of banks' liquid assets to their total deposit liabilities.

2.3. Statutory Reserves (SR)

According to CBN (2010), every bank shall maintain a reserve fund appropriated out of its net profits for each year (after due provision made for taxation) and before any dividend is declared as follows: Where the amount of the reserve funds is; (i) less than the paid-up share capital, transfer to the reserve fund a sum equal to not less than 30% of the net profits; and (ii) equal to or over the paid-up share capital, transfer to the reserve fund a sum equal to not less than 15% of the net profit; provided that no transfer under this subsection shall be made until all identifiable losses have been made good. Cash reserve ratio: The CBN shall prescribe the minimum cash reserve ratio for banks in Nigeria from time to time in line with its monetary policy's directions. Also, Bouwman (2013) observed that introduction of the statutory reserve is based on the mere assumption that a bank could overuse customers' savings or/and lend excessively. This is because reserve capitals do not originally exist with interest against banks but as financial tools warehoused to boost banks' liquidity through an interplay of interbank lending and borrowing, as well as exploiting discount window which can come with higher risks and financial demerits.

2.4. Asset Quality

Conceptually in the banking industry, asset quality refers to the review or an evaluation, which assesses the credit risk associated with any particular assets that normally require the payments of interest like investment and loans portfolios. Ombaba (2013) defined asset quality as the general risk attached to various assets held by a financial institution. It is commonly used by the financial institution to determine how many of their assets are at financial risk and how much allowance for potential losses they must make. Sangmi and Nazir, (2010) posited that the quality of assets of the banking industry is measured by the proportion of impaired credits to total credits while the statutory maximum threshold is 5%. The bank's asset is another bank-specific variable that affects the profitability of a bank; such bank asset includes among others current asset, loan portfolio, fixed asset, and other investments. However, more often than not the loan portfolio of a bank is the major asset that generates the highest share of the bank's income. Similarly, Debelle (2015) asserted that asset quality ratios of banks merit particular attention given its vital role in ensuring the safety and soundness of the banking system and following the collapse of many renowned world financial institutions in 2007-2009 and the recent market turmoil which had exposed significant risk management weaknesses in banking institutions. Iwedi and Onuegbu (2014) reported that banking industry had been hit by low-quality loan assets as a result of poor economic and financial conditions in the country following the great financial recession of 2008 and the negative oil price shock.

2.5. Interest Rate

Ngure (2014) defined interest rates as the price a borrower pays for the use of the money they borrow from a lender or fee paid on borrowed assets. Sayedi (2013) expressed an interest rate as the percentage rate over the amount

borrowed on saved over one year. Karl et al., (2009) posits that interest rates are derived from macroeconomic factors which agree with Irungu (2013) that interest rates are major economic factors that influence the economic growth in an economy. Also in the reports of PwC (2012), BCG (2016) and Sageworks (2016), it was stated that specific loan agreement terms and conditions vary and one of the most critical elements controlling the risk of the loan portfolio is the interest rate which is the price of a loan, however, the importance and challenges of the structured loan pricing have been recognized by many practitioners and have also received significant attention in recent years from both industry and academia.

2.6. Non-performing Loan

The concept of NPL has been defined differently by many authors; one of them is the International Monetary Fund (IMF), which defines it, as Loan would fall under the non-performing loan when the payment of its principal and interest had passed the due date by the period of three months or ninety days or more, (Dimitras et al, 2016). Despite having a clear definition for the NPLs, banks are assumed to react differently to NPLs ratios above or below a threshold, with NPLs above, the threshold hurts lending (Tracey, 2011). Non-performing loans (NPL) represent credits which the banks perceive as possible loss of funds due to loan defaults. They are further classified into substandard, doubtful or lost. Bank credit in the lost category hinders bank from achieving their set targets (Kolapo *et al*., 2012). Khemraj and Pasha (2012) explain that high percentages of NPLs are highly correlated with banks' performances especially in emerging economies while Karim, Chan and Hassan (2010) asserted that the main effect of bad loans is the ability to hinder the bank from growing financially as bad loans drag banks into liquidity problems and unable to extend credit to other potentially viable businesses. Recently, the issue of NPLs has been alarming not only in developing countries but also in developed countries (Akter and Roy, 2017). Consequently, to ensure maximum output and better performance of the banks, there is a need for concentration on the horizon of maturity of credit, better credit culture, and favourable macro-economic and business conditions to ensure the lowest rate of NPLs (Ranjan and Dhal, 2013). Banks are also faced with challenges of non-performing assets based on inaccurate information on clients, wrong clients profiling and weak controls within the financial system as evidence of the weak financial performance of many banks was seen in large provisions for bad loans being made, and subsequent write-offs of delinquent loans when they went bad, thus affecting bank performance (Odeke & Odongo, 2014).

