NATIONAL OPEN UNIVERSITY OF NIGERIA
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FACULTY OF MANAGEMENT SCIENCES

COURSE CODE: BFN305

COURSE TITLE: BANKING LAWS AND REGULATIONS

COURSE GUIDE
&
COURSE DEVELOPMENT

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INTRODUCTION

BFN 305: Laws and Regulations of Banking is a first semester course, two credit unit, 300 level core course. It will be available for all students offering undergraduate programme in B.Sc. Banking and Finance in the Faculty of Management Sciences. The course will introduce students to laws and regulations governing the banking industry. In this course, students will be exposed to the legal, regulatory and supervisory frameworks in the banking industry which will guide them in understanding the nitty-gritty and workings of the banking industry. Students will also be able to apply the knowledge in this course in a banking setting.

COURSE GUIDE

The course guide tells students briefly what the course is about, what course material will be used, and how you can work your way through the study material. It suggest some general guidelines for the amount of time you are likely to spend on each unit of the course in order to complete it successfully.

The guide also gives you some guidance on your tutor-marked assignments, which will be made available to you in the Study Centre. There are regular tutorial classes that are linked to the course. You are advised to attend these sessions.

WHAT YOU WILL LEARN IN THIS COURSE

The BFN 305 course consists of 14 units. Specifically, the course discusses the following:

- The concept 'Banking Regulation'
- A Review of Banking Regulatory Reforms I
- A Review of Banking Regulatory Reforms II
- The Structure and Key Players in Nigeria's Financial System
- Legislation and Regulatory Authorities on Banking in Nigeria
- Central Bank of Nigeria (CBN)
- Nigerian Deposit Insurance Corporation (NDIC)
- The Financial Services Regulations Coordinating Committee (FSRCC)
- Ethics and Best Practices in Banking Industry
- Corporate Governance in Banking
- Sources of Instability in the Banking Sector
- Regulatory Authorities Efforts at Stabilizing the Financial System
- Critical and Emerging Aspects of Banking Practices Subject to Control and Regulation
- Forms and Methods by which Regulatory Authorities Carry out Supervisory Functions in Banks

COURSE AIMS

The aim of this course can be summarised as follows:

It aims to give you an understanding of the concept 'regulation', 'supervision' and legal framework as they affect the banking industry. It also aims at facilitating a good knowledge of the banking regulatory reforms which had taken place in the past as well as the structure and key players in Nigeria's financial system.

Finally, you will have an insight into the ethics and bet practices in the banking industry and related issues concerning governance in the banking industry.

COURSE OBJECTIVES

To achieve the aims set out, the course sets overall objectives. Each unit also has specific objectives. The unit objectives are always specified at the beginning of a unit, you should read them before you start working through the unit. You may want to refer to them during your study of the unit to check your progress.

You should always look at the unit objectives after completing a unit. When you do that, you will ensure that you have followed the instructions in the unit. Below are the overall objectives of the course. By meeting these objectives, you should have achieved the aims of the course as a whole. On successful completion of the course, you should be able to:

- Enumerate the laws and regulations governing banking practices particular and the industry in general;
- Review the banking reforms that have taken place in Nigeria from 1892 to date;
- Define banking regulation and state the reasons for or against banking regulation in the world in general and in Nigeria in particular;
- List out the Structure and Key Players in Nigeria's Financial System as well as explain the role of each of them; and
- Discuss Ethics and Best Practices in Banking Industry, Critical and Emerging Aspects of Banking Practices Subject to Control and Regulation and Forms/Methods by which Regulatory Authorities Carry out Supervisory Functions in Banks.

WORKING THROUGH THIS COURSE

To complete this course, you are required to read the study units, read set books and read other materials provided by the National Open University of Nigeria (NOUN). Each unit contains assignments which you are required to attempt and submit for assessment purposes. At the end of the course, there will be a final examination. The course should take you a total of 16 - 17 weeks to complete.

Below, you will find listed all the components of the course. What you have to do and how you should allocate your time to each unit in order to complete the course successfully on time. The list of all the components of the course is as presented.

COURSE MATERIALS

Major components of the course are:

- Course Guide
- Study Units
- Textbooks
- Assignment
- Presentation Schedule

Study units

The study units in this course are as follows:

Module 1	**Evolution of Law and Bank Regulation in Nigeria**
Unit 1	The concept 'Banking Regulation'
Unit 2	A Review of Banking Regulatory Reforms I
Unit 3	A Review of Banking Regulatory Reforms II
Unit 4	The Structure and Key Players in Nigeria's Financial System
Module 2	**Regulatory Frameworks on Banking and Regulatory Authorities**
Unit 1	Legislation and Regulatory Authorities on Banking in Nigeria
Unit 2	Central Bank of Nigeria (CBN)
Unit 3	Nigerian Deposit Insurance Corporation (NDIC)
Unit 4	The Financial Services Regulations Coordinating Committee (FSRCC)
Module 3	**Ethics and Best Practices**
Unit 1	Ethics and Best Practices in Banking Industry
Unit 2	Corporate Governance in Banking
Unit 3	Sources of Instability in the Banking Sector
Unit 4	Regulatory Authorities Efforts at Stabilizing the Financial System
Unit 5	Critical and Emerging Aspects of Banking Practices Subject to Control and Regulation
Unit 6	Forms and Methods by which Regulatory Authorities Carry out Supervisory Functions in Banks

Textbooks

At the end of each unit of the course, there are reference materials to which you can refer in order to increase the depth of your knowledge on the course. Please take this seriously.

Assignment Files

A number of assignments have been prepared to help you succeed in this course. They will guide you to have understanding and good grasp of the course.

Presentation Schedule

The presentation schedule included in your course materials also have important dates of the year for the completion of tutor-marked assignments (TMAs) and your attending to tutorials.

Remember, you are to submit all your assignments by the due date. You should guard against failing behind in your work.

Assessments

There are two aspects to the assessment of the course: first are the tutor-marked assignments and a written examination.

In tackling the assignments, you are expected to apply information, knowledge and techniques gathered during the course. The assignments must be submitted to your tutor for formal assessment in accordance with the deadlines stated in the ***Presentation Schedule*** and the ***Assignment File***. The work you submitted to your tutor will count for 30 percent of your total course mark.

At the end of the course, you will need to sit for a final written examination of 'three hours' duration. This examination will also count for 70 percent of your total coursework.

TUTOR-MARKED ASSIGNMENTS (TMAs)

Each of the units in the course material has a tutor-marked assignment (TMA) in this course. You only need to submit five of the eight assignments. You are to answer all the TMAs and compare your answers with those of your course mates. However, you should ensure that you collect four (TMAs) from the Study Centre. It is compulsory for you to answer four (4) TMAs from the Study Centre. Each TMA is allocated a total of 10 marks. However, the best three (3) of the four marks shall be used as your continuous assessment score.

You will be able to complete your assignment from the information and materials contained in your reading, references and study units. However, it is desirable in all degree level education to demonstrate that you have read and researched more widely than the required minimum. Using other references will give you a broader viewpoint and may provide a deeper understanding of the subject.

FINAL EXAMINATION AND GRADING

The final examination for BFN 305 will not be more than three hours' duration and has a value of 70 percent of the total course grade. The examination will consist of questions, which reflect the types of practice exercises and tutor-marked problems you have previously encountered. All areas of the course will be assessed.

Use the time between finishing the last unit and sitting for the examination to revise the entire course. You may find it useful to review your tutor-marked assignments and comments on them before the examination. The final examination covers information from all parts of the course.

COURSE MARKING SCHEME

Table showing the total course marking scheme is shown below:

ASSESSMENT	MARKS
Assignment 4 (TMAs)	Best three marks of the 4 TMAs @ 10 marks is 30 marks of the course = 30%
Final Examination	70% of overall course marks
Total	**100% of course marks**

COURSE OVERVIEW

This table brings together the units and the number of weeks you should spread to complete them and the assignment that follow them are taken into account.

Unit	Title of Work	Week Activity	Assessment (end of unit
	Module 1		
1	The concept 'Banking Regulation'	1	Assignment 1
2	A Review of Banking Regulatory Reforms I	1	Assignment 2
3	A Review of Banking Regulatory Reforms II		
4	The Structure and Key Players in Nigeria's Financial System	1	Assignment 3
	Module 2		
5	Legislation and Regulatory Authorities on Banking in Nigeria	1	Assignment 4
6	Central Bank of Nigeria (CBN)		
7	Nigerian Deposit Insurance Corporation (NDIC)		
8	The Financial Services Regulations Co-ordinating Committee (FSRCC)	1	Assignment 5
	Module 3		
9	Ethics and Best Practices in Banking Industry	1	Assignment 6
10	Corporate Governance in Banking		
11	Sources of Instability in the Banking Sector	1	Assignment 7
12	Regulatory Authorities Efforts at Stabilizing the Financial System		
13	Critical and Emerging Aspects of Banking Practices Subject to Control and Regulation		
14	Forms and Methods by which Regulatory Authorities Carry out Supervisory Functions in Banks	1	Assignment 8

	Revision		
	Total	**14**	

HOW TO GET THE MOST FROM THIS COURSE

In distance learning, the study units replace the university lecturer. This is one of the great advantages of distance education. You can read and work through the specially designed study materials at your own pace, and at a time and place that suits you best. Think of it as you read the lecture notes and that a lecturer might set you some readings to do.

The study unit will tell you when to read your other materials. Jut as a lecturer might give you an in-class exercise, your study units also provide assignments for you to do at appropriate points.

Each of the study units follows a common format. The first item is an introduction to the subject matter of the unit, and how a particular unit is related with the other units and the course as a whole.

Next is a set of learning objectives. These objectives let you know what you should be able to do by the time you have completed the unit. You should use these objectives to guide your study. When you have finished the unit, you must go back and check whether you have achieved the objectives set. If you make a habit of doing this, you will significantly improve your chances of passing the course.

The main body of the unit guides you through the required reading from other sources. This will usually be either from **Reading Section** or some other sources.

Self-tests/assignments are interspersed throughout the end of units. Working through these tests will help you to achieve the objectives of the unit and prepare you for the examinations. You should do each of the assignments as you come to it in the study unit. There will also be numerous examples given in the study units, work through these when you come to them too.

The following is a practical strategy for working through the course. If you run into any trouble, telephone your tutor. When you need help, don't hesitate to call and ask your tutor to provide it. In summary:

(1) Read this course guide.

(2) Organise a study schedule. Refer to the course overview for more details. Note the time you are expected to spend on each unit and how the assignments relate to the unit. Important information e.g. details of your tutorials and the date of the first day of the semester is available. You need to gather together all information in one place, such as your diary or a wall calendar. Whatever method you choose

to use, you should decide on and write in your own dates for working on each unit.

(3) Once you have created your own study schedule, do everything you can to stick to it. The major reason that students fail is that they get behind with their coursework. If you get into difficulty with your schedule, please let your facilitator know before it is too late for help.

(4) Turn to unit 1 and read the introduction and the objectives for the unit.

(5) Assemble the study materials. Information about what you need for a unit is given in the 'Overview' at the beginning of each unit. You will always need both the study unit you are working on and one of your set books, on your desk at the same time.

(6) Work through the unit. The content of the unit itself has been arranged to provide a sequence for you to follow. As you work through this unit, you will be instructed to read sections from your set books or other articles. Use the unit to guide your reading.

(7) Well before the relevant due dates (about 4 weeks before the dates) access the Assignment file on the web and download your next required assignment. Keep in mind that you will learn a lot by doing the assignments carefully. They have been designed to help you meet the objectives of the course and, therefore, will help you pass the examination. Submit all assignments not later than the due dates.

(8) Review the objectives for each study unit to confirm that you have achieved them. If you feel unsure about any of the objectives, review the study material or consult your tutor.

(9) When you are confident that you have achieved a unit's objectives, you can then start on the next unit. Proceed unit by unit through the course and try to pace your study so that you keep yourself on schedule.

(10) When you have submitted an assignment to your tutor for marking, do not wait for its return before starting on the next unit. Keep to your schedule. When the assignment is returned, pay particular attention to your facilitator's comments. Consult your tutor as soon as possible if you have any questions or problems.

(11) After completing the last unit, review the course and prepare yourself for the final examination. Check that you have achieved the unit objectives and the course objectives.

TUTORS AND TUTORIALS

There are eight (8) hours of tutorials provided in support of this course. You will be notified of the dates, times and location of these tutorials, together with the names and phone number of your tutor, as soon as you are allocated a tutorial group.

Your tutor will mark and comment on your assignments, keep a close watch on your progress and on any difficulties you might encounter as they would provide assistance to you during the course. You must mail your tutor-marked assignments to your tutor well before the due date (at least two working days are required). They will be marked by your tutor and returned to you as soon as possible. Do not hesitate to contact your tutor by telephone, e-mail, or discussion board if you need help. The following might be circumstances in which you would find help necessary.

Contact your tutor if:

- you do not understand any part of the study units or the assigned readings;
- you have difficulty with the tutor-marked assignments;
- you have a question or problem with an assignment or with your tutor's comments on an assignment or with the grading of an assignment.

You should try your possible best to attend the tutorials. This is the only chance to have face-to-face contact with your tutor and to ask questions which are answered instantly. You can raise any problem encountered in the course of your study during such contact. To gain the maximum benefit from course tutorials, prepare a question list before attending them. You will learn a lot from participating in discussions actively.

SUMMARY

As earlier stated, the course BFN 305, Laws and Regulations of Banking is designed to introduce you to various techniques, guides, principles and practices relating to the regulations and practices of Banking.

We hope you enjoy your acquaintances with the National Open University of Nigeria (NOUN) and wish you every success in the future.

CONTENTS

Module 3

MODULE 1: EVOLUTION OF LAW AND BANK REGULATION IN NIGERIA

You are welcome to the first module of this course Bank Law and Regulation. This module discusses the concept of regulation. It traces the historical evolution of regulation in Nigeria's banking sector and highlights the importance of regulation to the sector. It also discusses the conditions necessary for effective regulation of banking activities as well as the objectives of bank regulation. Other important aspects of the topic discussed in this module include the fundamental elements of bank regulation and the nature of bank regulation. Also discussed are the theories of regulation as well as the different types of regulation.

There is a set of revision questions at the end of the module to enable students deepen their understanding of the topic. Guides are also provided on how these questions should be answered. A list of resource materials is also provided for reference purposes. For ease of understanding, the units under this module are:

UNIT 1 THE CONCEPT 'BANKING REGULATION'

Contents

1.0 INTRODUCTION

You are welcome to the first unit in this module. This unit deals with the meaning, purpose or objectives, importance as well as evolution of bank regulation in Nigeria.

2.0 OBJECTIVE

At the end of this unit, you should be able to:

- define the meaning of regulation with emphasis on the banking sector;
- state the evolution of Bank Regulation
- enumerate the importance of Bank Regulation

- discuss the nature, theories and types of regulation;
- list out the objectives of and conditions for effective regulation of the Banking industry in Nigeria.

3.0 MAIN CONTENT

Banking and the regulation of banks have both been key elements in the development of the Nigeria and its financial system. Banks have attained a unique and central role in the country's financial markets through their deposit-taking, lending, and other activities. Banks hold the vast majority of deposits that are transferable by cheque (Spong, 2000). These demand deposit powers have allowed bankers to become the principal agents or middlemen in many financial transactions and in the nation's payments system. As a result, most payments in Nigeria involve a bank at some point, and this payment system plays a vital role in enabling goods and services to be exchanged throughout our economy. In terms of deposit activities, banks are also important because individuals have traditionally placed a substantial amount of their funds in bank time and savings deposits.

On the lending side, banking organizations have significant flexibility in the types of borrowers they can accommodate. Banks are major lenders to the business sector and to individuals, and thus determine how a large portion of credit is to be allocated across the nation. Moreover, through a combination of lending and deposit activities, the banking system can affect the aggregate supply of money and credit, making banks a crucial link in the monetary mechanism and in the overall condition of the economy.

Other activities of banks are also of major consequence within the financial system and the overall economy. In particular, banking organizations, through the use of bank holding companies, are expanding into many new markets and financial services thereby participate more fully in insurance, securities, and merchant banking activities. Consequently, banking organizations can now provide a wide range of services, including insurance and securities brokerage and underwriting, mutual funds, leasing, data processing of financial information, and operation of thrift associations, consumer finance companies, mortgage companies, and industrial banks.

3.1 Why Regulation?

Given the overall importance of banks to the economy and the level of trust customers place in banks, few people would be surprised to find that governmental regulation and oversight extend to many aspects of banking. The general public, bankers, and regulators have all played roles in developing the present system of banking laws and supervision. As a consequence, the regulatory system has been responsive to many different needs and now serves an important function in establishing many of the guidelines and standards under which banking services are provided to the public. There are many reasons to study banking regulation and supervision, but two general objectives stand out (Spong, 2000).

One is practical: we all conduct transactions through the financial system and deal with banks on a frequent basis. Some knowledge of bank regulations is helpful in carrying out these transactions, understanding how the banking system works, and judging the extent of regulatory protection being provided. Moreover, an understanding of banking regulation has assumed added importance with the growing complexity of the financial system and the recent passage of major banking legislation. The other major reason for studying banking regulation is to ensure that this regulation both protects the public and fosters an efficient, competitive banking system. The actual benefits and costs of banking regulation, in fact, are a concern to many different groups. This attention originates from a number of factors, including the overall importance of the banking industry to the economy and the financial problems encountered by some bank and thrift organizations in past years. Another concern is whether credit and other banking services flow evenly to different segments of the population. In addition, some contend that banking regulation may impose excessive cost burdens that hinder banks in providing services to their customers and in competing with other financial institutions. The benefits and costs of banking regulation are also drawing attention because of many recent industry changes, such as electronic and internet banking, improved communications and data processing systems, and the development of new and more complex financial instruments and risk management practices. These revolutionary, technological changes are bringing banking closer to its customers, altering the way financial transactions and banking operations are conducted, and expanding the variety of services banks can provide. All of these factors are prompting much debate over the appropriate regulatory framework for banks and the types of financial services banks should be able to offer. This debate is also focusing attention on what the basic objectives of bank regulation should be and how existing and proposed regulations will affect our financial system in the future.

The purpose of this unit is to describe the current regulatory system and look at its influence on banks and their customers. The unit further provides a perspective on how banking regulation developed and the specific reasons or purposes for regulating banks. In addition, it outlines many of the changes taking place in banking today and their implications for banking regulation.

3.1.1 Definition of the Concept, 'Regulation'

Ebodaghe (2015) defines regulation as a body of specific rules or agreed behaviour, either imposed by some government or other external agencies or self-imposed by explicit or implicit agreement within the industry, that limits the activities and business operations of financial institutions. Regulation can also be explained as rule or principle developed by some authorities (like government or an agency of the government, association, etc.) – with or without the backing of the law**-** to control, direct, or manage an activity, process or behaviour. Regulation applies to virtually all fields of endeavour with the primary purpose of promoting orderliness through compliance with established standards. It offers a template for inter and intra organizational and individual behaviour, interactions or relationships.

Spong (2000) states that banking regulation, in its strictest sense, refers to the framework of laws and rules under which banks operate. Narrowly defined, supervision refers to the banking agencies' monitoring of financial conditions at banks under their jurisdiction and to the ongoing enforcement of banking regulation and policies. Throughout this course, however, regulation and supervision will be viewed in a more general sense and, in many cases, will be used interchangeably.

