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BANKING, RISK AND THE LAW: WHY LEGAL INEFFICIENCIES ARE HOLDING BACK ECONOMIC GROWTH

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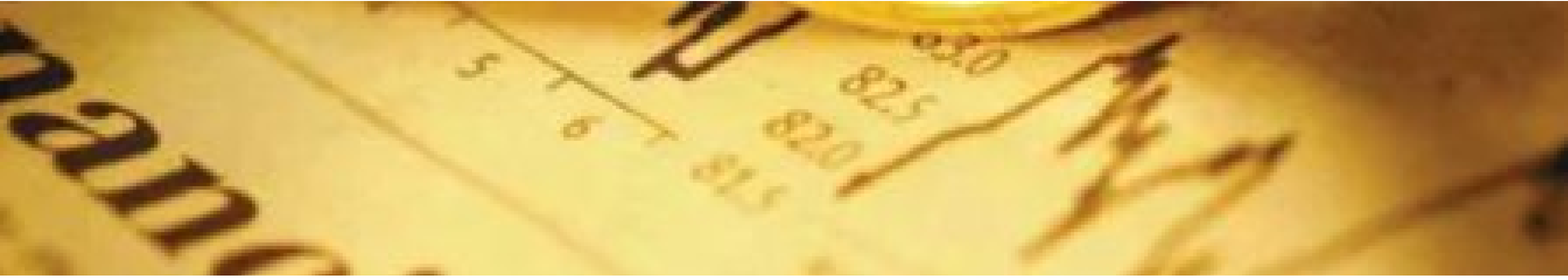

Introduction

Banking regulations may seem like distant concerns for lawyers, but their real-world effects extend far beyond the financial sector alone. These regulations influence whether businesses can access credit, how infrastructure is financed, and how resilient our economy is during times of stress. Recently, it has become increasingly clear that some of the challenges in our financial system are not purely financial; they are legal. Certain regulatory practices are being distorted – not necessarily because banks are mismanaging risk, but because the legal system has not evolved to support the demands of a modern economy.

Insufficient Collateral

One of the clearest examples lies in how the banking sector is required to treat loans secured by collateral. Typically, a loan backed by property should ordinarily carry lower risk, as the bank has the right to recover its funds by selling the collateral, should the borrower default. However, in Nigeria, this assumption often fails in practice due to the lethargy and unpredictability of the court system. Even where the collateral is valid and legally registered, enforcing it through the courts can take years.

Accordingly, the Central Bank treats loans secured by commercial property as though they have no collateral at all. For residential property, there is some regulatory relief, but it remains overly conservative. Under the current guidelines, the '*risk weighting*' (that is, the proportionate amount of capital the CBN requires a bank to hold against its assets, dependent on the riskiness of the facility) applied to secured exposures is, in many cases, rigid and excessive. For example, loans backed by commercial real estate, regardless of the value of the property or the loan-to-value ratio, are automatically assigned a 100% risk weight. This means that no credit risk relief is granted, even when the loan is properly secured and performing.

By contrast, residential mortgage-backed loans may qualify for a reduced 75% risk weight, but only under strict conditions, including a loan-to-value ratio that must not exceed 80%. There must also be a full legal mortgage registered and the property must be periodically revalued.

These requirements, while prudent in principle, create a high threshold that significantly limits the application of the relief. As a result, banks are compelled to set aside far more capital for secured transactions than necessary (in anticipation of a default), which reduces the amount of money available for lending.

This discourages credit extension to sectors that rely on property and other fixed assets, such as housing and infrastructure. Instead, banks are increasingly drawn toward government securities. These instruments are considered safe, with minimal risk of default. However, how the government ultimately utilises these borrowed funds is a separate matter, but that is a discussion for another article. What is clear as a result of the above is that banks end up funding activity that is largely unproductive in terms of direct economic value. In essence, the law, which is ordinarily designed to protect and enforce financial agreements, tends to have the opposite effect: eroding confidence and creating inefficiencies in the allocation of capital.

While prudence in financial regulation is important, this overly rigid approach penalises secured lending. Furthermore, it discourages banks from supporting real estate and long-term infrastructure projects. Both of which are critical to sustainable national development.

The Cash Reserve Dilemma

Another critical challenge is the Cash Reserve Ratio (CRR). Essentially, this simply refers to the portion of customer deposits that banks are required to maintain with the Central Bank. The current rate is 50% for Deposit Money Banks and 16% for merchant banks. These are distinct from regular deposits, as these funds cannot be used for lending or investment. Nigeria currently maintains one of the highest CRRs globally. While the policy is aimed at managing inflation and ensuring monetary stability, its practical impact restricts banks in two significant ways.

First, it reduces the amount of funds available for lending. Second, it limits profitability, since CRR balances yield little or no return. Lower earnings mean banks struggle to build up capital buffers organically. Without strong capital, banks cannot absorb shocks or expand their balance sheets. The consequence is a more fragile financial system and a reduced capacity to support private sector growth.
This has real implications for access to credit, particularly for individuals and professionals, such as young lawyers, who are looking to buy homes or set up their own practices. Their inability to access credit is not due to a lack of merit or potential, but rather to a systemic constraint that restricts credit supply and overstates financial risk. While the need to control inflation is well understood, there are limits to the effectiveness of monetary policy in achieving this goal.

Misunderstood Risk in Joint Funding

Joint funding presents yet another missed opportunity. In many infrastructure or development projects, banks collaborate with public sector institutions or international development partners to share costs and risks. However, current regulatory treatment often fails to recognise this shared exposure. Instead,

regulators assign the full risk of the project to the bank, even where the legal and financial arrangements clearly distribute the exposure between the parties.
This approach discourages banks from participating in collaborative financing models and undermines financial innovation. The tragic consequence of this is the limitation to large-scale funding solutions, which would serve to accelerate national development.

Legal Inefficiencies and Policy Gaps

While these challenges may appear technical, they are deeply rooted in inefficiency and consistent oversight. As legal professionals, particularly those engaged in commercial, regulatory, or development work, we have a role to play. We can assist in the design of more efficient frameworks for secured lending and collateral enforcement. We can engage in dialogue with regulators to promote more realistic risk classification standards. And we can advocate for a better alignment between legal process, financial regulation, and fiscal policy.

The goal should be to create a financial and legal ecosystem that is not just predictable and efficient, but most importantly, development-focused.

Legal Infrastructure is Essential to Financial Reform

These identified inefficiencies are not abstract concerns. They determine whether infrastructure gets built, whether businesses are able to scale, and whether young professionals can access credit to invest in their futures. A well-functioning legal system supports entrepreneurship and upward mobility by ensuring there is less uncertainty for all stakeholders, regardless of their position. Finally, it would provide the necessary structure for people to acquire homes, build businesses, and contribute meaningfully to the economy. That is why these issues matter deeply.

Conclusion

If the financial system intends to drive inclusive growth, we need more than theoretically sound banking regulations. We need a justice system that enforces contracts effectively, regulatory policies that reflect commercial realities, and fiscal strategies that prioritise productivity. The link between law, finance, and policy must be recognised and strengthened. And to this end, lawyers must see themselves not just as interpreters of the law, but as co-creators of a legal and economic framework that delivers value for the society it serves.

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