2.7. Empirical Findings Review

Chimkono, Muturi, and Njeru (2016) found that non-performing loan ratio, cost efficiency ratio and average lending rate significantly affected bank performance whereas cash reserve ratio directly associated with performance but was insignificant, however, Shingjergji (2013) found a negative effect of LAR on NPLs in the Albanian banking industry, which suggests an increase in the loan portfolio may not increase the NPL level. However, there are theoretical reasons to believe that with the increase in credit over total assets, the likelihood of adverse selection and the possibility of bad loans increases.

Etale, Ayunku and Etale (2016) investigated the link between non-performing loans and the performance of banks in Nigeria for the period 1994 to 2014 and the study adopted substandard loans, doubtful loans and bad loans to represent non-performing loans, while return on capital employed (ROCE) was used as a proxy for performance. Using descriptive statistics, ADF unit root test and multiple regression statistics to analyze data obtained from the annual reports of banks, the study found that a high level of non-performing loans reduced banks' performance.

Several other studies like Antzoulatos and Tuomas 2014; Cheng *et al.* 2016; and Mariathasan *et al.* 2014 found moral hazard as the prime cause of problem loans in financial institutions. Similarly, Jeitschko and Jeung (2005) found that moral hazard and adverse selection significantly drive high non-performing assets in financial institutions, particularly when capital levels are low. Similarly, using threshold value in the Chinese banking industry, Zhang *et al* (2016) argued that banks with moral hazard experience problem loans frequently. Several other studies (for example, Antzoulatos and Tsoumas 2014; Cheng *et al*. 2016; Mariathasan *et al* 2014) found moral hazard as the prime cause of problem loans in financial institutions. Asantey and Tengey (2014) examined the effects of bad loans on banks' lending ability and financial performance using secondary data from the annual reports of four listed commercial banks (Eco bank, GCB Bank, CAL Bank, and Agricultural Development Bank) for a-5 year period covering 2008 to 2013 and discovered a high negative correlation between bad loans and lending ability at 0.05 alpha level and a high negative correlation between bad loans and financial performance, measured as return on investment or net profit at 0.05 level.

S/N	Variables	Measurement
1	Reserve requirements	Loan deposit ratio
2	Statutory Reserves (SR)	Statutory Reserves/ Total Capital Reserves
3	Prime Lending Rates (PLR)	Interest rate of DMBs
4	Asset Quality (AQ)	NPL/Total Loan Portfolio
5	Non-performing loans (NPL)	Bad credit/Total Credit (NPL)
6	Loan Loss Provision (LLP)	Loan Loss Reserves/Gross Loans
7	Non-interest Income (NII)	Non-Fee based income/Total Income
8	Return on Assets (ROA)	Net income/ Total Assets.

Table 1: Measurement of Variables

3. Methodology

This study adopted *ex post facto* research design. Validated data were obtained on ten (10) selected banks based on the following criteria; they have over 60% control of the total assets and liabilities value of the banking sector and analyzed with the Ordinary Least Square (OLS) technique. Pooled panel regression analysis was employed to analyse the data with descriptive statistics, Pearson correlation model, multiple linear regression tools and various tests were also carried out including linearity test, heteroskedasticity, autocorrelation, co-integration and Hausman test to analyse the data.

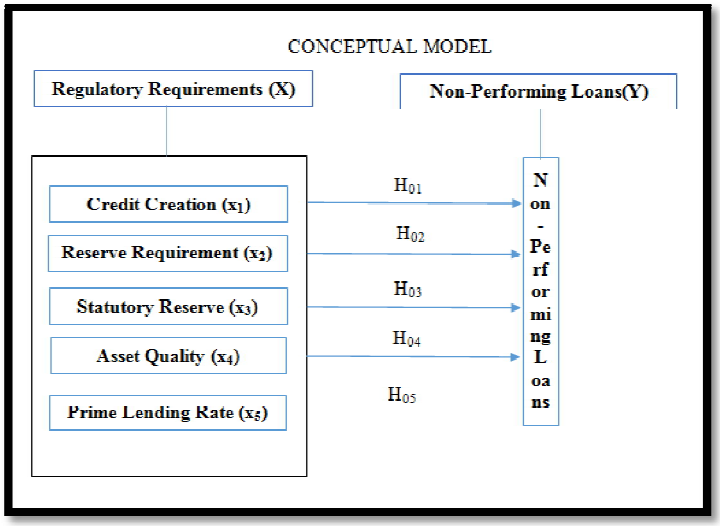

Figure 1: Conceptual Model
Researchers Model-2020

3.1. Model Specification

The operationalisation of the dependent and independent variables used for the study is based on the following linear regression equation:

X; = (CC, RR, SR, AQ, LP); Y=(NPL); Where: Y = f(X); The Dependent Variable Y = Non-performing loan while the independent Variable X= Regulatory Requirements Compliance (RRC).x_1 = Credit Creation (CC); x_2 = Reserve Requirement (RR); x_3 = Statutory Reserve (SR); x_4 = Asset Quality (AQ); X_5 = Prime Lending Rate (PLR); NPL= f (CC,RR,SR,AQ,PLR)

The model formulated for the hypothesis is written as: $NPL= \beta_0 + \beta_1 CC_{it} + \beta_2 RR_{it} + \beta_3 SR_{it} + \beta_4 AQ_{it} + \beta_5 PLR_{it} + e_{it}$

3.2. Analysis of Data

The study hypothesis that regulatory requirements compliance has no significant effect on non-performing loan in Deposit Money Banks in Nigeria.

NPL = 27.381 + 0.45558CC - 20100000RR - 130000000SR + 0.14497AQ + 0.542893PLR

Method	**PCSE**		
Variables	Coeff	z-stat	Prob
CC	0.45558	0.30	0.766
RR	-20.1m	-2.63	0.008
SR	-130m	-0.05	0.964
AQ	0.14497	0.43	0.664
PLR	0.452893	1.46	0.146
Constant	27.381	2.79	0.005
R-squared = 0.0242, Wald $chi^2(5)$ = 25.05; Prob > chi^2= 0.0001			
Hausman Test: $Chi^2_{(3)}$ = 2.37 Prob.> chi^2 = 0.4623			
Breusch-Pagan LM Test: $Chi^2_{(1)}$ = 36.37, Prob.> chi^2 = 0.000			
Breusch-Pagan/ White Test: $Chi^2(18)$ = 4.74, Prob.> chi^2 = 0.9992			
Wooldridge Test: $F_{(1, 9)}$ = 33.241, Prob. >F = 0.003			
LRAI Test: R-Squared = 0.3793, Adjusted R-Squared = 0.2868;F (9, 94) = 5.974, Prob. > F = 0.000			

Table 2: Hypothesis Three: Regulatory Requirements on Non-Performing Loan
Dependent Variable: Non-Performing Loans (NPL)
Significance @ 5%

4. Interpretation

The Hausman result shows that random effects model is the best estimate considering the probability value of 0.4623 which is greater 0.05 significant level; also, the LM test confirmed the result of Hausman that random effect existence with a significant ρ-value of 0.00. Breusch-Pagan/ White Test revealed that there is no heteroskedasticity problem in the model looking at the ρ-value of 0.9992 being insignificant as the null hypothesis specifies that the model is homogeneous; but there was serial correction shown under the Wooldridge test with the ρ-value of 0.003, which is significant and negates the null hypothesis which states that no serial autocorrelation; thus Panel-Corrected Standard Errors (PCSE) was conducted to correct the errors. Also corrected R-Squared and Adjusted R-squared was calculated using Linear Regression for Absorbing Indicators (LRAI).

The probabilities and the signs of the z-statistics as presented in Table 4.3.2 showed that credit creation (CC) having z-statistics of 0.30, which is positive and ρ-value of 0.766, which is greater than chosen significant level of 5%, means that CC has an insignificant positive effect on Non-Performing Loans (NPL); also, asset quality (AQ) with z-statistics of 0.43, which is positive and ρ-value of 0.664, which is greater than chosen significant level of 5%, implies that AQ has an insignificant positive effect on Non-Performing Loans (NPL). Similarly, prime lending rate (PLR) with z-statistics of 1.46, which is positive and ρ-value of 0.146, which is greater than chosen significant level of 5%, indicates that PLR has an insignificant positive effect on Non-Performing Loans (NPL). Contrarily, statutory reserves (SR) with z-statistics of -0.05, which is negative and ρ-value of 0.964, which is greater than chosen significant level of 5%, evidenced that SR has an insignificant negative effect on Non-Performing Loans (NPL). Considering the z-statistics and ρ-value of reserve requirements (RR) with a negative value of -20.1million and ρ-value of 0.008 means that RR negatively and significantly influences NPL. Interpreting the coefficients of RR which is -20.1m implies that a naira increase in RR would result in ₦20.1million decrease in NPL.