With regard to banking, regulation refers to the processes and procedures adopted by banking regulators to oversee, regulate, monitor or control the activities of any or all banking institution(s). Regulation defines the parameters within which an organization should operate. Bank regulation subjects banks to certain requirements, guidelines and restrictions aimed at promoting market transparency in the relationship between banking institutions and their customers. It is an activity exercised by institution(s) vested with the authority to discharge such functions. These institutions are referred to as regulators. In Nigeria, the Central Bank of Nigeria (CBN) is the apex regulator of the banking system with the Nigeria Deposit Insurance Corporation (NDIC) playing complimentary roles.

The imperative for the regulation of the banking sector is informed by the need to promote good banking habit, maintain internationally acceptable standards, protect depositors and creditors as well as provide adequate banking services to the economy. Another important justification for bank regulation derives from the unique nature of the banking industry itself. Though banks are established as distinct business entities, operationally they are highly inter-connected such that a problem in one bank, if not well managed, may be transmitted to other banks and may eventually become systemic. Banks also play pivotal roles in the growth and development process of an economy, hence national and global governments are interested in their operations.

According to Ebodaghe (2015), banks are generally known to hold the bulk of the money supply in an economy. They also create money through the loans and advances they extend to their customers. Banks act as the vehicles of implementing monetary policies and they intermediate between the surplus and deficit units of the economy. As a result of these sensitive activities of gathering of deposits and allocation of credits, banks are vulnerable to liquidity problems and loss of public confidence. It is for these reasons that government usually regulates the banking industry more than any other sector of an economy. Although banks are operated for profit and bankers are free to make many decisions in their daily operations, banking is commonly treated as a matter of public interest. To that extent, banking laws and regulations extend to many aspects of banking, including who can open banks, what products can be offered, and how banks can expand. Consequently, a familiarity with regulatory objectives and goals is essential for understanding how the system of bank regulation and supervision arose and what the purpose of particular regulations might be. Much of the regulatory system has developed in response to financial crises and other historical and political events. No central architect was assigned to design the overall system or lay out a single set of principles. Instead, many people with many viewpoints, objectives, and experiences have been responsible for the current supervisory framework. As a consequence, bank regulation has evolved to serve numerous goals - goals which have changed over time and on occasion even been in conflict with one another. The following sections focus on several of the more commonly accepted goals of bank regulation. Also, because of the potential for conflict among regulatory goals, special attention is given to what banking regulation should not do.

(a) Protection of Depositors

The most basic reason for regulation of banking is depositor protection. Pressure for such regulation arose as the public began making financial transactions through banks, and as businesses and individuals began holding a significant portion of their funds in banks. Banking poses a number of unique problems for customers and creditors. First, many bank customers use a bank primarily when writing and cashing cheques and carrying out other financial transactions. To do so, they must maintain a deposit account. As a consequence, bank customers assume the role of bank creditors and become linked with the fortunes of their bank. This contrasts with most other businesses, where customers simply pay for goods or services and never become creditors of the firm. A second problem for bank depositors is that deposits are only partially backed by the reserves banks hold in the form of cash and balances maintained with the Central Bank of Nigeria (CBN). As a result, depositor safety is linked to many other factors as well, including the capital in a bank and the condition and value of its loans, securities, and other assets. A thorough investigation of these factors is likely to be too complex and costly for the vast majority of depositors, many of whom have accounts too small to justify the scrutiny that might be given to major investments. Even if depositors could accurately assess banks, this condition could change quickly whenever the economy changes or when banks take on new depositors or alter their asset holdings and commitments. In addition, an important part of the information needed to evaluate the condition of a bank may be confidential and unavailable to the public. In summary, bank depositors may have more difficulty protecting their interests than customers of other types of businesses. While depositors could conceivably make general judgments about the condition of banks, the task would still be difficult, costly, and occasionally prone to error. These facts explain much of the public pressure for banking regulation to protect depositors.

(b) Monetary and Financial Stability

Banking regulation must also seek to provide a stable framework for making payments. With the vast volume of transactions conducted every day by individuals and businesses, a safe and acceptable means of payment is critical to the health of our economy. In fact, it is hard to envision how a complex economic system could function and avoid serious disruptions if the multitude of daily transactions could not be completed with a high degree of certainty and safety. Ideally, bank regulation should thus keep fluctuations in business activity and problems at individual banks from interrupting the flow of transactions across the economy and threatening public confidence in the banking system.

The CBN has responsibility for controlling the overall volume of money circulating throughout the economy and thus for providing a stable base for our payments system. Banks play an important role in this monetary system, since their deposit obligations make them the major issuers of money in the economy. This role is further acknowledged through specific laws and regulations determining which institutions can offer deposit accounts, the level of reserves that must be held against these accounts, and the various deposit reports that must be filed. Another policy aspect of monetary stability is supervision and regulation of the banking system. To provide stability, banking regulation should foster the development of strong banks with adequate liquidity and should discourage banking practices that might harm depositors and disrupt the payments system. In banking regulation, the objective of monetary stability has been closely linked with the goal of depositor protection. Financial crises and unintended fluctuations in the money supply have been prevented primarily by promoting confidence in banks and guaranteeing the safety of deposits.

(c) Efficient and Competitive Financial System

Another aspect of a good banking system is that customers are provided quality services at competitive prices. One of the purposes of bank regulation, therefore, is to create a regulatory framework that encourages efficiency and competition and ensures an adequate level of banking services throughout the economy. Efficiency and competition are closely linked together. In a competitive banking system, banks must operate efficiently and utilize their resources wisely if they are to keep their customers and remain in business. Without such competition, individual banks might attempt to gain higher prices for their services by restricting output or colluding with other banks. Competition is also a driving force in keeping banks innovative in their operations and in designing new services for customers. A further consideration is that for resources throughout the economy to flow to activities and places where they are of greatest value, competitive standards should not differ significantly across banking markets or between banking and other industries.

The promotion of an efficient and competitive banking system carries a number of implications for regulation. Competition and efficiency depend on the number of banks operating in a market, the freedom of other banks to enter and compete, and the ability of banks to achieve an appropriate size for serving their customers. For instance, too few banks in a market could encourage monopolization or collusion, while banks of a suboptimal size might be unable to serve major customers and might be operating inefficiently. Consequently, regulators must be concerned with the concentration of resources in the banking industry and with the opportunities for entry and expansion across individual banking markets. Banking regulation must also take an approach that does not needlessly restrict activities of commercial banks, place them at a competitive disadvantage with less regulated firms, or hinder the ability of banks to serve their customers' financial needs. Finally, regulation should foster a banking system that can adapt and evolve in response to changing economic conditions and technological advances.

(d) Consumer Protection

Another goal of banking regulation is to protect consumer interests in various aspects of a banking relationship. The previous regulatory objectives serve to protect consumers in a number of ways, most notably through safeguarding their deposits and promoting competitive banking services. However, there are many other ways consumers are protected in their banking activities. The first is to require financial institutions to provide their customers with a meaningful disclosure of deposit and credit terms. The main intent behind such disclosures is to give customers a basis for comparing and making informed choices among different institutions and financial instruments. The disclosure acts also serve to protect borrowers from abusive practices and make them more aware of the costs and commitments in financial contracts. A second purpose of consumer protection legislation is to ensure equal treatment and equal access to credit among all financial customers. The equal treatment acts can be viewed as the financial industry's counterpart to civil rights legislation aimed at ensuring equal treatment in such areas as housing, employment, and education. Other purposes associated with consumer protection include promoting financial privacy and preventing problems and abusive practices during credit transactions, debt collections, and reporting of personal credit histories.

Consumer protection objectives are generally consistent with good banking principles. In fact, credit and deposit disclosures and informed customers should be of most benefit to bankers offering competitive services. Likewise, equal and nondiscriminatory treatment of borrowers is necessary for any banker aiming to maximize profits. The growing complexity of financial instruments and the uniqueness of individual customers, though, have made consumer protection a very complicated and detailed regulatory process.

3.2 Evolution of Banking Regulation in Nigeria

Regulation is a dynamic process. To be effective, the regulation process must change and adapt to changes in its wider environment. As in many countries of the world, the banking industry is put under serious scrutiny through regulations because of the nature of its activities. The role of banks in the mobilization of funds is considered important to the direction and pace of economic growth and development. The general areas of banks' specialness in the economy include:

- Information services
- Liquidity services
- Price-risk reduction services
- Transaction cost services
- Maturity intermediation services

More specifically, banks are channels for monetary policy transmission and conduits of the payment system. The failure to provide these services or a breakdown in their efficient provision can be costly to both the ultimate sources (households) and users (firms) of savings. The negative externalities affecting firms and households when something goes wrong in the banking sector make a case for regulation. That is, banks are regulated to protect against a disruption in the provision of the services highlighted above and the costs this would impose on the economy and the society at large. For example, bank failures may destroy household savings and at the same time restrict a firm's access to credit. In addition, individual bank failures may create doubts in savers' minds regarding the stability and solvency of banks in general and cause panics and even runs on sound institutions. There is therefore a compelling need for regulation to avert market failure.

Although regulation may be socially beneficial, it also imposes private costs, or a regulatory burden, on individual bank owners and managers. For example, regulations prohibit banks from granting loans and advances beyond a defined percentage of their shareholders funds to single borrowers, the so-called obligor limits. This limit exists despite the possibility that those loans may have a positive net present value to the bank thereby creating an artificial under-investment problem for a bank that is so restricted. Consequently, regulation is an attempt to enhance the social welfare benefits and mitigate the social costs of the provision of financial services. The private costs of regulation relative to its private benefits for the producers of financial services, is called the net regulatory burden.

Regulation in banking, seeking to enhance the net social welfare benefits in the provision of financial services, can be categorized into six (Saunders and Cornett, 2006: 11-14):

1. Safety and soundness regulation: to protect depositors and borrowers against the risk of bank failures, for example, by requiring diversification of credits (sectoral credit allocation), specifying minimum capital required for operations, and provision of safety net through deposit insurance schemes.

2. Monetary policy regulation: For example, the imposition of cash reserve and liquidity ratios on banks to influence the volume of money supply in the economy.

3. Consumer protection regulation: For example, to prevent discrimination in lending especially on the basis of race, age, sex or income.

4. Entry regulation: This exists through licensing and restriction on the types of business that banks may be involved. Licensing will usually specify the minimum requirements to establish a bank (e.g. capital).

5. Credit allocation regulation: These regulations may require a bank to hold a minimum amount of assets in one particular sector of the economy or to set maximum interest rates, prices, or fees to subsidize certain sectors. For example, Nigerian banks have been encouraged to subsidize agricultural loans in Nigeria.

6. Investor protection regulation: This is especially relevant to banks with investment banking business. Various laws exist to protect investors against abuses such as insider trading, lack of disclosure, outright malfeasance, and breach of fiduciary duties.

With regards to Nigerian banking regulation, eight periods are discernible and these are discussed in the next two units. It was also a period when there was an absence of a central bank and the only monetary authority then was the West African Currency Board (WACB) which was no more

than a glorified money changer; the advent of regulation when the colonial government could no longer tolerate a laissez faire regime as a result of distress of proliferating indigenous banks.
The Paton Report of October 1948 provided the basis for the Banking Ordinance of 1952. In addition, the Central Bank of Nigeria (CBN) was established by the CBN Ordinance of 1958 though after much colonial authorities' resistance. The Banking Ordinance of 1958 repealed the 1952 Ordinance. Some amendments were introduced in 1962 and seven years after, a new Banking Decree of 1969 was introduced. Next, intensive regulation under the indigenization era. Next, market-deregulation or liberalization during the SAP-era. Next, the period of guided deregulation especially of the foreign exchange market. Next, the universal banking era. Consolidation era followed. 'Current banking reforms' ended this review.

3.3 Importance of Bank Regulation

All over the world, the banking sector is considered a highly regulated sector of the economy. The attention given to regulation of the banking sector underscores its importance to the promotion of the growth and development objectives of an economy. The traditional role of financial intermediation performed by the banking system promotes efficiency in the use of scarce financial resources thereby enhancing productivity and economic well-being of individuals. The performance of the sector can be used as an indicator of the economic health of a nation. Thus, it can be said that when the banking sector sneezes, the economy catches cold.

There are many reasons for the importance attached to regulation of banking financial institutions but the overriding consideration is maintenance of stability of the financial sector. Adequate regulatory structure ensures that changes in economic conditions do not undermine the health of the economy. Regulation of banking operations helps in the promotion of national interest. The Nigerian Enterprises Promotion Acts I and II which emphasized increased participation of Nigerians and the Nigerian government in banking business was aimed at achieving this objective.

Also, regulation ensures that banks conduct their activities in accordance with the wider economic and social objectives of the government such as maintenance of low interest rates in order to support real sector growth and development and ensuring the flow of credit in line with government pre-determined objectives. Regulation also serves to protect depositors' interests as well as promote efficiency and integrity of the banking system. It also helps to minimize problems of conflict of interest among participants. Other reasons include promotion of efficiency in allocation of credit, curbing monopoly power, and protecting the financially unsophisticated.

3.4 Objectives of Bank Regulation

The objectives of bank regulation are as follows:

(a) to protect depositors through restrictions on the level of risk to which they are exposed.
(b) to minimize the contagion effect of bank failure so that it does not become systemic.
(c) to promote confidentiality of customer information.
(d) to ensure that banks do not become a channel for the transmission of illicit funds.
(e) to promotion of national interest through issuance of guidelines on the flow (magnitude and direction) of credit. In the pursuit of national interest also, regulation may target increased domestic participation in the banking industry (the case of Nigerian Enterprises Promotion Act I & II)
(f) to ensure that customers are fairly treated.
(g) to ensure that banks discharge their corporate social responsibility (CSR).

(h) to promote efficiency and integrity of the financial market by minimizing problems of conflict of interest among participants.
(i) to protect the financially vulnerable or unsophisticated groups and reduce monopoly power in the banking sector.
(j) to promote the stability of the banking sector.

3.5 Nature of Bank Regulation

Essentially, bank regulation can take any of the following forms:

- Capital Requirement: The requirement for capital adequacy in each jurisdiction is based on the standards set by the Bank for International Settlements' Basel Committee on Banking Supervision which sets a framework on how bank capital should be managed in relation to bank assets.

- Reserve Requirement: Originally banks were expected to maintain minimum reserves to control the stock of money in circulation as well as promote safety of banking institutions. Over time however, emphasis on the use of reserve requirements for safety has shifted to its use for liquidity or capital adequacy.

- Reporting and Disclosure Requirement: All information relevant to the operations of a bank should be publicly disclosed in accordance with the specified guidelines. Annual financial reports of banks should be prepared according to accepted reporting standards.

- Corporate Governance: The use of corporate governance as an instrument of regulation is aimed at ensuring that banks are prudently managed. It requires that senior management of banks should maintain close surveillance over the operations of all departments of a bank. There is a positive link between quality of governance and bank performance.

- Restrictions on credit exposure to individual counterparties or groups of connected counterparties: By restricting the volume of credit to high-risk investments, the safety of the banking system is enhanced. High-risk investments may be in the form of over exposure to a single individual or to a group of connected individuals or to high-risk sectors of the economy. It may also be in the form of funding a particular activity like margin lending.

3.6 Theories of Regulation

(a) Public interest theory: This is also called the "helping hand" theory of regulation. Proponents of the theory argue that regulation is supplied in response to the demand of the public for correction of inefficient or inequitable market practices. A primary assumption of the public interest theory is that regulation seeks to promote public interest. Public interest theory also assumes that regulators have adequate information on all dimensions of firm behaviour in addition to requisite enforcement powers to promote public interest. Public interest theorists see the regulatory agencies as a harmless and generous agency of the government capable of correcting market failures. The theory is also based on the assumption that some organizations do not always function in the public interest unless they are supervised or controlled. The theory has been criticized on the following grounds:

(1) The market can regulate itself without any form of government intervention.

(2) Where the market fails to regulate itself, any conflicts among participants can be addressed through law courts.
(3) Where the market fails to regulate itself and private litigation also fails to resolve conflicts, regulation may only add to or compound the problem of market imperfection because government regulators are incompetent, corrupt and captured.
(4) Management of organizations may become unduly oriented towards satisfying the regulators than towards achieving its proper demands and objectives.

(b) Private interest theory: This is also known as the capture theory of regulation. The private interest theory of regulation posits that regulation is supplied in response to the demands of interest groups struggling among themselves to maximize the incomes of their members. Proponents contend that regulation is acquired by the industry and is designed and operated primarily for its benefit. The theory assumes that all economic agents pursue their own interests which may or may not include elements of public interest. Proponents also contend that regulators do not have all the information relating to firm behaviour.

3.7 Conditions for Effective Regulation of the Banking System

The conditions precedent for effective regulation of the banking system is as follows:

(1) The central bank must have the power or authority to control the supply of money or monetary aggregates. This implies that the central bank must be autonomous or independent and therefore be free to formulate and implement monetary policy without government intervention.

(2) The solvency of banking institutions in particular and the entire financial system in general must be assured through appropriate regulatory safeguards.

3.8 Fundamental Elements of Bank Regulation

Below are the fundamental elements of bank regulation:

(a) Licensing and Supervision: A key component of bank regulation is that banks must be duly licensed to operate before they can commence business. To acquire an operating license, prospective applicants must have satisfied relevant conditions specified by the regulator. While in operation, banks are supervised to ensure compliance with operating guidelines.

(b) Minimum Requirements: In order to facilitate the attainment of government economic development objectives, the regulator imposes some minimum standards on banks. A critical element of minimum requirements expected of banks is maintenance of minimum bank capital. There are also minimum reserve requirements, minimum credit to specified sectors, minimum levels of cash (cash ratio) and liquidity (liquidity ratio), etc.

(c) Market Discipline: Banks are required to maintain market discipline by making available all relevant information (financial and otherwise) to the public so that depositors and other creditors are able to make informed investment selection decisions.

(d) Sanctions: Regulations should specify appropriate sanctions for non-compliance.

3.9 Types of Economic Regulation

Below is the list of various economic regulations available:

(a) **Government or command and control regulation**: This refers to the imposition of standards or rules backed up by legislations which specify sanctions when standards are not met or rules complied with. This type of regulation relies on the force of law to define and prohibit certain types of action or impose some types of action on the public. Command regulations are introduced by the operation of the law or by the action of regulators who are legally empowered to establish them. Since they have the backing of the law, they are easily implemented. They also have clearly defined limits. However, they may be complex and too legalistic. Also, government regulations may establish a close relationship between the regulator and regulatee leading to regulatory capture. Regulatory capture refers to a situation where the regulatory agencies become overwhelmed by the very groups they were meant to regulate such that rather than act in public interest they end up advancing the private (commercial or political) interests of some dominant groups.

(b) **Self-regulation**: This may be described as a "do-it-yourself" type of regulation because it is often the result of a conscious effort of the business or trade association to establish its own rules of performance which it enforces and monitors though in some cases, there may be some level of government oversight. A major advantage of self-regulation is that since it evolved from within the business community, it is perceived as serving their collective interest and therefore enjoys a high level of acceptance and commitment. It also enjoys a high level of flexibility because it does not require legislation to modify in line with changing circumstances. Also, the standards are considered to be more realistic and enforcement is cheaper. However, enforcement may be weaker and independent oversight more difficult. It could also be self-serving and could promote monopolistic tendencies.

(c) **Incentive-Based regulation**: This is a "carrot and stick" approach to regulation. Under this approach, emphasis is to induce the regulatee to stop or limit some undesirable activity through imposition of levies (taxes) or granting of subsidies in order to achieve socially desirable objectives. This approach entails low regulatory discretion and low enforcement costs. It also promotes innovation and allows regulatees freedom of choice. On the other hand, it has some inherent drawbacks which include: difficulty in predicting impact, complexity and inflexibility of rules, assumption of economic rationality which may not always be true and inefficient reward system.

(d) **Market-based regulation**: This are essentially used to regulate the activities of the market and can prove to be a more cost-effective method of enforcing regulation as it can minimize regulatory interference in the daily operations of business organizations. Market-based regulations are applicable across sectors, have low enforcement costs because disputes are easily resolved by participants, are more flexible, and are easily responded to. However, market-based regulation may promote monopolistic tendencies through imposition of barriers to entry. It also relies so much on market efficiency which may not always exist. Also, there may be a lack of response in times of crisis.

4.0 CONCLUSION

There are exogenous and endogenous that can precipitate instability in the banking system. These include macroeconomic shocks emanating from the negative effects of financial liberalization, globalization and rapid technological changes (exogenous factors) and the endogenous factors that include inappropriate corporate governance and inadequate regulatory and supervisory capacity among others.

5.0 SUMMARY

We have in this unit defined regulation with emphasis on the banking sector; stated the evolution of Bank Regulation; enumerated the importance of Bank Regulation; discussed the nature, theories and types of regulation; and listed out the objectives of and conditions for effective regulation of the Banking industry in Nigeria.

In the next two units, a review of banking regulatory reforms would be made for students to have a proper grasp of what transpired over the years in the banking sector.

6.0 TUTOR-MARKED ASSIGNMENT

1. Discuss the basic elements of bank regulation.
2. What are the basic objectives of bank regulation?
3. Globally, it is said that the banking is the most heavily regulated sector. Why do governments attach so much importance on the regulation of the banking industry?
4. Discuss the major types of bank regulation.
5. Discuss the major theories of bank regulation.
6. Briefly explain the nature of bank regulation as practiced in Nigeria.

Suggested Answers to TMA Questions

1. The basic elements bank regulations are as follows:
    (a) Licensing and Supervision: Licensing is a basic requirement for a firm to operate as a bank. To acquire an operating license, prospective applicants must have satisfied relevant conditions specified by the regulator. While in operation, banks are supervised to ensure compliance with operating guidelines.
    (b) Minimum Requirements: In order to facilitate the attainment of government economic development objectives, the regulator imposes some minimum standards on banks. A critical element of minimum requirements expected of banks is maintenance of minimum bank capital. There are also minimum reserve requirements, minimum credit to specified sectors, minimum levels of cash (cash ratio) and liquidity (liquidity ratio), etc.
    (c) Market Discipline: Banks are required to maintain market discipline by making available all relevant information (financial and otherwise) to the public so that depositors and other creditors are able to make informed investment selection decisions.
    (d) Sanctions: Regulations should specify appropriate sanctions for non-compliance.

2. The objectives of bank regulation are:
    (a) To protect depositors through restrictions on the level of risk to which they are exposed.
    (b) To minimize the contagion effect of bank failure so that it does not become systemic.
    (c) To promote confidentiality of customer information.
    (d) To ensure that banks do not become a channel for the transmission of illicit funds.
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(g) To ensure that banks discharge their corporate social responsibility (CSR).
(h) To promote efficiency and integrity of the financial market by minimizing problems of conflict of interest among participants.
(i) To protect the financially vulnerable or unsophisticated groups and reduce monopoly power in the banking sector.
(j) To promote the stability of the banking sector.

3. All over the world, the banking sector is considered a highly regulated sector of the economy. The attention given to regulation of the banking sector underscores its importance to the promotion of the growth and development objectives of an economy. The traditional role of financial intermediation performed by the banking system promotes efficiency in the use of scarce financial resources thereby enhancing productivity and economic well-being of individuals. The performance of the sector can be used as an indicator of the economic health of a nation. Thus, it can be said that when the banking sector sneezes, the economy catches cold.

   There are many reasons for the importance attached to regulation of banking financial institutions but the overriding consideration is maintenance of stability of the financial sector. Adequate regulatory structure ensures that changes in economic conditions do not undermine the health of the economy. Regulation of banking of operations helps in the promotion of national interest. The Nigerian Enterprises Promotion Act I and II which emphasized increased participation of Nigerians and the Nigerian government in banking business was aimed at achieving this objective. Also, regulation ensures that banks conduct their activities in accordance with the wider economic and social objectives of the government such as maintenance of low interest rates in order to support real sector growth and development and ensuring the flow of credit in line with government pre-determined objectives. Regulation also serves to protect depositors' interests as well as promote efficiency and integrity of the banking system. It also helps to minimize problems of conflict of interest among participants. Other reasons include promotion of efficiency in allocation of credit, curbing monopoly power, and protecting the financially unsophisticated.

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   Regulatory capture refers to a situation where the regulatory agencies become overwhelmed by the very groups they were meant to regulate such that rather than act in public interest they end up advancing the private (commercial or political) interests of some dominant groups.

   Self-regulation: This may be described as a "do-it-yourself" type of regulation because it is often the result of a conscious effort of the business or trade association to establish its own rules of performance which it enforces and monitors though in some cases, there may be some level of government oversight. A major advantage of self-regulation is that since it evolved from within the business community, it is perceived as serving their collective interest and therefore enjoys a high level of acceptance and commitment. It also enjoys a high level of flexibility because it does not require legislation to modify in line with changing circumstances. Also, the standards are considered to be more realistic and enforcement is cheaper. However, enforcement may be weaker and independent oversight more difficult. It could also be self-serving and could promote monopolistic tendencies.

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5. **Public interest theory**: This is also called the "helping hand" theory of regulation. Proponents of the theory argue that regulation is supplied in response to the demand of the public for correction of inefficient or inequitable market practices. A primary assumption of the public interest theory is that regulation seeks to promote public interest. Public interest theory also assumes that regulators have adequate information on all dimensions of firm behavior in addition to requisite enforcement powers to promote public interest. Public interest theorists see the regulatory agencies as a harmless and generous agency of the government capable of correcting market failures. The theory is also based on the assumption that some organizations do not always function in the public interest unless they are supervised or controlled.

   The theory has been criticized on the following grounds:
   (i) The market can regulate itself without any form of government intervention.
   (ii) Where the market fails to regulate itself, any conflicts among participants can be addressed through law courts.
   (iii) Where the market fails to regulate itself and private litigation also fails to resolve conflicts, regulation may only add to or compound the problem of market imperfection because government regulators are incompetent, corrupt and captured.
   (iv) Management of organizations may become unduly oriented towards satisfying the regulators than towards achieving its proper demands and objectives.

   Private interest theory: This is also known as the capture theory of regulation. The private interest theory of regulation posits that regulation is supplied in response to the demands of interest groups struggling among themselves to maximize the incomes of their members. Proponents contend that regulation is acquired by the industry and is designed and operated primarily for its benefit. The theory assumes that all economic agents pursue their own interests which may or may not include elements of public interest. Proponents also contend that regulators do not have all the information relating to firm behaviour.

6. Essentially, bank regulation can take any of the following forms:
    1. Capital Requirement: The requirement for capital adequacy in each jurisdiction is based on the standards set by the Bank for International Settlements' Basel Committee on Banking Supervision which sets a framework on how bank capital should be managed in relation to bank assets.

    2. Reserve Requirement: Originally banks were expected to maintain minimum reserves to control the stock of money in circulation as well as promote safety of banking institutions. Over time however, emphasis on the use of reserve requirements for safety has shifted to its use for liquidity or capital adequacy.

    3. Corporate Governance: The use of corporate governance as an instrument of regulation is aimed at ensuring that banks are prudently managed. It requires that senior management of banks should maintain close surveillance over the operations of all departments of a bank. There is a positive link between quality of governance and bank performance.

    4. Reporting and Disclosure Requirement: All information relevant to the operations of a bank should be publicly disclosed in accordance with the specified guidelines. Annual financial reports of banks should be prepared according to accepted reporting standards.

    5. Restrictions on credit exposure to individual counterparties or groups of connected counterparties: By restricting the volume of credit to high-risk investments, the safety of the banking system is enhanced. High-risk investments may be in the form of over exposure to a single individual or to a group of connected individuals or to high-risk sectors of the economy. It may also be in the form of funding a particular activity like margin lending.

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UNIT 2: REVIEW OF BANKING REGULATORY REFORMS I

Contents

1.0 INTRODUCTION

In the last unit, we defined regulation with emphasis on the banking sector; stated the evolution of Bank Regulation; enumerated the importance of Bank Regulation; discussed the nature, theories and types of regulation; and listed out the objectives of and conditions for effective regulation of the Banking industry in Nigeria.

In this unit and the next one, a review would be made of the banking regulatory reforms to facilitate easy understanding of what transpired over the years in the banking sector.

2.0 OBJECTIVES

At the end of this unit, you should be able to review the banking regulatory reforms that took place up to and including 1993.

3.0 MAIN CONTENT

3.1 Era of Free Banking or Laissez-Faire Banking (1891 – 1951)

Commercial banking in Nigeria commenced in 1891 with the advent of the African Banking Corporation of South Africa in 1892. In 1894, the operations of the African Banking Corporation were taken over by the Bank of British West Africa (BBWA), now First Bank of Nigeria Limited. In 1899, a second foreign bank, Bank of Nigeria, was established. This bank was absorbed by the BBWA in 1912. BBWA had the banking field to itself for the next five years with the year 1917 seeing the advent of the Colonial Bank (later, Barclays D.C.O. and then Union). Colonial banking in Nigeria was initially established to provide services to the colonial government and to nurture British commercial interests. It was therefore not surprising that these banks were registered in London, headquartered in London and controlled from London (Uche, 1998). The colonial banks thus fell under the regulatory jurisdiction of London and had little need for host territory regulation. They established operations in localities where British commercial interests predominated and did not aim to satisfy the needs of Africans. In the eyes of the British authorities and colonial banks, the African was too primitive to merit banking services. Africans were also not considered creditworthy. The colonial banks were however willing to receive African deposits but not to extend credit to them. Up to 1952, banking activities was conducted without any form of regulation. The era could be described as one of free-for-all banking without any requirement for an operating license or any form of regulation to restrict and control the establishment and operations of banking business. The period saw the emergence of quite a number of banks which rapidly collapsed in quick successions, the greatest victims being those established through indigenous initiatives. These banks collapsed owing to factors that include low level of bank capital or inadequate capitalization, poor staffing, gross insider abuses, corruption, over-expansion and other structural constraints.

The discriminatory policies and practices motivated the establishment of indigenous banks to challenge the status quo. In this regard, Nigeria was unique as it was the only country among the British West African colonies to establish indigenous banks alongside the colonial banking system (Uche 2000; Anyanwu, et al 1997; Nwankwo 1980). The period 1892 to 1951 was basically a period generally referred to as the era of "free banking" or laissez-faire banking because there were no rules or guidelines controlling the activities of banks. There were no rules, regulation and/or laws that regulated the business of banking until 1952 when the first ordinance was enacted. During this period a number of indigenous banks came up but many failed as a result of inadequate capital, bad management, poor staffing and fraud. The early banks that operated in Nigeria in the late 19th century had extensive British links. At the time, the United Kingdom did not have any formal and elaborate structure of banking supervision, as the regulation of banking in the UK began with informal controls by the Bank of England and was eventually placed on a statutory basis by the Banking Act 1979.

Accordingly, from the onset there was no attempt to regulate banking in Nigeria. Most of the early foreign banks in Nigeria were established to cater for British trading interests and the banking needs of the colonial government. It was not their aim to service the indigenous people. This discriminatory attitude led to the emergence of indigenous banks. Most of these banks were poorly staffed, poorly capitalized and sometimes fraud infested (Ogowewo and Uche, 2006: 167). Specifically, the first attempt at establishing an indigenous bank in Nigeria came in 1929 with the establishment of the Industrial and Commercial Bank. This bank failed in 1930. In 1931, the Nigerian Mercantile Bank was established but collapsed in 1936. The National Bank of Nigeria (NBN) was established in 1933 with an authorized capital of N500,000, of which only N1,152 was paid up initially. With this came the break of the monopoly of domestic banking scene by foreign banks. The Agbonmagbe Bank was set up in 1945. This bank metamorphosed into Wema Bank. Within this same period, the Nigerian Penny Bank was established but collapsed quickly thereafter in 1946. In 1947, the third successful indigenous bank, the African Continental Bank (ACB) was established with an authorized capital of N20,000. The indigenous banks were established partly to augment the activities of the few expatriate banks - Bank of British West Africa (now First Bank), Barclays Bank DCO (now Union Bank) and British and French Bank (now United Bank for Africa) and partly to serve the credit needs of indigenous businesses which were largely discriminated against in the credit delivery operations of the foreign banks. Of the indigenous banks established during the period, only the defunct National Bank of Nigeria, Agbonmagbe Bank (now Wema Bank) and the now defunct African Continental Bank survived.

Specifically, these 3 indigenous banks owed their survival to the support of regional governments. In the period 1950-51, which is often referred to as the period of banking boom in Nigeria, about eighteen banks were hurriedly established. By the end of 1954, seventeen banks had either gone into voluntary liquidation or were closed by the police. The only survivor was the Merchant Bank, which finally collapsed in the early part of 1960 (Ajayi and Ojo, 2006:20). The development of indigenous banks within the Nigerian economy was indeed a very turbulent one. The collapse of many indigenous banks weakened public confidence in them. A host of factors was responsible for the failure of these banks. First, many of the banks had insufficient capital. Fourteen of the eighteen banks had a paid-up capital of less than N1,200 (equivalent of six hundred pounds), and this was often used to pay off the losses incurred in the previous year. Second, many of the banks were poorly managed and lacked foresight. Third, records were either badly kept or not kept at all. Fourth, many of the banks expanded their offices too rapidly. For example, the Nigerian Farmers and Commercial Bank with a paid-up capital of about N26,000 had twenty-eight offices within a short time. Finally, there were no banking regulations to specify banking code of conduct. The distress of indigenous banks in the 1940s made it difficult for the colonial government to sustain this laissez faire banking regulatory regime in the Nigerian colony. The spate of bank failures during the free banking period prompted the setting up of a commission of enquiry by the then colonial administration to investigate the conduct of banking activities in the country. Mr. G.D. Paton of the Bank of England was therefore appointed to review the Nigerian Banking system with a view to introducing regulation. The Paton Report of 1948 laid the foundation for the enactment of the first banking legislation in Nigeria, the 1952 Banking Ordinance.

The banking sector in Nigeria, to date, has witnessed quite a number of legislations aimed at promoting the development of the sector and by extension the performance of the entire economy. Regulation of the financial sector is very crucial for the smooth functioning and orderly development of the sector in particular and the economy in general.

The financial sector is made up of the money and capital markets. At the initial period, the apex regulator of the financial market in Nigeria was the Central Bank of Nigeria (CBN). The CBN Act of 1958 confers regulatory authority over the financial sector in Nigeria on the Central Bank of Nigeria. However, owing to the need to promote efficiency of the regulatory function, the Securities and Exchange Commission (SEC) was established, through the Securities and Exchange Commission Decree of 1979, to exclusively regulate capital market activities while the CBN concentrates on the regulation of the money market, with the Nigeria Deposit Insurance Corporation (NDIC) playing complementary roles.

A review of the banking regulation in Nigeria would be discussed in great detail in subsequent module/units.

3.2 The Era of Banking Regulation (Beginning from 1952)

In 1948, the colonial authorities set up a commission to enquire into banking business in Nigeria and make recommendations to the government on the extent as well as the form of control that was required in the country. The Paton Committee that was set up in September 1948 reported in October same year and produced the Paton Report, Report on Banking in Nigeria. There are, at least, three discernible periods in this era of banking regulation.

The first was the era of limited regulation from 1952-1958, the era of intensive regulation from 1958-1972 and the era of regulation and indigenization (1972 – 1986). With the enactment of the 1952 Banking Ordinance came the initial attempt at regulating the banking industry. The 1952 Banking Ordinance defined banking business as "the business of receiving from the public on current account, money which is to be repayable on demand by cheque and on making advances to customers." The Ordinance stipulated the provisions for licensing of banks. Only a registered company could hold a valid banking license. It also stipulated the procedures for banking business by prescribing minimum capital requirements for banks. Specifically, if a banking license is to be granted by the Financial Secretary:

- The minimum paid-up capital required for indigenous banks was £12,500 (or ₦25,000) and for expatriate banks £100,000 pounds (or ₦200,000).

- Banks were required to maintain a reserve fund into which at least 20 percent of their profits had to be paid annually. This allocation had to be made until the total fund was equal to the paid-up capital.
- Provide an adequate degree of liquidity satisfactory to the Financial Secretary.
- Abstain from granting loans and advances on the security of their own shares and granting unsecured loans and advances in excess of 300 pounds to any one or more of its directors or related parties.
- Refrain from paying dividends until all their capital expenditure not represented by tangible assets had been written off; Make periodic returns to the Financial Secretary.
- The Ordinance became effective immediately for new banks, while the existing banks were given a three-month grace period within which they were required to obtain a license and three years to comply with the provisions of the Ordinance.
- The Financial Secretary was given the power to refuse or to withdraw a license if, in his opinion, he was satisfied that there was some defined deficiency in the operations of a bank.
- Finally, another important provision of the Ordinance was the periodic examination and supervision to which the banks were subjected. This was to ensure that banks did comply with the provisions of the Ordinance.

While the 1952 Banking Ordinance was seen as a great advancement in the attempt to develop a sound financial system, it nevertheless had inherent defects. In the first place, no provision was made for assisting banks in need. More damaging to the indigenous banks was the three-year ultimatum given to comply with the provisions of the Ordinance or discontinue banking business. The fact that the indigenous banks were given a maximum period of three years to comply or face liquidation, coupled with the fact that there was no deposit insurance scheme in place to compensate depositors in the event of such a liquidation precipitated a run on those under-capitalized indigenous banks. Secondly, the single obligor limit was specified in absolute terms instead of relating it to some measure of bank-specific risk or capacity to absorb losses (e.g. capital). Third, many banks kept idle cash in order to maintain the required liquidity level. Since there was no avenue for them to invest these funds, it was indeed an economic waste. This must have hindered the efficiency of their intermediation role.

The expatriate banks on the other hand were in an advantageous position. Not only could they get funds from their overseas headquarters in times of need, they also had access to the money and capital markets in London. Furthermore, in the absence of a Central Bank, the credibility of bank examination was at stake. The use of bank examiners was not as successful as envisaged because of the dubious window-dressing techniques that banks used to deceive the bank examiners. In addition, the laws were capable of preventing undercapitalized banks from being established, but they were incapable of preventing malpractices and abuses in banking (Ajayi and Ojo, 2006:25).