Following the ρ-value of F-statistics of 0.00, which is significant because it is less than the chosen significance level of 5%, it evidenced that Regulatory requirements significantly effects on Non-Performing Loan. The value of adjusted R-squared of 0.2868 explains the power of the explanatory variables. It simply means that a variation in the combined powers of the explanatory variables (CC, RR, SR, AQ, and PLR) would lead to 28.68% variation in the explained variable, that is, Non-Performing Loan (NPL), while the remaining 71.32% changes that could occur in NPL resulted from other factors that are not captured in this model.

4.1. Result of Findings/Decision

Therefore, the null hypothesis (H03) which states that regulatory requirement dimensions do not significantly affect Non-Performing Loan of selected deposit money banks in Nigeria is hereby rejected while the study accepted the alternate hypothesis that regulatory requirement dimensions significantly affect Non-Performing Loan of selected deposit money banks in Nigeria.

4.2. Discussion of Findings

The result re-emphasized that inability to recover loans and advances granted customers have led to the revocation of several banking licenses in the Nigerian banking history. Presently, AMCON is warehousing about N6.7 trillion toxic assets purchased based on 60k to #1 from overburdened deposit money banks in Nigeria and provided them with lifeline through liquidity provision. Furthermore, some banks were also bailed out to the tune of N800bn in recent time on account of distress impasse caused mainly by non-performing assets and consequent illiquidity experience which triggered being taken-over by the central bank. An example is Skye Bank now Polaris and Diamond bank that was also acquired by Access bank. Hence regulatory requirements could not sustain significant effect on non-performing loan in DMBs in Nigeria and supported by literature as follows: Karim, Chan and Hassan (2010) asserted that the main effect of bad loans is the ability to hinder the bank from growing financially as bad loans drag banks into liquidity problems and unable to extend credit to other potentially viable businesses. Agu and Okoli, (2013) stated that, NPLs result from the inability of debtors to repay their loans and their interests within the specified time resulting in adverse effects on the financial condition of the creditor. Using threshold value in the Chinese banking industry, Zhang *et al*. (2016) argued that banks with moral hazard experience problem loans frequently. Several other studies (Antzoulatos and Tsoumas 2014; Cheng *et al*. 2016; Mariathasan *et al*. 2014), found moral hazard as the prime cause of problem loans in financial institutions due to the loan to assets ratio (LAR) will affect credit growth and risk appetite of a bank, hence failure to maintain effective credit standards with increasing loan portfolios may raise the possibility of bad loans (Ekanayake & Azeez 2015; Klein, 2013). Furthermore, non-performing loans have the risk to damage the reputation of banks. Any increase in non-performing loans will limit the opportunities of co-financing and syndication of the bank that may be realized with other banks by affecting negatively the credit rating of the bank beside the bank profitability (Bhattarai, 2016). The Asset Management Corporation of Nigeria (AMCON) was established by the Federal Government in July 2010 to buy off trillions of toxic assets to stave off a major collapse of the Nigeria banks and having succeeded in buying off about 95% of the non-performing loans, the corporation has achieved the primary purpose for which its action was made, with a caveat not to buy new non-performing loans (CBN, 2010). Ayeni and Kolapo (2012) carried out a study on credit risk and commercial banks' performance in Nigeria: a panel model approach where it found that increase in the non-performing loan, increase in loan loss provision and increase in total loan and advances have a significant impact on the profitability of Nigerian banks. Lydnon, Peter and Ebitare (2016) investigated the relationship between non-performing loans and bank performance in Nigeria for the period of 1994-2014. The multiple regression techniques were used to analyze the data. The result of the study shows that Bad loans (BAL) and Doubtful Loans (DOL) had a statistically negative

significant influence on Return on Capital Employed (ROCE), while Substandard Loan (SUL) had a statistically negative insignificant impact on ROCE. The result further shows that a high level of non-performing loans would reduce the performance of banks in the long-run in Nigeria.

5. Conclusion and Recommendations

Deposit money banks, especially in an emerging country like Nigeria, should reduce non-performing loans (NPLs) drastically. They should strictly adhere to regulatory requirements in their loan administration functions to minimize incidents of non-performing loans. Similarly, CBN should curb the culture of impunity by ensuring that bank directors; management and credit officers are held answerable for incidents of unethical and unprofessional approval of loans and advances to defaulting customers since they make their loan policies. Finally, the study recommended the creation of a special court that will be adjudicating on loan default and recovery matters expeditiously to discourage the accumulation of bad credit which is hindering the performance of banks.

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