The period of intensive regulation began with the Banking Ordinance of 1958 and the CBN Act of 1958. Specifically, the new Banking Ordinance 1958 raised the minimum share capital for foreign banks from £100,000 (pounds sterling) to £200,000 (pounds sterling) while the requirement for indigenous banks remained unaltered. As Ogowewo and Uche (2006) noted, this new capital requirement had little practical impact on the Nigerian Banking industry at the time as most of the existing foreign banks had paid-up capital above the recommended minimum. Barclays Bank (DCO), for instance, had a paid up share capital of £7.1 million (1947) while that for the Bank of British West Africa was £1.2 million (1948). Other important aspects of the Ordinance include:

- The raising of the proportion of profits to be transferred to the reserve fund from 20 percent to 25 percent;

- The prohibition of banks from trading or owning real estate except where absolutely necessary;
- The fixing of a limit of loans to any one person or client at 25 percent of paid-up capital; and
- The provision for a reserve requirement, the amount and composition of which could be changed by the Central Bank.

However, the CBN Act of 1958 gave legal backing to the establishment of the Central Bank of Nigeria (CBN). The bill establishing the CBN was passed in the Federal House of Representatives in 1958 based on the report of J.B. Loynes of 22nd August 1957. However, real banking operations did not start until July 1959. With this, the CBN was armed with the power to stipulate measures to curb bank failures. The Act gave the Central Bank the power to promote and integrate the Nigerian financial system. From a brief historical perspective during the period in which the four British West African territories were under colonial rule, the West African Currency Board (WACB) was the colonial monetary authority. The WACB was set up in 1912 with headquarters in London. The constitution of the WACB charged it 'to provide for and control the supply of currency to the British West African Colonies, Protectorates and Trust Territories'. In practice, however, the Board was no more than a Bureau de Change issuing as much local currency as the banks wanted to buy for sterling and vice versa. Such a system satisfied the Bank of England's monetary policy objective of achieving price stability in the colonies. The price stability policy was compatible with both the British trade interests and the colonial Banks that oiled the trade mechanism. The Board remained in operation until the early 1960s.

Unlike the indigenous banks, the foreign banks were happy with the WACB which ensured price stability and did not interfere with their operations. The indigenous banks however favoured the establishment of a Central Bank with the hope that such a bank could act as a lender of last resort to poorly capitalized and poorly staffed indigenous banks. In other words, Africans saw the establishment of central bank as a vehicle to assist their beleaguered banks. Also entwined in this event was the belief by indigenes that a central bank would make it easier for them to access credit, which would help power the much needed development. Such views sometimes stemmed from a misconception of central banking. Also, the WACB was seen as the financial hallmark of colonialism. Dismantling it was therefore a legitimate part of the de-colonization process. Foreign banks were uncomfortable with such views. Policies that involved taking orders from indigenous African governments, with respect to their operations, could not be accepted with joy. The WACB system, which exerted little influence on their operations, therefore suited their interests best. Further, the monopoly of the two chief banks in the distribution of government silver currency was bound to be lost with the introduction of a central bank. In addition, the Bank of England was against the establishment of central banks in under-developed economies. The Bank believed that without developed political structures, political interference in the activities of such central banks was inevitable. It was also believed that such central banks would be of little use in territories with undeveloped money markets. Furthermore, developmental functions were then outside the scope of central banking at least in colonial government circles (Uche, 2009a). Foreign banks were not the only beneficiaries of the WACB system. The colonial government also earned seigniorage profits from the system.

The motion for a central bank with lender of last resort functions, not surprisingly, did not please the Financial Secretary appointed by the colonial government who argued that Nigeria at "its stage of development" was better served by a Currency Board than a Central Bank. He was nevertheless prepared to reconsider the matter. This culminated in the revision of the motion to exclude assistance to indigenous banks. In other words, the colonial government did not consider it important that a central bank, if established, should concern itself with developmental functions such as providing assistance to the existing African banks. J. L. Fisher of the Bank of England was subsequently invited to examine the matter. He advised against the establishment of a central bank in the colony. A 1953 Report of the International Bank for Reconstruction and Development (IBRD) disagreed with the Bank of England position on central banking in Nigeria. This helped resuscitate the central banking idea in the colony and culminated in the establishment of Central Bank of Nigeria in 1958. The IBRD's report on Nigeria also influenced the establishment of a central bank in Ghana (1957), Sierra Leone (1963) and Gambia (1971). Amendments to the Banking Act 1958 occurred in 1962 with the following important provisions:

- The minimum share capital of banks was reviewed upwards: indigenous banks £250,000;
- foreign banks £250,000. Existing banks were given a seven-year grace period to comply with the new regulation. [This grace period was commendable compared to the three-year period of the 1952 Banking Ordinance].
- Foreign banks were required to give a satisfactory undertaking to the Minister of Finance to retain in Nigeria, funds equal to the minimum £250,000. The composition of liquid assets was re-defined.
- Banks were allowed to own real estate for the purpose of future development. Just as the seven years grace period was about to expire, a new banking decree, repealing the earlier banking legislation of 1958, was enacted by the then military dictatorship. Specifically, the minimum paid-up capital was reviewed upwards from £250,000 to £300,000 for indigenous banks.
- Expatriate banks were required to beef up capital to minimum of £750,000. All banks were required to be incorporated locally with the enactment of the Companies Act 1968.
- Only the balance sheet of their Nigerian operations was required to be published.
- The Central Bank was given the power to monitor as well as approve banks' advertisement and also to authorize the opening and the closure of bank branches.
- In addition to the existing requirement for banks to transfer 25 percent of their net profit into a reserve fund until the total sum was equal to the paid-up capital, this Decree further required that a transfer of 12.5 percent of net profit be made where the amount of reserve funds was equal to, or in excess of, paid-up share capital.
- The CBN was strengthened to exercise its powers in maintaining monetary stability within the economy. Limits were imposed on interest rates and bank lending to the private sector.

The end result of these share capital increases was the exit of private indigenous banks from the Nigerian banking space. By 1969, all the indigenous banks that survived the 1953-54 crises had been taken over by the regional/state governments. This was because share capital increases had made private indigenous participation in bank ownership difficult (Ogowewo and Uche, 2006: 168). As Uzoaga (1986) noted: ''The cumulative effect of the successive increase in minimum capital requirements has been the socialisation of the most promising private indigenous banks as well as the erection of thorny barriers against effective participation of private indigenous companies in the banking business. Only two groups can now afford to meet easily the stringent capital requirements to operate banks in Nigeria. These are the expatriate banking companies and the statutory or state sponsored agencies.''

3.3 The Era of Regulation and Indigenization (1972-1986)

During the 1970s, government acquired controlling shares in a number of foreign banks, including the "big three" commercial banks which dominated the Nigerian banking space, with the objective to directly influence their lending policies to the maximum benefit of the economy. The motivation for the Federal Government equity participation in banking was the urgent need to control strategic industries (or what was popularly referred to as the commanding heights of the economy) and to further the indigenization policy that it was pursuing (Ajayi and Ojo, 2006:28; Uche, 2011). The policy of Government in banks in which it held equity was to appoint board members including the Chairman and to set out broad policy guidelines for their operations, while the daily running was left with banks' management. While the Exchange Control Act of 1962 did not deal with banks directly, banks were however affected as the transactions were carried out through the banking system. The existing foreign exchange restrictions would necessarily affect the activities of banks. Nevertheless, the arrangement of government equity participation in banks explains the relative stability that reigned in the banking system up until the adoption of the Structural Adjustment Programme (SAP) in 1986.

During this Pre-SAP era of intensive regulation and government ownership of banks, the government was unwilling to let any of its banks fail irrespective of the bank's financial condition or quality of management. Government feared the potential adverse effects on confidence in the banking system and in the economy following a bank failure. Consequently, government deliberately propped up a number of inefficient banks, thus implicitly protecting the shareholders. The stability however was accompanied with some 'private costs' in the form of substantial bad debts that resulted from lending to government and preferred sectors.

In the subsequent phase (SAP era), government focus shifted from shareholders' protection (by averting bank failure) to protection of depositors through the establishment of an explicit deposit insurance scheme. Specifically, it has been argued that the foundation of another phase of banking distress was laid during the Indigenization era. It has been severally argued that the balance sheet structure of banks (maturity mismatching of assets and liabilities and the non-marketability of some assets) render them particularly vulnerable to inflation. In the words of Merton Miller, banking is a 19th century disaster-prone technology. It is thus, in the interest of such banks to lobby for the enforcement of policies that will counter inflation which was caused by government fiscal recklessness. The huge government reserves accumulated from the oil boom at that time fuelled fiscal indiscipline. Indigenization therefore greatly weakened the ability of the banking sector to protect itself. Government ownership of the banks ensured that when it came to the inflation debate, government was simply talking to itself (Uche 2007: 11). It simply became difficult to distinguish between views of government and views of the banks. This was further complicated by the fact that the small size of the Nigerian financial system relative to the GDP effectively reduced banks' clout with respect to influencing government policies. Until fiscal recklessness is checked, the use of monetary policies alone to achieve macroeconomic stability will remain nothing more than an illusion. Thus, under this scenario and even in a democratic setting, any talk about central banking independence will be of little consequence on price stability. This argument became quite obvious with the distress that later plagued the banking industry during the SAP and Post-SAP periods.

A rural banking scheme was launched in July 1977 with the decision to allocate banks to identified rural areas on the basis of a formula which related the number of each bank's rural branches to its total branch network throughout the country. The purpose was to mobilize rural savings and channel them to rural development. Specifically, banks were required to establish over 750 rural branches over a period of 10 years. The sole aim was to mobilize the financial resources of the rural areas, promote banking habit, attract cash held in the rural areas to the banking system in order to enhance the effectiveness of monetary policy and extend credit to the rural areas. The CBN offered a number of incentives to encourage rural bank establishment, including waiving feasibility study for rural branches, excluding rural bank credits from total loans and advances (e.g. for purpose of prudential loan-to-deposit limits), granting a reasonable monopoly period in a rural branches location to enable a bank build up sizeable number of branches in the same locality; and allowing a 5 percent (from April 1980) investment allowance in excess of what is normally allowable in industrial companies (normal initial 15% and annual 10% allowed by banks as industrial enterprises). However, problems such as infrastructural deficits, poverty levels and illiteracy contributed to the low volume of rural business to cover banking overheads.

Further, the nationalization of the major banks heightened focus on compliance with the allocative policy on lending in accordance with the Banking Decree of 1969. Thus, direct control measures such as sectoral credit guidelines and interest rate controls were used to influence allocation of resources to the public and preferred sectors of the economy, notably agriculture and manufacturing. In addition, interest rates in real terms were generally negative leading to low savings, misdirected lending and low growth. The era was characterized by poor service culture, low level of technology utilization for accounting and operations, and made banking halls the most unwelcome places to visit as long queues and the use of "tally numbers" were commonplace. It was the era of "sellers market" characterized by armchair banking.

3.4 The Era of Structural Adjustment Programme (SAP) / Financial System Deregulation (1986-1993)

In 1986 the Babangida Administration, under pressure from the International Monetary Fund (IMF) and the World Bank, launched the Structural Adjustment Programme (SAP). The sharp fall in oil revenues in the first half of the 1980s, accumulated trade arrears and increased debt service burden had precipitated an economic crisis which also reinforced the liberalization of government controls in the economy. SAP was therefore introduced and designed to achieve balance of payment viability by altering and restructuring the production and consumption patterns of the economy, eliminating price distortions (to improve efficiency of resource allocation), reducing the heavy dependence on consumer goods imports and crude oil exports, enhancing the non-oil export base, rationalizing the role of the public sector, accelerating the growth potential of the private sector and achieving sustainable growth. To achieve the stated objectives, the main strategies of the programme were:

- the adoption of a market-determined exchange rate for the Naira (₦),
- the deregulation of external trade and payments arrangements,
- reductions in price and administrative controls and
- more reliance on market forces as a major determinant of economic activity.

An integral part of this programme was the deregulation of the banking system. Bank licensing policy was liberalized thereby giving rise to a proliferation of banks and other financial institutions. For instance, during the period 1985-1992, the number of licensed commercial and merchant banks increased from 40 to 120. Most of these new banks were no more than money changers (Bureau de Change). The deregulation of the economy had obvious loopholes and sometimes made outright evasion of the law possible for some of the banks to survive and prosper by mainly trading foreign exchange. Other policy thrust during the SAP era included:

- Deregulation of interest rate regime
- Establishment of the Nigerian Deposit Insurance Corporation (NDIC)
- Promulgation of the CBN Act 1991 and Banks and Other Financial Institutions Act (BOFIA) 1991 (Decree numbers 24 and 25 respectively);
- Introduction of Open Market Operations.

As early as the beginning of SAP, the deregulation of interest rates was accepted as an important element of the reform process. Early in 1987, the interest rate structure was adjusted upwards. This policy was taken as a means of improving the efficiency of the banking system and improving resource allocation. The principles of maintaining a minimum level of interest rate on savings and time deposits and a maximum lending rate was retained. The controls on interest rates were removed in 1987 and the CBN adopted the policy of fixing only its minimum rediscount rate. This was to signal the CBN's desired direction of interest rate changes.

Another major interest rate policy that was taken was in 1989 when the CBN announced that banks could pay interest on current account deposits while the rate to be paid would be negotiable between banks and their customers. Subsequently, the payment of interest on demand deposits was made mandatory for banks in January 1990. The purpose of this was to enhance greater competition in the mobilization of savings. Two major changes to interest rates occurred before 1992. The first was the issuance of guidelines by the CBN on the spread of banks' interest rates. This affected the spreads between savings deposit and prime lending rates, the prime and the highest lending rates and the margin between inter-bank interest rates and prime lending rates. The second modification was in January 1991 when the government, as a temporary measure had to prescribe a maximum margin between the banks' average cost of funds and their maximum lending rates as well as a minimum level of savings deposit rates. The resultant high interest rates were suspected to inhibit investment and hence growth, thus counterproductive. In 1992, the policy of interest rate deregulation was reinstated as a result of the orderliness that has been restored to the interest rate regime. The reforms in the financial sector were designed to increase competition, and strengthen the supervisory role of the regulatory authorities.

The proliferation of banks that ensued from financial liberalization brought about mixed blessings. While the increased number of banks brought about keen competition with all the different innovations, it also overstretched the limited number of qualified people in the industry. Some banks resorted to poaching in an attempt to get the necessary manpower for the management of their banks. As a result of the increasing demand for high-level manpower, given the limited supply, standards were compromised. As a result of the compromise of standards together with other defects such as rampant internal mismanagement, insider abuse, massive loan repayment defaults and macroeconomic instability, there was systemic distress in the banking sector in the Post-SAP era (between 1995 and 2000). Indeed a total of 33 terminally distressed banks had their licenses revoked between 1994 and 2000 - 2 in 1994, 2 in 1995, 26 in 1998 and 3 in 2000.

The deregulation of the economy created both risks and opportunities for the banks and there was increased competition not just amongst banks but also with non-bank financial institutions such as finance houses which were also a creation of deregulation. SAP therefore fundamentally changed the structure of banking in the Nigerian economy. The new spirit of competition meant that the decision as to whether banks failed or not was to be determined by market forces. Government therefore focused on protecting the depositors, hence the establishment of the NDIC in March 1989. Government guarantee of deposits, although limited, also necessitated closer prudential monitoring of the activities of the insured banks. Prudential Guidelines were released to ensure proper credit classification and income recognition, as part of the measures to promote the financial health of banks. The Prudential Guidelines attempted to align banking regulations with international best practices. For instance, the capital adequacy requirements were introduced in accordance with the Basel Accord and rules on classification of/ provisions for loan exposures and off-balance sheet commitments were based on International Accounting Standards. The profits declared by most banks shrunk as a result of this prudential regime and their financial condition could have been much worse had they not been allowed to spread the required provisions over a period of four years. For example, First Bank of Nigeria made a loss after tax of ₦205.4m in 1990 compared to a profit after tax of ₦106m reported for the previous year (Ajekigbe, 2009:14).

In addition, Government's directive that back-log of naira deposits for foreign exchange applications yet to be approved and all public-sector deposits be transferred to the CBN, to curb rising inflation, also triggered a liquidity crisis in the financial system. With the promulgation of the CBN Decree No 24 of 1991 and the BOFI Decree No 25 of 1991, the independence of the CBN was strengthened and its capacity to supervise both banks and non-bank financial institutions was enshrined in our legal framework. Prior to that period, one of the problems that plagued the Nigerian financial system was the lack of adequate legal framework for the effective regulation and supervision of both banks and non-bank financial institutions. In addition, the repealed CBN Act of 1958 and the Banking Act of 1969 were not only inadequate but were also riddled with ambiguities. The new CBN Decree however, made it possible for the Central Bank to report directly to the President instead of through the Ministry of Finance. Furthermore, the CBN acquired the powers to compile and circulate to all banks in Nigeria, a list of:

- Bank debtors whose debts to any bank had been classified by bank examiners (S. 52).
- The BOFID vested the CBN with the sole licensing power for both banks and non-bank financial institutions (S. 2, 3, 56 and 57).

This, therefore, brought the activities of primary mortgage institutions, discount and finance houses, etc. under the regulatory ambit of the CBN. The CBN was vested with the powers to deal with any failing (or ailing) bank and failed bank. For instance, the CBN, with the approval of the President, can assume control and management of a failing bank (S.34) and apply to a court either to purchase a failing bank for a nominal fee, for the purpose of restructuring it or liquidating it (S.36). To enhance the CBN's newly granted administrative enforcement powers, the Decrees overflow with provisions imposing high monetary penalties ranging from ₦5,000 to ₦1m as well as imprisonment terms ranging from one to ten years. The NDIC, at the time, endorsed the provisions of the Decrees. Further, the practice of government equity participation in banks, as under the indigenization era, came to an end between 1992 and 1993 when the Federal Government divested most of its equity holdings in banks to Nigerian private investors.

The reforms also led to the emergence of privately-owned banks that introduced online banking services and automation of banking processes, which reduced queues in banking halls. They also provided incentives for banks to innovate, offer new products and run efficiently. In effect, the structure of banking was dramatically altered with the emergence of 'new generation' banks who contested for the existing banking market space with their 'old generation' counterparts. The new generation banks thrived with their unique value proposition, to corporate, high net worth individuals, high-income professionals, which was hinged on efficient services and higher interest rates on deposits following the deregulation of interest rates in 1987. Unfortunately and as earlier mentioned, the proliferation of banks heightened abuses in the foreign exchange market as banks sought to take advantage of arbitraging opportunities which existed between exchange rates at the official and parallel markets. Most of these banks were no more than Bureau de Changes (Uche, 2000).

Also, the phenomenal growth in number of banks overstretched regulatory capacity while the growing sophistication in the design and use of financial instruments heightened credit and operational risks. The desired reallocation of credit from the public to the private sector did not occur because of the Federal Government huge spending that resulted in ever-increasing budget deficits after 1987. Thus, government domestic borrowing ballooned which was also occasioned by the inability of the CBN to perform effectively some of its statutory functions. Huge government borrowing, therefore, crowded out the private sector from the credit markets although the problems afflicting the real sector and the arbitraging opportunities in the foreign exchange market also made granting of credit unattractive to most banks. One of the main objectives of the CBN is the promotion of monetary stability and sound financial system in Nigeria.

The Government, however, has a considerable say in the appointment of Directors and management of the CBN. For instance, the Governor, Deputy Governors and Directors of the CBN are appointed by the President (s. 9 and 11 of CBN Decree 1991). Also the Decree only requires that the CBN shall use its best endeavour to maintain external reserves at levels considered by the Bank to be appropriate for the monetary system of Nigeria (s.25). Doubtless, these provisions give enormous leeway for the Federal Government to influence central banking policies, especially with respect to financing government activities. This was one of the reasons why the British colonial government was reluctant to allow the establishment of a central bank in Nigeria. It was to prevent such political interference that the British colonial government ensured that the 1958 CBN Ordinance which they midwifed contained a clause specifically stating that:

> "The value of the reserve . . . shall-
> (a) for a period of five years. . . be not less than the aggregate of an amount representing sixty per cent- of the Bank's notes and coins in circulation together with an amount representing thirty-five per cent of the Bank's other demand liabilities;
>
> (b) after five years.. . be not less than forty per cent of the aggregate of the Bank's notes and coins in circulation and other demand liabilities' (s.26).

The 1991 Decree, however, contained provisions that if adhered to will assist in the attainment of the policy objective of monetary stability. For instance, section 33 asserts that: 'the Bank may grant temporary advances to the Federal Government in respect of' temporary deficiency of budget revenue at such rate of interest as the Bank may determine. . . The total amount of such advances outstanding shall not at anytime exceed twelve and a half per cent of the estimated recurrent budget revenue of the Federal Government for the year in which the advances are granted. . .' All advances made pursuant to this section shall be repaid as soon as possible and shall in any event be repayable by the end of the Federal Government financial year in which they are granted and if such advances remain unpaid at the end of the year, the power of the Bank to grant such further advances in any subsequent year shall not be exercisable, unless and until the outstanding advances have been repaid'. Unfortunately, this important provision is rarely heeded and the CBN has continued to finance government fiscal deficits without any inhibitions, advancing more than 50 percent of the budgeted revenue in some years.

Pius Okigbo, in his report, argued that on no account should the Governor either break or be allowed to break the law. His report therefore proposed that the breach of this provision is a sufficient condition for the removal of the CBN Governor. But will such a provision help? Not necessarily. A government that flouts one law can easily flout another. In other words, the problem is not necessarily with the law but with its implementation (Uche, 2000). The challenge was heightened because Nigeria was under a military rule where checks and balances in government process were practically non-existent. Such a government was unlikely to adhere to such a stringent monetary policy requirement unless there was an incentive to do so. Since the government did not derive its powers from the electoral box, electoral considerations were of little importance. Focus might have been on policies that kept the military happy, such as preventing an insurrection within its rank and file. This was Nigeria's experience under 16 years of unbroken military rule from 1983-1999.

Apart from the electorate, another constituency that could have supported anti-inflationary pressures/policies were banks. It has been argued that the balance sheet structure of banks (maturity mismatching of assets and liabilities and non-marketability of some assets) render them particularly vulnerable to inflation. It is thus, in the interest of such institutions, to lobby for the enforcement of policies that will help in the attainment of the monetary policy objective of price stability. As had already been mentioned, government fiscal indiscipline was one of the main causes of the banking crisis in the deregulation and post-SAP era. Unfortunately, Nigerian banks were unable to constitute an effective anti-inflation lobby group because they were largely government owned until the divestment of government holdings in the early 1990s. Thus, as earlier mentioned, a side-effect of the indigenization decree of the 1970s was that it destroyed the ability of banks to serve as a check against government fiscal indiscipline which causes inflation. The Indigenization decree greatly weakened the ability of the banking industry to protect its interests. Therefore, the strengthening of this potentially important group will therefore be critical in any attempt to enable the CBN to carry out its legitimate role fearlessly.

A robust financial system will represent a strong constituency for low inflation which can side with the CBN should it choose to obey the law and disobey the government. In this regard, the divestment of government equity participation in banks during the later-SAP era was a welcome development. SAP also demanded a change in strategy for training and recruiting regulators. What the programme did was to infuse entrepreneurial ingenuity into the various segments of the Nigerian economy. Entrepreneurs pushed against the boundaries of existing laws. In fact, in some cases, their operations lie outside the law. Bureaucracy, however, did not always allow the government (regulators) to rewrite the laws in order to keep pace with the activities of such entrepreneurs. Also, under a market economy, it is easy to accuse such governments of floating regulations that stifle competition. For instance, government found it difficult to restrict banks from collusion to manipulate the foreign exchange market. This was especially so given the imperfect nature of the Nigerian economy. Any interference with the market in form of regulatory controls, could tamper with the long-term workability of such markets. Another aspect of the problem was the fact that SAP extensively promoted competition among employers with respect to wages. Partly because of bureaucracy, regulators' wages – regulators' are usually employed by the government - almost always lagged behind those of private entrepreneurs. Again, partly because of bureaucracy, the regulators were slower at adapting and responding to technologically changes. The result was that the regulators had inferior credentials and expertise compared to those being regulated. Under such a circumstance, it became easy for the regulator to be compromised or outwitted by the regulatees.

4.0 CONCLUSION

The era up to 1891 to 1952 could be described as one of free-for-all banking without any requirement for an operating license or any form of regulation to restrict and control the establishment and operations of banking business. It also saw the emergence of quite a number of banks which rapidly collapsed in quick successions, the greatest victims being those established through indigenous initiatives.

The 1952 Banking Ordinance defined banking business as "the business of receiving from the public on current account, money which is to be repayable on demand by cheque and on making advances to customers."

The Pre-SAP era of (1972-1986) saw intensive regulation and government ownership of banks, the government was unwilling to let any of its banks fail irrespective of the bank's financial condition or quality of management.

In 1986 – 1993, Structural Adjustment Programme (SAP) was introduced and designed to achieve balance of payment viability by altering and restructuring the production and consumption patterns of the economy, eliminating price distortions, reducing the heavy dependence on consumer goods imports and crude oil exports, enhancing the non-oil export base, rationalizing the role of the public sector, accelerating the growth potential of the private sector and achieving sustainable growth.

5.0 SUMMARY

In this unit, we discussed comprehensively the four phases in the evolution of regulation in the banking sector. They were:

- The Era of Free Banking or Laissez-Faire
- The Era of Banking Regulation (Beginning from 1952)
- The Era of Regulation and Indigenization (1972 – 1986), and
- The Era of Structural Adjustment Programme (SAP) / Financial System Deregulation (1986 – 1993).

In the next unit, we shall continue with a review of the remaining phases in the evolution of regulation in the banking sector.

6.0 TUTOR-MARKED ASSIGNMENT (TMA)

1. The period 1891 to 1951 was considered as the era of free banking or laissez-faire. What salient issues characterised this period?
2. The era of banking regulation began in 1952 up to 1971. How would you describe the type of regulation in place during this period?
3. What is the relevance of the era of regulation and indigenisation of 1972 to 1986?
4. The period 1986 to 1993 marked the era of financial system deregulation. What are the issues involved in this period?

Suggested answers:

1. Up to 1952, banking activities was conducted without any form of regulation. The era could be described as one of free-for-all banking without any requirement for an operating license or any form of regulation to restrict and control the establishment and operations of banking business. The period saw the emergence of quite a number of banks which rapidly collapsed in quick successions, the greatest victims being those established through indigenous initiatives.

2. With the enactment of the 1952 Banking Ordinance came the initial attempt at regulating the banking industry. The 1952 Banking Ordinance defined banking business as "the business of receiving from the public on current account, money which is to be repayable on demand by cheque and on making advances to customers." The Ordinance stipulated the provisions for licensing of banks. Only a registered company could hold a valid banking license. It also stipulated the procedures for banking business by prescribing minimum capital requirements for banks.

3. During this Pre-SAP era of intensive regulation and government ownership of banks, the government was unwilling to let any of its banks fail irrespective of the bank's financial condition or quality of management. Government feared the potential adverse effects on confidence in the banking system and in the economy following a bank failure. Consequently,

government deliberately propped up a number of inefficient banks, thus implicitly protecting the shareholders. The stability however was accompanied with some 'private costs' in the form of substantial bad debts that resulted from lending to government and preferred sectors.

4. The sharp fall in oil revenues in the first half of the 1980s, accumulated trade arrears and increased debt service burden had precipitated an economic crisis which also reinforced the liberalization of government controls in the economy. SAP was therefore introduced and designed to achieve balance of payment viability by altering and restructuring the production and consumption patterns of the economy, eliminating price distortions (to improve efficiency of resource allocation), reducing the heavy dependence on consumer goods imports and crude oil exports, enhancing the non-oil export base, rationalizing the role of the public sector, accelerating the growth potential of the private sector and achieving sustainable growth.

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UNIT 3 REVIEW OF BANKING REGULATORY REFORMS II

Contents

1.0 INTRODUCTION

In the last unit, we discussed comprehensively the four phases in the evolution of regulation in the banking sector, which include:

- The Era of Free Banking or Laissez-Faire
- The Era of Banking Regulation (Beginning from 1952)
- The Era of Regulation and Indigenization (1972 – 1986), and
- The Era of Structural Adjustment Programme (SAP) / Financial System Deregulation (1986 – 1993).

In the next unit, we shall continue with a review of the remaining phases in the evolution of regulation in the banking sector.

2.0 OBJECTIVES

At the end of this unit, you should be able to understand and discuss how the remaining phases of regulation evolved.

3.0 MAIN CONTENT

3.1 Guided Deregulation (1994-1998)

As earlier noted, despite the promulgation of the CBN Decree and BOFI Decree both of 1991 and the extensive powers granted the CBN and the NDIC, banking stability was still threatened. This period was characterized by lots of policy reversals following the change in government and perhaps a fatigue from SAP-induced reforms. The political instability, unpredictable policy changes and rising inflation resulted in capital flight and massive withdrawal of funds by depositors. The macro-economic policy reversal through the 1994 fiscal budget worsened the already weak position of banks. By 1994/1995, 50 percent of the banks were distressed and ratio of the aggregate non-performing loans to total loans ratio stood at 43 percent.

To salvage the situation, the CBN and NDIC adopted measures, including provision of liquidity support via accommodation facilities, imposition of holding action against further lending, takeover, restructuring and liquidation of terminally distressed banks. The official and market rates, which were merged under the Inter-bank Foreign Exchange Market (IFEM) in January 1989, were separated through a policy of "guided deregulation" of the foreign exchange market in 1995. The foreign exchange market was segmented into two: official, which accommodated government transactions at a special rate of ₦22 to US$1 and the Autonomous Foreign Exchange Market (AFEM) for all other users at a rate of ₦80 to US$1. This segmentation created incentives for "rent-seeking", round tripping and other market abuses.

As the need to attract and retain (foreign) capital within the Nigerian economy heightened, it became imperative to relax market restriction on foreign equity participation. Thus, the Nigerian Enterprises Promotion Decree No. 7 of 1995 and the Nigerian Investment Promotion Commission (NIPC) Decree No. 16 of 1995 were promulgated. These abolished all restrictions on foreign shareholding and guaranteed unconditional transferability of dividends, profits, loan repayments, interests and remittance of divestiture proceeds. The immediate effect of these reforms was a capital market boom as the number of listed securities increased together with other market indices such as overall capitalization, activity levels and relative size of the Nigerian Stock Exchange (NSE) with other African Stock Exchanges. Thus, during this period, the NSE came under the searchlight of the Standards and Poor's Emerging Markets FACTBOOK.

Another notable highlight of this period was the reform of the national payment system, following the incorporation of the Nigerian Inter-Bank Settlement System (NIBSS) and the introduction of card-based payment system in 1993. Further to this, the Magnetic Ink Character Recognition (MICR) technology for clearing cheques and the revised clearing rules became operational in 16 1995. Quite important too, the required capital base for both commercial and merchant banks was raised to N500 million in 1997. Prior to that time, Merchant banks and commercial banks were required to maintain a minimum capital base of N40m and N50m respectively as per BOFI Decree 1991. Table 1 below reveals history of minimum share-capitalization for Nigerian banks as required by the regulator since 1952.

TABLE 1: HISTORY OF REQUIRED BANK CAPITALIZATION IN NIGERIA

YEAR	**REQUIRED CAPITAL**	**REMARKS**
1952	£12,500 £100,000	Indigenous banks Foreign banks Three-year ultimatum was given for under-capitalized banks to recapitalize. (17 indigenous banks failed consequently).
1958	£12,500 £200,000	Indigenous banks Foreign banks
1962	£250,000	Both foreign and indigenous banks.
1969	£300,000 £750,000	Indigenous banks Foreign banks
1979	₦1,000,000 ₦2,000,000	Merchant banks Commercial banks
1988	₦6,000,000 ₦10,000,000	Merchant banks Commercial banks
1989/1990	₦12,000,000 ₦20,000,000	Merchant banks Commercial banks
1991	₦40,000,000 ₦50,000,000	Merchant banks Commercial banks
1997	₦500,000,000	Both merchant and commercial banks

1999- 2002	₦1 billion	All banks
Jan 2004	₦2 billion	All banks
July 2004- 2005	₦25 billion	The increase of 1150% came even before the expiration of the ₦2billion recapitalization exercise
2009-2010	₦10 billion ₦25 billion ₦50 billion	Regional Banks National Banks International Banks

Source: Central Bank of Nigeria.

3.2 Universal Banking Era (1999-2003)

With the return of civilian rule in May 1999, there was an apparent return to the path of economic reforms again. Universal banking was adopted in January 2000 in response to unprecedented pressure from merchant banks clamouring for equity - a level playing field due to their disadvantaged position especially with regards to the cost of funds. The adoption of universal banking, though, has been argued as being merely a legal attempt to legislate existing practices. Prior to that period, some commercial banks owned subsidiaries that were merchant banks. Generally, many banks had subsidiaries that were providing investment banking services, capital market, pension, insurance, registrar-ship and other related financial services.

Consequently, the functional delineation between commercial and merchant banking, brought about by the Banking Decree 1969 was effectively removed thus paving the way for uniform licences to be issued to all banks and for them to determine in which segment of the financial services market to operate. The Small and Medium Enterprises Equity Investment Scheme, under which banks set aside 10% of their annual profits for equity investment in Small and Medium Enterprises (SMEs) was set up in August 2001. This initiative was followed by the establishment of the Bank of Industry Limited (BOI) in October 2001 following the reconstruction of the Nigerian Industrial Development Bank (NIDB), in keeping with Federal Government's intent to use SMEs as instruments for rapid industrialization, sustainable economic development, poverty alleviation and employment generation.

In addition, it was during this era that a minimum capital base of N1billion was required for all banks. In the five years to 2004, the CBN intensified its supervisory role over banks while making concerted efforts to shut down arbitrage windows in the foreign exchange markets. As part of this process, CBN suspended 21 banks for contravening foreign exchange regulations in 2002 and also introduced the Dutch Auction System (DAS). In addition, the CBN undertook an internal reform programme tagged Project EAGLE, which was designed to improve its regulatory efficiency and effectiveness. Table 2 below shows the pre-consolidation top four Nigerian banks vis-à-vis other big African banks.

TABLE 2: CAPITALIZATION OF TOP 4 NIGERIAN BANKS PRE-CONSOLIDATION (2003)

S/N	AFRICA'S TOP 4	CAPITAL USD$'m	NIGERIA'S TOP 4	CAPITAL USD$'m
1.	Standard Bank	2,971	Union Bank	269
2.	First Rand	1,851	First Bank	201
3.	ABSA	1,715	UBA	117
4.	NedBank	1,680	Zenith Bank	99
	Sub-Total	**8,217**	Sub-Total	**686**

Source: Ajekigbe (2009:24)

From the table, the ratio of the combined capital of Nigerian top 4 banks to that of their African mega counterpart was a mere 8.3 percent. This implies that Nigerian banks were only marginal players on the African continent.

3.3 Consolidation Era (2004-2008)

In his address to the Special Meeting of the Bankers Committee on July 6, 2004, the CBN Governor, Professor Charles Soludo, announced a 13-point Reform Agenda tagged “the New Agenda for Repositioning the CBN and the Financial System for the 21st Century”, and outlined as follows:

1. Requirement that the minimum capitalization for banks should be ₦25billion Full compliance before end-December 2005 (18-month expiry period). Only banks that meet the requirement can hold public sector deposits and participate in the DAS by end 2005. Names of banks that qualify by 31st December 2005 will be published.
2. Phased withdrawal of public sector funds from banks, starting in July 2004.
3. Consolidation of banking institutions through mergers and acquisitions.
4. Adoption of a risk-focused and rule-based regulatory framework. CBN will pre-announce the rules of the game and abide by them.
5. Adoption of zero-tolerance in the regulatory framework, especially in the area of data/information rendition/reporting. Bank MDs to sign all bank returns henceforth. Manipulation of accounts/concealment of unsavoury transactions off-balance sheet will henceforth attract serious sanctions.
6. Automation of rendition of returns by banks and other financial institutions.
7. Establishment of a hotline, confidential internet address (governor@cenbank.org) for all Nigerians wishing to share any confidential information with the Governor of the Central Bank on the operations of any bank or the financial system. Only the Governor has access to this address.
8. Strict enforcement of the contingency planning framework for systemic banking distress.
9. Establishment of an Asset Management Company as an important element of distress resolution.
10. Promotion of the enforcement of dormant laws relating to, for instance, issuance of dud cheques, vicarious liabilities of the Board members of banks in cases of failings by the bank.
11. Revision and updating of relevant laws, and drafting of new ones relating to the effective operations of the banking system.
12. Closer collaboration with the Economic and Financial Crimes Commission (EFCC) in the establishment of the Financial Intelligence Unit (FIU), and the enforcement of the anti-money laundering and other economic crimes measures.
13. Single obligor limit of 10% of shareholders’ funds as opposed to the present 25%, with aggregate borrowing pegged at 800% of shareholders’ funds. This was actually stated by the CBN Director of Banking Supervision.

The objective of the reform programme was to create a diversified, strong and reliable banking sector, which would:

(i) ensure the safety of depositors’ money (ii) play active developmental roles in the economy, and

(ii) become competent and competitive players both in the African and global financial systems. The direct impact of the reform programme was a drastic reduction in the number of banks from 89 to 25.

A major fall-out of the exercise was that 76 out of 89 banks made the recapitalization deadline of December 31, 2005. The 76 banks either went through some form of merger or acquisition with the exception of a few banks that stood alone. At the launching of the re-capitalization idea, a lot of criticisms grew from industry practitioners and academics. Some observers felt the exercise was targeted at eliminating the small banks and reducing the number of banks in the country. Job security was further threatened by perceived reduction in number or elimination of small banks. Further, the exercise was criticized as an attempt to (mis)use share capitalization to force the emergence of mega banks whose constituents might be "strange bed-fellows". A policy of forced consolidation has its downsides. In fact, consolidation – as has been noted by the Central Bank in its ''Code of corporate governance for banks in Nigeria post consolidation''– poses the following grave governance risks:

- technical incompetence of the board and management; board squabbles due to the meshing of different corporate cultures;
- disputes between management and staff; increased levels of risks; ineffective integration of entities; poor integration and development of information technology, accounting and record systems;
- inadequate management capacity; resurgence of a high level of malpractices; insider-related lending;
- rendition of false returns; continued concealment; ineffective audit committees; inadequate operational and financial controls;
- absence of a robust risk management system; disposal of surplus assets to boost profits so as to cover operational losses and inefficiencies; and
- a lack of transparency.

It was, therefore, difficult to applaud this policy on the grounds that its tangential effect would be to improve corporate governance. Furthermore, it was not evident that an increase in the share capital of Nigerian banks will automatically provoke any significant attitudinal change. Further, a policy of ''forced consolidation'' is not risk free. It increases the likelihood that value destroying consolidations may have been consummated. Mergers and acquisitions are in the best of circumstances – when they are entered into because of the identification of a strategic business objective – fraught with many difficulties. Where the strategic objective is regulatory pressure, the odds against successful consolidations increase. By ''forcing'' banks to approach mergers with an eye to achieving a balance sheet consolidation, rather than on the synergies to be created, the Central Bank increased the risk that ill-fitting entities may have consolidated their balance sheets. Consolidated entities that ended up destroying shareholder value could hardly be regarded as successful mergers (Ogowewo and Uche, 2006: 173). For instance, the experience with Spring Bank after consolidation, until its eventual acquisition by the CBN, provides strong support for these arguments. In fact, the collapse of many alliances (formalized in Memoranda of Understanding) during the exercise indicated that many value-destroying consolidations were in fact avoided; this in no way does not eliminate the point that some value-destroying consolidations were implemented.

Ogowewo and Uche (2006) argued that the risk of shareholder value destruction was heightened in the case of banks which met the minimum capitalization figure, not through a capitalization of reserves, but instead through an issue of fresh shares. For such banks, the challenge of maintaining their pre-consolidation earnings per share post-consolidation will be formidable, since there will now be more shares in issue. Furthermore, there will be post-merger integration challenges to grapple with. Contrary to the thinking of the Central Bank, as evident from its May 2006 circular to banks, the harmony of new partners cannot be decreed by fiat. Interestingly, the

Central Bank did not need to use the increase in bank share capital to goad banks towards mergers.

Before the announcement of the 25 billion share capital requirement, developments in the Nigerian banking arena showed that the industry was ripe for consolidations. Following the announcement of the minimum share capital requirement of 2 billion in 2004, applications for new banking licenses had all but disappeared. Furthermore, at the end of 2003, there were about a dozen or so banks that were clear candidates for restructuring. There was, therefore, ample room for consolidation to occur in the Nigerian banking sector. The important thing to bear in mind is that absent regulatory pressure, the consolidations would have been strategic and the risk of value destroying consolidations will have been reduced. A policy of encouraging strategic consolidations, whilst intellectually tasking, is superior to a policy of ‘‘forced’’ consolidations. As expected, banks became awash with liquidity and thus an increased appetite to be global players.

This era marked massive overseas expansion of Nigerian banks. Access Bank, for instance, has subsidiaries in Cote D’Ivoire, Democratic Republic of Congo, Gambia, Rwanda, Sierra Leone and Zambia while Zenith Bank has subsidiaries in Sierra Leone and Ghana. The magnitude and speed of Nigerian banking investments abroad was such that as at September 23, 2008, ten out of 24 Nigerian banks had full-fledged licensed bank in a foreign country. The banks were First Bank, Union Bank, Intercontinental Bank, Access Bank, Bank PHB, United Bank for Africa (UBA), Guaranty Trust Bank, Zenith Bank and Oceanic Bank. The last to make the list is FinBank, formerly First Inland Bank, which announced on September 22, presence in the Gambia through the acquisition of the Arab Gambian Islamic Bank (Uche, 2009b). Further, banks approached the capital market between 2007 and 2008 to raise equity funds with some banks securing foreign listing in developed capital market. For instance, it was during this period that Guaranty Trust Bank secured its quotation on the London Stock Exchange.

Table 3 below shows some industry statistics during the period 1986-2008. It is worth mentioning that despite the reduction in the number of banks from 41 to 24, three key performance indicators have improved viz: branch network (market penetration), total assets (scale) and credit to the private sector (financial intermediation). The figures shown are however, nominal.

Table 3: Some Banking Industry Statistics (1986- 2008)

Year	Number of Banks	Number of Branches	Total Assets	Credit to private sector
1986	41	1,394	48.1	17.4
1987	50	1,516	62.1	25.5
1988	66	1,711	75.2	29.8
1989	81	1,909	86.7	30.9
1990	107	2,013	110.4	36.6
1991	119	2,107	155.5	45.3
1992	120	2,391	201.3	80.0
1993	120	2,382	279.9	95.5
1994	116	2,547	357.5	151.0
1995	115	2,512	465.1	211.4
1996	115	2,554	548.8	221.8
1997	115	2,477	694.9	275.0
1998	89	2,220	821.2	351.8
1999	89	2,344	1,196.0	455.2
2000	89	2,306	1,707.1	596.0

2001	90	2,306	2,247.0	855.0
2002	90	3,123	2,766.9	955.8
2003	90	3,247	3,047.9	1,301.6
2004	89	3,247	3,392.9	1,534.4
2005	89	3,357	4,389.3	2,007.4
2006	25	3,468	6,738.0	2,565.8
2007	24	4,579	10,431.0	5,056.7
2008	24	4,995	14,825.4	7,341.1

Source: Central Bank of Nigeria.

Total Assets and Credit to Private Sector are in ₦'Billions

Table 4 also presents information on the top Nigerian four banks as at the end of 2007 vis-à-vis the African mega banks. The ratio of their combined capital (of the four Nigerian banks) to the combined capital of the African mega banks has increased from 8.3 percent to 39.8 percent.

TABLE 4: CAPITALIZATION OF TOP 4 NIGERIAN BANKS AFTER CONSOLIDATION (2007)

S/N	AFRICA'S TOP 4	CAPITAL USD$'m	NIGERIA'S TOP 4	CAPITAL USD$'m
1.	Standard Bank	8,015	First Bank	2,500
2.	First Rand	5,169	Union Bank	3,040
3.	ABSA	5,089	UBA	1,696
4.	NedBank	4,080	Zenith Bank	1,650
	Sub-Total	**22,353**	Sub-Total	**8,886**

Source: Ajekigbe (2009:24)

The 'new' ₦25 billion capitalization requirement for banks by the CBN, despite its numerous flaws, could well have turned out to have some unintended positive consequences. Mega banks will no doubt be in a much stronger position to make the point that Government's reckless fiscal policy and its attendant macroeconomic instability is the main cause of financial instability. Until the fiscal recklessness of the Government is checked, the use of monetary policies to achieve macroeconomic stability will remain nothing more than an illusion.

3.4 Banking Reforms of 2009 – 2012

The banking regime of 2009 – 2012 focused on implementation of some "unfinished business" of the prior regime i.e. consolidation agenda. It is important to note that this era was accompanied by financial crisis in the global financial system. On a positive note, the consolidation programme helped Nigerian Banks to have built some resilience against the financial crisis. The civilian to civilian government transition in May 2007 came with a strong commitment of the Federal Government to make Nigeria one of the 20 largest economies in the world by the year 2020, and one of the broad policy frameworks for achieving this goal is the Financial System Strategy 2020 (FSS 2020).

The above reforms are designed to build on the successes of earlier reforms with the overriding objective of fostering financial stability. After the consolidation, eight major interdependent factors led to an extremely fragile financial system that was tipped into crisis by the global financial crisis and recession (Sanusi, 2010) namely:

- Macroeconomic instability caused by large capital inflows

- Major failures in corporate governance at banks
- Lack of investor and consumer sophistication
- Inadequate disclosure and transparency
- Major weaknesses in the business environment
- Unstructured governance & management processes at the CBN
- Uneven supervision and enforcement
- Critical gaps in regulatory framework and regulations

The CBN in conjunction with the NDIC initiated special examination of Nigerian banks. The reports of the special examination team revealed that ten out of 24 banks were in a grave situation, prompting capital injection of N620 billion into nine banks by the CBN. In particular, Non-performing loans in the ten banks totalled ₦1,696 billion, representing 44.38 percent of total loans. Aggregate provisioning required in the ten banks amounted to ₦1,221.52 billion. Capital Adequacy Ratio in the ten banks ranged between (1.01) and 7.41 percent, which were below the statutory minimum ratio of 10 percent. The additional capital injection required by the banks was N495.83 billion. One key aspect of earlier reforms was Universal Banking which allowed banks to venture into different businesses and which posed a serious challenge to the regulators. The CBN initiatives included:

- Injecting N620 billion into nine banks
- Replacing the Chief executives and executive directors of eight of the banks with turnaround managers.
- Reaffirming guarantee of the local inter-bank market to ensure continued liquidity for all banks.
- Guaranteeing foreign creditors and correspondent banks' credit lines to ensure confidence and maintain important correspondent banking relationships

The capital injection enabled the banks to continue normal business operations and prevented a run on the banks. The current banking reform is based on four pillars (Sanusi, 2010) namely:

- Enhance the quality of banks¬Regulatory framework reform; Risk based supervision; Consumer protection; Corporate governance; Disclosure and transparency.
- Establish financial stability¬Financial stability committee; Macro prudential issues; Capital market development (as alternative to bank funding); Counter-cyclical fiscal policies.
- Enable healthy financial sector evolution¬Competitive banking industry structure; Improved cost structure of banks through cost control and business process outsourcing; Reliable and secure payment systems; Greater financial inclusion; Improving financial infrastructure: credit bureaus and registrars.
- Ensure the financial sector contributes to the real economy¬Improving effectiveness of existing development finance institutions; Examination of critical issues for economic development (e.g. power, port, railways) Leveraging on CBN's role as an adviser to the Government on economic matters; Greater engagement with the Banking Industry;

Specifically, this era has witnessed emphasis on a risk-based supervisory framework for banks and other financial institutions; Strict enforcement of the contingency planning framework for systemic banking distress; Establishment of the Asset Management Corporation of Nigeria (AMCON) to takeover non-performing assets of banks Improvement in disclosure and transparency (IFRS Adoption by banks, full disclosure and common year end for Nigerian banks). Promotion of the enforcement of dormant laws, revision and updating of relevant laws relating to the effective operations of the banking system. Emergence of some Nigerian banks in the list of top 1000 global banks.

The categorization of banks based on Share Capitalization into three namely:

1) Regional Banks – N10 billion
2) National Banks - N25 billion
3) International Banks – N50 billion.

Introduction of Cheque Truncation whereby clearing cheques are retained at the receiving banks instead of being passed to the issuing/paying banks. Instead, only the images are transmitted to the issuing/paying banks. Developing new regulation such as: Review of Universal Banking: The phased break-up of mega banks from being full-service banks into specialized banks. Margin lending; Prudential Guidelines; Corporate Bonds; Enhancement of the Developmental role of the CBN through: SME Interventions (Credit Guarantee Scheme); Power/ Manufacturing Intervention (N500bn); Introduction of the Cash less (or Cash lite) policy with the objective to reduce the volume of cash transactions in the economy. Banks as conduits of the payments system are expected to promote the use of electronic media for payment and settlement of business transactions.

The impact of the review of universal banking is questionable as banks, through their holding company structure, will effectively carry out activities that they consider profitable. The failure of regulators to consider banking history in Nigeria could well imply that the industry's future is bleak post-consolidation. Financial regulators do not consider the study of banking history important, thus the absence of an archival policy that encourages the study of banking past. The consequences of this are already evident in the roller-coaster nature of Nigerian banking policies. Policies are being churned out without the benefit of historical lessons. The result is that the mistakes of yesterday remain the mistakes of today. The withdrawal of universal banking model by the CBN is a clear illustration of this point. The failure of regulation in placing restrictions on the operations of universal banks was a more proximate cause of the liquidity crisis than the insider-abuses which is common to virtually every facet of the Nigerian economy.

The financial crisis in the developed countries snowballed into a global economic crisis and recession. It is this global recession, rather than the subprime mortgage crisis that caused damage to the financial system of countries with inconvertible currencies and exchange control restrictions. In other words, financial system-induced recession in some of the world's biggest economies have led to economic crisis in several developing countries. Specifically, this has resulted in declining commodity prices, investments, credit and exports. Nigerian banks that were exposed to these markets experienced significant write-down in their risk assets portfolios. The resulting liquidity and credit squeeze created problems for the financial system in Nigeria and other developing countries. Most African countries fall under this category.

3.5 Post 2013 Reform – Entrenching Macroeconomic Stability and Engendering Economic Development in Nigeria

In his maiden press briefing on 5th June, 2014, Godwin Emefiele, incumbent Governor of CBN was reported to have said as follows:

In contextualizing the **domestic macroeconomic environment** in the light of the global economy, there was a gradual decrease but not total dissipation. Global growth is projected to strengthen from 3 percent in 2013 to 3.6 percent in 2014. This is principally due to the reduction in fiscal tightening and continuation of highly accommodative monetary policy in a number of advanced economies, as well as strong exports to the advanced economies from emerging markets and frontier economies. In the United States, real GDP grew by 1.9 percent in 2013, a deceleration from the 2.18 percent recorded in 2012. However, a downturn in exports and private investment led to an annualized 1 percent contraction in US GDP during the first quarter of 2014, which is the country's worst economic performance in three years.

Policy actions over the past year have addressed important tail risks and stabilised financial markets in the euro area, resulting in an expected growth of about 1.2 percent in 2014. However, lingering financial fragmentation, tight credit conditions, and high corporate and sovereign debt burdens remain key downside risks. In Japan, private investment and exports are expected to strengthen, especially in the fact of substantial depreciation in the yen over the past year. The economy, which expanded by 1.5 percent in 2013, is projected to grow by 1.4 percent in 2014.

China is projected to expand by about 7.5 percent in 2014, a modest decline from 7.7 percent recorded in 2013. The forecast for 2014 is predicated on the assumption of reduced credit growth and a rebalancing of domestic output. Growth in Sub-Saharan Africa remains robust and is expected to rise from 4.9 percent in 2013 to 5.5 percent in 2014. This expansion expectedly reflects dividends of large megaprojects in infrastructure in natural resource enclaves as well as bountiful agricultural production.

Relative to both global and sub-Sahara African growth trajectories, the Nigerian economy performed appreciably well over the last seven year (2007-2013). During the period, the economy expanded by an average of 7 percent, while sub-Sahara Africa's real GDP grew by 7.7 percent, mainly driven by an 8.8 percent growth in the non-oil sector. For fiscal 2013, the economy grew by 6.9 percent, with the non-oil sector providing 8.1 percent backbone to the strong growth.

Owing to the tight monetary policy of the Bank coupled with improved food harvest, inflation moderated to a six-year low of 7.9 percent at end-April 2014. Debt-to-GDP ratio fell to 11 percent, while foreign exchange reserves stood at $37.15 billion as at May 27, 2014. This external reserve level could finance about eight (8) months of imports and compares favourably with the external reserves of many peer countries. As at end-April 2014, year-on-year private sector credit increased by 26.4 percent, reflecting strong appetite by the banking system to catalyse the real economy. Over the last four years (2010-2013), the country attracted over $22 billion in foreign direct investment (FDI), making Nigeria one of the top FDI destinations on the African continent.

Results from the latest job creation survey by the National Bureau of Statistics (NBS) indicate that the private sector posted a significant share of the 1.2 million jobs created in the country in 2013. While this achievement is laudable, it clearly suggests that we need to do more to cater for existing job seekers as well as for new entrants into the labour market.

Brief Overview of the Nigerian Financial System

The Nigerian financial system has undergone several years of critical reforms, designed to position it as Africa's financial hub. These reforms have produced a financial landscape characterised by large and strong banks, an efficient payments system and improved financial infrastructure. For instance, the average Capital Adequacy Ratio (CAR) of the banking system stood at 16.7 percent at end-March 2014, higher than the global threshold of 10.0 percent. At end-March 2014, average Tier 1 capital to risk-weighted assets stood at 15.4 percent, while the industry NPL ratio decreased from 34.5 percent in November 2010 to 3.8 percent as at end-March 2014.

The Central Bank's payments system initiatives, such as the Payment Terminal Aggregator (PTA) and standardised T+1 settlement, have led to a significant reduction in transactions costs and currency management costs. The cash-less policy is gradually entering the next phase of implementation – the nationwide roll-out in the remaining states of the Federation – which has been scheduled for July 1, 2014, while the mobile money initiative has continued to enhance financial inclusion with the number of unbanked public declining from 46.3 percent in 2010 to 37.9 percent in 2013.

In terms of the monetary aggregates, broad money supply (M2) rose by 1.9 percent in April 2014 over the level at end-December 2013. At an annualized growth of 5.8 percent, M2 was below the growth benchmark of 15.5 percent for 2014 but consistent with the tight stance of monetary policy. The increase in money supply reflected the growth in net domestic credit (NDC) of 1.6 percent in April over the level at end-December 2013. At an annualized growth of 4.9 percent, growth in NDC was lower than the provisional benchmark of 28.5 percent for 2014.

Money market interest rates moved in tandem with the tight monetary policy stance and the persisting environment of excess liquidity. Thus, at end-April 2014, the average inter-bank call and Open buy back (OBB) rates stood at 10.5 and 10.6 percent, respectively. The equities segment of the capital market has continued in recovery territory since the global crisis. Relative to end-March 2014, the All-Share Index (ASI) rose by 0.7 percent on May 16, while Market Capitalisation (MC) remained strong at ₦12.85 trillion.

Key Policy Stance of the Central Bank

Since 2012, the Bank has maintained a tight regime of monetary policy, with the Monetary Policy Rate (MPR) and the Cash Reserve Requirement (CRR) mostly remaining unchanged at 12 percent. The CRR on public sector deposits was, however, raised to 50 percent in July 2013 and subsequently to 75 percent in March 2014 when the CRR on private sector deposits was also adjusted upwards to 15 percent. This was to address the liquidity effects of the Federation Account Allocation Committee (FAAC) statutory allocations to the three tiers of government and the redemption of AMCON bonds towards the end of 2013, the effects of which lingered into 2014.

The CBN's exchange rate policy is based on the managed float regime that allows a movement of +/- 3 percent around the midpoint Naira/Dollar exchange rate of ₦155/US$1. Whenever justifiable, the bank intervenes to offset pressures on the exchange rate and restore stability in the value of the Naira. This policy stance has served the Bank well since they have properly anchored expectations, created policy certainty in macroeconomic management while offering a window of flexibility to respond to new information and developments globally as they emerge. However, there exists much room for improvement in the policy environment.

Vision of the Central Bank of Nigeria

According to the Governor of the Central Bank of Nigeria the vision of the Bank is to "be the Model Central Bank delivering price and financial system stability and promoting sustainable economic development". This vision draws inspiration from the understanding of the multiple mandate of the Bank to pursue both price and financial system stability as well as provide complementary developmental functions by creating an environment for Nigerians to live better and more fulfilled lives. Rather than being competing goals, as some may argue, these mandates are truly complementary. In fact, price stability can rarely by adjudged a goal in itself except cast against the ultimate objective of improvement in the quality of life. Price stability, therefore, remains a cardinal contribution, indeed a cornerstone, to the ultimate goal of economic development. Reasonably stable prices provide a catalyst for rational consumption and investment decisions and for orderly economic progress. This explains why throughout most of economic history, periods of price and financial system stability have coincided with economic growth and development.

Attainment of the vision of the CBN is anchored on pursuit of the following:

a) Macroeconomic Stability: Macroeconomic stability is essential for the attainment of price and financial system stability. This can be pursued through:

Monetary Policy:It is important to pursue a gradual reduction in interest rates. A comparison of selected macroeconomic aggregates from some emerging market countries including South Africa, Brazil, India, China, Turkey, and Malaysia indicates that Nigeria has one of the highest T-bill rates. Such high rates create a perverse incentive for commercial banks to simply buy virtually risk-free government bonds rather than lend to the real sector.

To enhance financial access and reduce borrower cost of credit, it is essential to pursue policies targeted at making Nigeria's T-bill rates more comparable with other emerging markets and by extension, pursue a reduction in both deposit and lending rates. While a reduction in deposit rates would encourage investment attitudes in savers in real sector projects, a reduction in lending rates would make credit cheaper for potential investors. The Bank should also begin to include the unemployment rate as one of the key variables considered for its Monetary Policy decisions.

Exchange Rate Policy: A key objective of the CBN is to maintain exchange rate stability. In view of the high import-dependent nature of the economy and significant exchange rate pass-through, a systematic depreciation of the Naira would literally translate to considerable inflationary pressure with attendant effect on macroeconomic stability. Therefore, it is important that the Bank strives to focus on maintaining exchange rate stability in order to preserve the value of the domestic currency. The managed float policy regime of exchange rate management should be sustained as this will allow the Bank to intervene when necessary to offset pressures on the exchange rate. To support this strategy, the bank will strive to build-up and maintain a healthy external reserves position and ensure external balance.

There is no doubt that reducing the interest rate and maintaining stable exchange rate are very daunting twin goals. However, the CBN should work assiduously with all stakeholders to device countervailing measures that would ensure that these goals are mutually achieved.

Financial System Stability: The CBN should promote and sustain effective management of potential threats and avoid systemic crisis. It should effectively manage potential threats to financial stability and create a strong governance regime that is conducive for financial intermediation, innovative finance and inclusiveness. In this regard, efforts should anchor on two main pillars: managing factors that create liquidity shocks and zero tolerance on practices that undermine the health of financial institutions. In order to achieve these goals, the Bank should:

- Work with the relevant stakeholders to aggressively shore up reserves. We hope to engage the fiscal and political authorities, as well as other stakeholders to improve our policy buffers, which will create space for the Bank to implement monetary policy using its limited instruments;
- Enhance the Bank's supervisory purview over the banking system as well as strengthen macro-prudential regulation by improving supervisory diligence, ethical standards as well as highest level of professionalism in carrying out on and off-site supervision activities;
- Strength risk-based supervision mechanism of Nigerian banks to ensure overall health and banking system stability. To that end, banks shall be enjoined to proffer remedial actions

where weaknesses are observed in RBS examination reports so as to avoid further build-up of NPLs. Where banks proffer inadequate remedies, the CBN shall advance its own solutions and insist on compliance;

- In the light of the size of the economy following the rebased GDP, the trigger thresholds from a macro-prudential perspective are no longer adequate. In due course, the CBN would consider and announce measures to effectively address this anomaly.
- Pursue a zero-tolerance policy on fraudulent borrowers. The Bank should collaborate with commercial banks to significantly improve the credit culture in the Nigerian banking system. The CBN's focus would be directed at serial debtors who access loans from different banks and default on all of them even when they have the means to pay. Going forward, the CBN will work towards reducing the effect of information asymmetry in the credit market. In this regard, the following considerations are important:
    - Enhancement of the operation of Credit Reference Bureau;
    - Establishment of Secured Transaction and National Collateral Registry;
    - Strengthening the sanction system to include: blacklisting of companies/individuals that have been found to be serial loan defaulters. Indeed, these names would be circulated in the banking system to guide banks in identifying bad borrowers and denying them access to credits in the banking system;
    - Implementation of stringent loan provisions and penalties for banks that lends to blacklisted persons and companies;
    - Intensifying collaboration with relevant agencies, and in particular, the Justice Ministry, to strengthen bank's ability to enforce contracts and recover matured debts;
    - Renewing vigorous advocacy for the creation of commercial courts for quick adjudication on loan and related offences;
    - Establishment of a National Credit Scoring System that will improve access to information on borrowers and assist to make good credit decisions.

Banking Supervision:To enhance banking supervision,it is important to develop a better risk-based supervision framework. This will be achieved by:

- Training sector-specific bank examiners. For example, while the banking industry has excessive concentration in oil and gas loans, the CBN does not have the expertise to analyse and monitor the risks inherent in these credits. In other words, every examiner is a generalist.
- In connection with the above, specialisation will help reduce an increasing reliance on outside consultants, ensure that confidential supervisory information are protected and guarantee a staff department that can generate robust in-house data to help senior Central Bank officials prepare adequately for public engagements.

The Payment System: To achieve an effective payment system, it is imperative to better align the Cashless Policy. This policy was introduced in 2012 with pilots now completed in Lagos, Kano, Anambra, Abia, Rivers and the FCT. The policy was expected to go nationwide on 1st July 2014. Over the course of the pilot, the CBN was inundated with complaints by customers particularly regarding the charges being imposed for cash deposits. This resulted in customers devising various means to avoid the charges through opening of multiplicity of accounts and other disingenuous behaviour all aimed at undermining the objective of this policy. Given these outcomes and to better reflect the goal of having more cash under the control of the CBN, all charges on deposits were stopped with immediate effect. Charges on withdrawals, in view of their eventual elimination, remain sustained at the current 3 percent for individual transactions exceeding N500,000 and 5 percent for corporate transactions exceeding N3 million.

Central Banks and Economic Development

For quite some time, the dominant school of thought regarding central banking was that focusing on low inflation will eventually lead to greater growth, increase in employment generating activities, and poverty reduction. However, early and recent evidence of central banking in places such as the United States, England, Japan, and France indicate that supporting selected economic sectors using "direct methods" of intervention have been essential tasks of their central banks. As Epstein (2005) encapsulates, "virtually all central banks, including the Bank of England (BOE) and the U.S. Federal Reserve (the Fed) have used direct means to support economic sectors. And this has not simply been a matter of historical aberration, but rather, it has been an essential aspect of their structures and behaviour for dealers on end.

In particular, a crucial role for both the BOE and the Fed has been to promote the financial sectors of their economies, and especially, to support the international role of their financial services industries. They have done this by using subsidized interest rates, legal restrictions, directed credit and moral suasion to promote particular markets and institutions. Moreover, at times, they have even oriented their overall monetary policy toward promoting the development of this particular economic sector".

As has been shown in the section on recent macroeconomic developments, Nigeria has witnessed impressive GDP growth rates over the past several years until recently. Yet, there is an absence of a corresponding reduction in the unemployment rate in Nigeria, which rose to 23.9 percent in 2012 relative to 13.9 percent in 2000. Particularly worrisome is the rate of youth unemployment, which is too high. With an annual addition of 1.8 million Nigerians to the labour pool, the Central Bank cannot afford to sit and concentrate only on price and monetary stability. Additional measures are required towards identifying productive sectors of the economy and channeling credit towards these sectors, while imposing proper monitoring and performance measures in order to ensure that the goals of increased employment and poverty reduction are attained. This will require a review of the Bank's development finance programme, the participatory agencies responsible for the disbursement of funds, improving our monitoring capacity and developing performance targets relevant to our focus on generating employment and poverty reduction. To be effective, the measures taken by the Bank will not work in isolation. The monetary authorities (the CBN) will work with the fiscal authorities in reducing other structural distortions to productive growth, as this will enhance access to credit, as well as stimulate growth and employment generation.

a) CBNs Agenda for Development Finance

The core principle here is that the CBN will act as a financial catalyst by targeting predetermined sectors that can create jobs on a mass scale and significantly reduce our import bills. The CBN would deploy developmental initiatives to create an enabling environment with appropriate incentives to empower innovative entrepreneurs to drive growth and development. It is important to stress here that the CBN would not be targeting individual companies but rather specific sectors. There should be established rules and criteria that create a level playing field so that anyone who fairly qualifies can benefit from these schemes.

Some of the Central Bank's developmental functions will include credit allocations and direct interventions in key sectors of the economy such as Power, Agriculture, MSME, Oil & Gas, and Health. While playing an active developmental role, the CBN will not only operate within the law and its mandate but will also be transparent about what it believes as strategic and appropriate interventions.

A New Framework for Funding SMEs

Funding for SMEs in Nigeria has largely been viewed from a social development perspective with the primary goal of reducing poverty through job and wealth creation. This has put the development of the sector squarely in the hands of the government, with mixed results. For a robust and vibrant SME sector, a business approach to funding SMEs, which requires the strong involvement of the private sector is advocated. The proposed framework will combine the profit motives of the private sector and the development objectives of the government. It proposes a structure that enables the government to leverage the project selection and credit analysis processes of private sector investors who will place more of their resources at risk in funding the SMEs.

At the moment, the CBN has a number of initiatives including the ₦220 billion to finance Small-and-Medium-Scale Enterprises with specific focus on women entrepreneurs and to be administered through Microfinance Banks owned either by state governments and/or private organisations. While the private sector invests more of their risk capital in the selected companies, CBN funds will focus on resolving challenges such as access to collateral, enterprise development support, development of a nationwide credit scoring system, etc.

Aside from this new collaboration with the private sector, the CBN will also design a programme for prospective entrepreneurs who need as low as ₦50,000 without collaterals through registered and accredited local cooperatives. Venture capital companies and business angels should be encouragedto fund SMEs and the Bankers' Committee should be engaged to play more active role in supporting SMEs.

The Agricultural Sector

There is need for the CBN to revisit the goals and implementation of its intervention programmes in the agricultural sector in order to ensure that high value addition is obtained from funds provided by the bank. Interventions in the sector will be better driven towards improving productivity in areas with high domestic demand, where opportunities exist to improve domestic supply, such as rice, fish, wheat and sugar and thereby conserve foreign exchange. These four commodities constitute a huge proportion of our food import bill of over₦1.3 trillion annually.

The CBN should facilitate the creation of an ecosystem that will identify and link various local producers and processors with major importers of selected products. With the expected increase in local production, identified major importers would be encouraged to act as off-takers to local producers. For example, between 2009 and 2013, the CBN's Commercial Agricultural Credit Scheme (CACS) disbursed a total of about ₦16.2 billion to 12 rice producers who have managed to meet about 10 percent of national consumption. It is expected that an increase on this amount will enable these producers meet a much higher share of our national consumption, thereby, reducing our import needs for importation of commodities such as rice. Towards this end, 60 percent of the CACS will now be targeted at the identified commodities, while the loan limit under the Agricultural Credit Guarantee Scheme (ACGS) can be increased to expand the resources available to small agricultural projects. This scheme is intended to reward good borrowers with more loans and encourage importers of same products to reduce their demand for foreign exchange, thereby reducing the Bank's sale of foreign exchange and thus building the stock of external reserves.

The Power Sector

Given CBN's mandate to develop and implement various policies, programmes and schemes aimed at the effective, efficient and sustainable delivery of financial services to special sectors of the economy, there is an important role the CBN must play to ensure the success of the power sector reforms. The corresponding effect on GDP that could occur as a result of improvements in the power sector cannot be overstated.

How then can the CBN add value in the power sector? While these plans still need to be fully developed, permit to share broad outlines:

i. The CBN should facilitate investment in key parts of the value chain by providing funds at concessionary rates to targeted investments in the power sector. It should encourage investment in the gas to power infrastructure to improve the reliability of supply to gas to the existing and new power plants.
ii. The CBN should also support investments in renewable energy in rural areas through matching funds schemes, and providing first loss guarantees.

The Oil and Gas Sector

Although Nigeria produces millions of barrels of crude oil per day, the importation of refined petroleum products alone consumes about 35 percent of our annual import bill. The CBN should support efforts at domesticating our oil and gas resources to ensure that much more of these resources are produced and used here in Nigeria. This will stimulate inclusive growth, create jobs and reduce the pressure on the exchange rate occasioned by demand for imports of finished petroleum products. These initiatives should be pursued in collaboration with the Ministry of Petroleum and Natural Resources, who set the core priorities for the sector. Also, any initiatives proposed, will need to be aligned with the policy intent of the Petroleum Industry Bill (PIB). With this in mind, the CBN will:

- Contribute to policy development:In recognition of the fact that one of the sticking points in the passage of the PIB is the proposed fiscal regime, the CBNshould play an active role in working with the Ministry of Petroleum and Natural Resources and other stakeholders to secure a win-win outcome for the sector.
- Upstream investment incentives: To reduce the losses (theft and leakages) in the amount of produced crude that is officially sold, we will support initiatives to meter at ports and secure pipelines. Working with the lead Ministry, the CBNshould look at investment incentives that encourage local Niger Delta based SMEs to play an active role in metering services and pipeline protection technologists.
- Incentives for FDI in upstream: The requirement for investment in the upstream sector especially for the Federal Government owned component of Upstream Joint Ventures should be recognised. They currently struggle to match the investment in infrastructure provided by the international oil companies (IOC) partners. Alongside the Ministry of Finance and the Ministry of Petroleum and Natural Resources, the CBN should support efforts to secure these investments.
- Support for refineries and pipeline construction:The CBN should support the Ministry of Petroleum and Natural Resources by looking at investment incentives in refining and promoting investment in the construction of much needed gas pipelines. It should also support the establishment of small-scale modular refineries that can serve some of our domestic markets.

The Health Sector

Given the myriad of issues facing this sector, which has led to a huge bill of foreign exchange for medical travels overseas, the CBN is expected to play a facilitating role by unlocking the potentials that exist for the private sector to invest at various points along the healthcare value chain including hospital services, health insurance, pharmaceuticals, supply chain, and financing.

This window of opportunity, has already led the private sector to establish an institutional platform for health known as the Private Sector Health Alliance of Nigeria (PHN), with the support of the government.

The CBN should explore opportunities for partnering with the PHN to galvanise the private sector into playing a more active role in the health sector. The Bank should maintain a keen interest in supporting the development of institutions, create an enabling environment to trigger private sector investment and curb the growing trend of medical tourism.

Conclusion

In conclusion, to promote sustainable economic growth and development, the CBN should:

i. Pursue a gradual reduction in key interest rates, and include the unemployment rate in monetary policy decisions;
ii. Maintain exchange rate stability and aggressively shore up foreign exchange reserves;
iii. Strengthen risk-based supervision mechanism of Nigerian banks to ensure overall health and banking system stability;
iv. Build sector-specific expertise in banking supervision to reflect loan concentration of the banking industry;
v. In view of inadequate trigger thresholds from a macro-prudential perspective, consider and announce measures to effectively address this anomaly;
vi. Abolish fees associated with limits on deposits and reconsider ongoing practice in which all fees associated with limits on withdrawals accrue to banks alone;
vii. Introduce a broad spectrum of financial instruments to boost specific enterprise areas in agriculture, manufacturing, health, and oil and gas;
viii. Establish Secured Transaction and National Collateral Registry as well as establish a National Credit Scoring System that will improve access to information on borrowers and assist lenders to make good credit decisions;
ix. Build resilient financial infrastructure that serves the needs of the lower end of the market, especially those without collateral;
x. Renew vigorous advocacy for the creation of commercial courts for quick adjudications on loan and related offences;

4.0 CONCLUSION

The period of guided deregulation was characterized by lots of policy reversals following the change in government and perhaps a fatigue from SAP-induced reforms. The political instability, unpredictable policy changes and rising inflation resulted in capital flight and massive withdrawal of funds by depositors. The macro-economic policy reversal through the 1994 fiscal budget worsened the already weak position of banks. By 1994/1995, 50 percent of the banks were distressed and ratio of the aggregate non-performing loans to total loans ratio stood at 43 percent.

It must be emphasized that one striking reason for the laws is the necessity of evolving a sound financial system. Apart from strengthening the banking system as a whole to prevent a recurrence of earlier banking crises (1950s and 1990s), the Central Bank’s control span widened and opportunities for effective monetary policy also enlarged. But monetary policy is never enough to guarantee macroeconomic stability within which banks can thrive. The monetary policy, which is within the ambit of the CBN in promoting price stability, must be coordinated with other government policies (fiscal, commercial, income, etc) in order to realize maximum benefit to the economy especially in terms of non-inflationary growth.

Universal banking was adopted in January 2000 in response to unprecedented pressure from merchant banks clamouring for equity - a level playing field due to their disadvantaged position especially with regards to the cost of funds. Consequently, the functional delineation between commercial and merchant banking, brought about by the Banking Decree 1969 was effectively removed thus paving the way for uniform licences to be issued to all banks and for them to determine in which segment of the financial services market to operate.

There was consolidation reform agenda aimed at repositioning CBN and the Financial System, the highpoint of which was requirement for minimum capitalization for banks at ₦25billion. The objective of the reform programme was to create a diversified, strong and reliable banking sector, which would:

(a) ensure the safety of depositors' money (ii) play active developmental roles in the economy, and
(b) become competent and competitive players both in the African and global financial systems. The direct impact of the reform programme was a drastic reduction in the number of banks from 89 to 25.

The 2009-2012 reforms are designed to build on the successes of earlier reforms with the overriding objective of fostering financial stability. After the consolidation, eight major interdependent factors led to an extremely fragile financial system that was tipped into crisis by the global financial crisis and recession (Sanusi, 2010) namely:

- Macroeconomic instability caused by large capital inflows
- Major failures in corporate governance at banks
- Lack of investor and consumer sophistication
- Inadequate disclosure and transparency
- Major weaknesses in the business environment
- Unstructured governance & management processes at the CBN
- Uneven supervision and enforcement
- Critical gaps in regulatory framework and regulations

Finally, the post-2013 policies addressed the following areas:

a. Pursuit of a gradual reduction in key interest rates, and include the unemployment rate in monetary policy decisions;
b. Maintenance of exchange rate stability and aggressively shore up foreign exchange reserves;
c. Strengthening risk-based supervision mechanism of Nigerian banks to ensure overall health and banking system stability;
d. Building sector-specific expertise in banking supervision to reflect loan concentration of the banking industry;
e. In view of inadequate trigger thresholds from a macro-prudential perspective, consider and announce measures to effectively address this anomaly;
f. Abolishing fees associated with limits on deposits and reconsider ongoing practice in which all fees associated with limits on withdrawals accrue to banks alone;
g. Introduction of a broad spectrum of financial instruments to boost specific enterprise areas in agriculture, manufacturing, health, and oil and gas;
h. Establishment of a Secured Transaction and National Collateral Registry as well as establish a National Credit Scoring System that will improve access to information on borrowers and assist lenders to make good credit decisions;

i. Building a resilient financial infrastructure that serves the needs of the lower end of the market, especially those without collateral; and
j. Renew of vigorous advocacy for the creation of commercial courts for quick adjudications on loan and related offences;

5.0 SUMMARY

In this unit, we had reviewed the remaining phases in the evolution of regulation in the banking sector, namely:

- Guided Deregulation (1994 – 1998)
- Universal Banking Era (1999 – 2003)
- Consolidation Era (2004 – 2008)
- Banking Reforms of 2009 – 2012
- Post-2013 Regulatory Guidelines

In the next unit, we shall consider the structure and key players in Nigeria's financial system.

6.0 TUTOR-MARKED ASSIGNM ENT (TMA)

1. Write a short note on the following:

    - Guided Deregulation (1994 – 1998)
    - Universal Banking Era (1999 – 2003)
    - Consolidation Era (2004 – 2008)
    - Banking Reforms of 2009 – 2012
    - Post-2013 Regulatory Guidelines.

2. Trace the historical evolution of the requirement for minimum capital as a major tool for the resolution of banking crisis in Nigeria.

3. State the policy objectives of the Microfinance policy.

4. Discuss the implications of the CBN Act 2007 with respect to the operational status of the Central Bank of Nigeria.

5. With respect to corporate governance, discuss the relevant provisions of the prudential guidelines 2010.

Suggested answers:

1. The period of guided deregulation was characterized by lots of policy reversals following the change in government and perhaps a fatigue from SAP-induced reforms. The political instability, unpredictable policy changes and rising inflation resulted in capital flight and massive withdrawal of funds by depositors.

    Universal banking was adopted in January 2000 in response to unprecedented pressure from merchant banks clamouring for equity - a level playing field due to their disadvantaged position especially with regards to the cost of funds.

Consolidation reform era was aimed at repositioning CBN and the Financial System, the highpoint of which was requirement for minimum capitalization for banks at ₦25billion. The objective of the reform programme was to create a diversified, strong and reliable banking sector, which would ensure the safety of depositors' money (ii) play active developmental roles in the economy, and become competent and competitive players both in the African and global financial systems. The direct impact of the reform programme was shrinkage in the number of banks from 89 to 25.

The 2009-2012 reforms are designed to build on the successes of earlier reforms with the overriding objective of fostering financial stability. After the consolidation, eight major interdependent factors led to an extremely fragile financial system that was tipped into crisis by the global financial crisis and recession. The CBN initiatives included:

- Injecting N620 billion into nine banks
- Replacing the Chief executives and executive directors of eight of the banks with turnaround managers.
- Reaffirming guarantee of the local inter-bank market to ensure continued liquidity for all banks.
- Guaranteeing foreign creditors and correspondent banks' credit lines to ensure confidence and maintain important correspondent banking relationships

The ideas in CBN Governor's address which captured the agenda for the post-2013 policy can be summarised as follows:

a. Pursuit of a gradual reduction in key interest rates, and include the unemployment rate in monetary policy decisions;
b. Maintenance exchange rate stability and aggressively shore up foreign exchange reserves;
c. Strengthening risk-based supervision mechanism of Nigerian banks to ensure overall health and banking system stability;
d. Building sector-specific expertise in banking supervision to reflect loan concentration of the banking industry;
e. In view of inadequate trigger thresholds from a macro-prudential perspective, consider and announce measures to effectively address this anomaly;
f. Abolishing fees associated with limits on deposits and reconsider ongoing practice in which all fees associated with limits on withdrawals accrue to banks alone;
g. Introduction of a broad spectrum of financial instruments to boost specific enterprise areas in agriculture, manufacturing, health, and oil and gas;
h. Establishment of a Secured Transaction and National Collateral Registry as well as establish a National Credit Scoring System that will improve access to information on borrowers and assist lenders to make good credit decisions;
i. Building resilient financial infrastructure that serves the needs of the lower end of the market, especially those without collateral; and
j. Renewing vigorous advocacy for the creation of commercial courts for quick adjudications on loan and related offences;

2. Prior to the advent of regulation of the Nigerian banking sector, banking practice can be described as very chaotic with the indiscriminate establishment of banking institutions and subsequent failures of the institutions. Among the factors often identified as major causes of these failures include inadequate capitalization as there was no requirement for minimum capital during the period.

Minimum capital requirement was introduced for the first time in the nation's banking history in the 1952 Banking Ordinance which specified a minimum capital of£12,500 for indigenous banks and £100,000 for foreign banks. With the enactment of the CBN Act of 1958, minimum capital for banks operating in Nigeria was raised to £25,000 for indigenous banks and £200,000 for foreign banks. This was later reviewed upward to £250,000 and £400,000 in 1962 for indigenous and foreign banks respectively. The 1969 Banking Decree further raised the minimum bank capital requirement to £300,000 for indigenous banks and £750,000 for foreign banks.

The 1979 Banking Decree officially introduced the merchant banking model in Nigeria with a minimum capital requirement of N2 million. The Decree also specified a capital requirement of N600,000 for commercial banks and N1.5 million for foreign banks. Up to 1979, there existed different capital requirements for indigenous and foreign banks but not beyond. In 1988 there were two amendments to the 1979 Decree, first in February and later in October. The first raised minimum bank capital to N5 million and N3 million for commercial and merchant banks while the later raised it to N10 million and N6 million for the respective banks. The 1989 Amendment Decree further raised minimum bank capital to N20 million for commercial banks and N12 million for merchant banks while the BOFI Decree of 1991 further increased it to N50 million and N40 million for commercial and merchant banks respectively.

In 1997, a uniform bank minimum bank capital of N500 million was specified for both categories of banks. This was increased to N1 billion in 1999 and later to N2 billion in 2001. The 2004/2005 capital review further raised the minimum bank capital to N25 million. The 2010 amendment repealed the universal banking model and created a three-pillar banking structure comprising banks with regional, national and international mandate with different capital requirements. It specified a minimum capital requirement of N10 billion for banks with regional mandate, N25 billion for banks with national mandate, and N50 billion for banks with international mandate.

3. The specific objectives of the microfinance policy are to:
   - Make financial services accessible to a large segment of the potentially productive Nigerian population which otherwise would have little or no access to financial services
   - Promote synergy and mainstreaming of the informal sub-sector into the national financial system
   - Enhance service delivery by microfinance institutions to micro, small and medium entrepreneurs
   - Contribute to rural transformation
   - Promote linkage programmes between universal/development banks, specialized institutions and microfinance banks.

4. The CBN Act of 2007 granted the CBN the legal authority to set its policy goals (in the areas of interest rate, exchange rate, inflation rate, etc.) without seeking the approval of the Government. The implication of the new legal status conferred on the CBN by the 2007 Act is that the CBN has full responsibility for the formulation and implementation of monetary and credit policy for the country. Under the Act, the CBN has power to exercise discretion in choosing the appropriate mix of monetary policy instruments required to achieve its goals. They are at liberty to determine the extent of credit to advance to the government in line with their own economic objectives for the country. In other words, the economic objectives of the

CBN take precedence. However, to enhance the credibility of such economic goals the CBN has always, out of its volition, consulted with the government in setting goal targets.

The Act also granted the CBN freedom to run its operation (freedom to set and approve its budget, appoint and promote competent staff, etc.) without interference from either the executive or legislative arm of the government.

Article 3 of the CBN Act of 2007 specifically provides that the CBN shall be an independent body in the discharge of its functions. Article II further reinforced the autonomy of the CBN by stating, among others, that the removal of the governor shall be supported by two-thirds majority of the senate praying that he be so removed.

5. On corporate governance, specific provisions of the 2010 guidelines include:
   (a) Maximum of 10 years tenure for bank CEOs.
   (b) A person who has served his maximum term of 10 years shall not be re-appointed in any capacity in the same bank or its subsidiaries until after 3 years.
   (c) A governor/deputy governor of CBN and CEO of NDIC as well as executive directors of NDIC shall not be appointed in any capacity in any bank until after 5 years of exit from office.
   (d) Departmental Directors of the NDIC and the CBN shall not qualify for appointment in banks in any capacity or any subsidiary of banks under the supervision of the NDIC and the CBN until after 3 years of exit from the NDIC or the CBN.
   (e) Banks' external auditors shall serve a maximum of 10 years at the end of which they (the audit firm) shall not be reappointed in the same bank until after a period of 10 years.
   (f) Executive Directors' compensation and bonuses, including profit sharing arrangements shall be fully disclosed in the Annual audited financial statements as separate component of operating expenses.

6. For risk management, the 2010 guidelines dealt with issues of credit policy and loan exposure limits. It also specified stipulated risk-related ratios namely, liquidity, loan to deposits, cash, capital adequacy, and non-performing to total loan ratios.

   For loan loss provisioning, all loans are to be classified into performing and non-performing based on level of borrowers' compliance to loan agreement. Specifically, loans are classified as performing if payments of both interest and principal repayments are up-to-date in line with the terms of the loan. Non-performing loans are defined as those whose interests and principal repayments fall due but remain unpaid for 90 days or more or interest payment equal to 90 days pro-rated interest or more have been capitalized, rescheduled, or rolled over into a new loan. Non-performing loans are further classified into:

   (i) Sub-standard: Objectively defined as where interest and/or principal repayments which fall due remain unpaid for more than 90 days but less than 180 days and subjectively defined as loans that show defined weaknesses capable of jeopardizing the capacity of the borrower to pay back. For this category of loans, a loan loss provision of 10% is to be made for the outstanding balance.
   (ii) Doubtful: Here interest and/or principal repayment remain unpaid for up to 180 days but less than 360 days and subjectively defined as loans with identified weaknesses as in (i) above which in addition indicate that full repayment is uncertain or whose expected realizable value of collateral will be inadequate to off-set the bank's exposure. For this category of facilities, a loan loss provision of 50% is required.

(iii) Lost: Where accrued interest and/or principal repayment remain unpaid for 360 days or more and are not appropriately secured and subjectively defined as those that harbour the weaknesses associated with doubtful facilities and in addition whose collaterals are deemed unrealizable and/or are of such value that continuation as bankable assets are not realistic. For this category of loans, a loan loss provision of 100% should be made.

Finally, the 2010 guidelines specified that a loan loss provision of 2% should be made for all performing facilities. This is a conservative approach to loan management based on the assumption that even the performing facilities may have some latent weaknesses which may impair their realisability.

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APPENDIX

Table 5: BANKING SECTOR NEW CREDITS ACROSS ECONOMIC SECTORS MAY 2010

S/N	BUSINESS LINES	N'M	% OF TOTAL
1	Oil and Gas	57,420.28	33.04
2	Manufacturing	40,640.39	23.39
3	Transportation & Storage	30,184.06	17.37
4	General	21,771.28	12.53
5	General Commerce	17,804.97	10.25
6	Government	6,367.37	3.66
7	Construction	5,699.94	3.28
8	Real Estate Activities	4,379.41	2.52
9	Professional, Scientific & Technical Activities	2,874.93	1.65
10	Agriculture, Forestry and Fishing	2,597.98	1.50
11	Finance & Insurance	1,177.01	0.68
12	Information & Communication	725.30	0.42
13	Education	613.42	0.35
14	Human Health & Social Work Activities	554.11	0.32
15	Activities of Extraterritorial Organizations & Bodies	303.20	0.17
16	Capital Market	116.71	0.07
17	Administration & Support Service Activities	56.75	0.03
18	Arts, Entertainment & Recreation	4.00	0.00
19	Power & Energy	-	0.00
20	Public Utilities	-	0.00
21	Water Supply, Sewerage, Waste Management, etc.	-	0.00

SOURCE: Central Bank of Nigeria

UNIT 4 THE STRUCTURE AND KEY PLAYERS IN NIGERIA'S FINANCIAL SYSTEM

Contents

1.0 INTRODUCTION

In the last unit, we reviewed the remaining phases in the evolution of regulation in the banking sector, namely:

- Guided Deregulation (1994 – 1998)
- Universal Banking Era (1999 – 2003)
- Consolidation Era (2004 – 2008)
- Banking Reforms of 2009 – 2012
- Post-2013 Regulatory Guidelines

In this unit, we shall consider the structure and key players in Nigeria's financial system.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- enumerate the regulatory authorities and briefly describe their role;
- discuss money market, its participants and their roles;
- list the capital market operators and briefly describe their functions;
- discuss the development finance and other non-financial institutions.

3.0 MAIN CONTENT

The Nigerian financial system comprises of bank and non-bank financial institutions which are regulated by the:

- Federal Ministry of Finance (FMF),
- Central Bank of Nigeria (CBN),
- Nigeria Deposit Insurance Corporation (NDIC),
- Securities and Exchange Commission (SEC),
- National Insurance Commission (NAICOM),
- Federal Mortgage Bank of Nigeria (FMBN) and
- The National Board for Community Banks.

3.1 Regulatory Authorities

3.1.1 The Federal Ministry of Finance (FMF)

The Federal Ministry of Finance advises the Federal Government on its fiscal operation and co-operates with CBN on monetary matters.

3.1.2 The Central Bank of Nigeria (CBN)

The CBN is the apex regulatory authority of the financial system. It was established by the Central Bank of Nigeria Act of 1958 and commenced operations on 1st July 1959. Among its primary functions, the Bank promotes monetary stability and a sound financial system, and acts as banker and financial adviser to the Federal Government, as well as banker of last resort to the banks. The Bank also encourages the growth and development of financial institutions. Enabling laws made in 1991 gave the Bank more flexibility in regulating and overseeing the banking sector and licensing finance companies, which hitherto operated outside any regulatory framework.

3.1.3 The Nigerian Deposit Insurance Corporation (NDIC)

The NDIC complements the regulatory and supervisory role of the CBN. It is however autonomous of the CBN and reports to Federal Ministry of Finance. NDIC effectively took off in 1989 and was set up to provide deposit insurance and related services for banks in order to promote confidence in the banking industry. The NDIC is empowered to examine the books and affairs of insured banks and other deposit taking financial institutions. Licensed banks are mandated to pay 15/16 of 1 per cent of their total deposit liabilities as insurance premium to the NDIC. A depositor's claim is limited to a maximum of N50, 000.00 in the event of a bank failure.

The Nigerian Deposit Insurance Corporation (NDIC) has concluded plans to hike the insured deposit of banks to N200,000.00.

3.1.4 The Securities and Exchange Commission (SEC)

This is formerly called the Capital Issues Commission; the SEC was established by the SEC Act of 27th September 1979, which was further strengthened by the SEC Decree of 1988. It is the apex regulatory organ of the capital market. The Commission approves and regulates mergers and acquisitions and authorises the establishment of unit trusts. In the course of deregulation of the capital market, the function of price determination has been transferred to the issuing houses. The SEC maintains surveillance over the market to enhance efficiency. It issues guidelines on the establishment of Stock Exchanges in furtherance of the deregulation of the capital market. Following the enactment of the Nigerian Investment Promotion Commission Decree and the Foreign Exchange (Monitoring and Miscellaneous Provisions) Decree in 1995, SEC released guidelines on foreign investment in the Nigerian capital market.

3.1.5 Debt Management Office (DMO)

The Federal Government of Nigeria took a major step in addressing the debt problems recently by establishing an autonomous Debt Management Office (DMO). The creation of the DMO consolidates debt management functions in a single agency, thereby ensuring proper coordination. The DMO centralizes and coordinates the country's debt recording and management activities, including debt service forecasts; debt service payments; and advising on debt negotiations as well as new borrowings.

3.1.6 National Insurance Commission (NAICOM)

The National Insurance Commission (NAICOM) replaced the Nigerian Insurance Supervisory Board (NISB). The NAICOM is charged with effective administration, supervision, regulation and control of the business of insurance in Nigeria. Its specific functions include the establishment of standards for the conduct of insurance business, protection of insurance policy holders and establishment of a bureau to which complaints may be submitted against insurance companies and their intermediaries by members of the public. NAICOM ensures adequate capitalization and reserve, good management, high technical expertise and judicious fund placement in the insurance industry.

3.1.7 The Federal Mortgage Bank of Nigeria (FMBN)

The FMBN took over the assets and liabilities of the Nigerian Building Society. The FMBN provides banking and advisory services, and undertakes research activities pertaining to housing. Following the adoption of the National Housing Policy in 1990, FMBN is empowered to licence and regulate primary mortgage institutions in Nigeria and act as the apex regulatory body for the Mortgage Finance Industry. The financing function of the Federal Mortgage Bank of Nigeria was carved out and transferred to the Federal Mortgage Finance, while the FMBN retains its regulatory role. FMBN is under the control of the Central Bank of Nigeria.

3.1.8 Financial Services Co-ordinating Committee (FSCC)

The Committee was established in 1998 and charged with the primary responsibility to promote safe, sound and efficient financial sector in the country. It’s membership is drawn from the key regulatory and supervisory institutions in the nations financial system, namely, Central bank of Nigeria (CBN), Security and Exchange Commission (SEC), National Insurance Commission (NAICOM), Corporate Affairs Commission (CAC) and the Federal Ministry of Finance. This committee chaired by the Ministry of Finance co-ordinates the activities of all regulatory institutions in the financial system.

3.2 The Money Market and its Institutions

This is a market for short-term debt instruments. The major function of the money market is to facilitate the raising of short-term funds from the surplus sectors to the deficit sectors of the economy. The deficit units, which could be public or private, obtain funds from the market to bridge budgetary gaps by either engaging in inter-bank taking or trading in short-term securities such as Treasury Bills, Treasury Certificates, Call Money, Certificates of Deposit (CD), and Commercial Papers (CP). With the commencement of Open Market Operations (OMO) by the CBN, the scope of the money market has been expanded. The number of participants in the market also increased with the establishment of five discount houses. Money market institutions constitute the hub of the financial system. These institutions include discount houses, commercial and merchant banks, and special purpose banks, like the Nigerian Agricultural Co-operative and Rural Development and Community banks.

3.2.1 Discount Houses

A discount house is a special, non-bank financial institution intervenes in mobilizing funds for investments in securities in response to the liquidity of the system. It does this by providing discount/rediscounting facilities in government short-term securities. In the process of shifting the financial system from direct market-based monetary control, discount houses were established to serve as financial intermediaries between the CBN, licensed banks and other financial institutions. Some of the discount houses currently in operation in Nigeria include First Securities Discount House Limited, Express Discount House Limited, Associated Discount House Limited, Kakawa Discount House Limited and Consolidated Discount House Limited.

3.2.2 Universal Banking

CBN has approved the introduction of Universal Banking in Nigeria. Since the release of the guidelines, more than ten banks have converted to universal banking status. Thus, such banks operate Commercial and Merchant functions.

3.2.3 Commercial and Merchant Banks

Commercial and Merchant Banks operate under the legal framework of the Banks and other Financial Institutions (BOFI) Act 25 of 1991 (as amended).

Commercial banks perform three major functions, namely, acceptance of deposits, granting of loans and the operation of the payment and settlement mechanism. Since the Government commenced active deregulation of the economy in September 1986, the commercial banking sector has continued to witness rapid growth, especially in terms of the number of institutions and product innovations in the market.

Merchant banks take deposit and cater for the needs of corporate and institutional customers by way of providing medium and long-term loan financing and engaging in activities such as equipment leasing, loan syndication, debt factoring and project advisers to clients sourcing funds in the market. The first merchant bank in Nigeria, Nigerian Acceptance Limited (NAL), started operations in 1960.
Currently, there is a general banking operation. With this banks performs multiple operations whether commercial or merchant operation.

3.2.4 Community Banks

A community bank in Nigeria is a self-sustaining financial institution owned and managed within a community to provide financial services to that community. The National Board for Community Banks (NBCB) processes applications for the establishment of community banks. The first community bank commenced operation in December 1990. Since then, NBCB has issued provisional licences to 1,366 community banks and are expected to be issued final licences by the CBN after operating for two years.

3.2.5 Micro Finance Banks and Non-Interest Banks

Micro-finance banks: regulated by the CBN pursuant to its Revised Regulatory and Supervisory Guidelines for Micro-finance Banks.

Non-interest banks: regulated pursuant to the Guidelines for the Regulation and Supervision of Institutes Offering Non-Interest Financial Services in Nigeria.

3.3 The Capital Market and Major Participants

The Nigerian Capital Market is a channel for mobilising long-term funds. The main institutions in the market include the Securities and Exchange Commission (SEC), which is at the apex and serves as the regulatory authority of the market, the Nigerian Stock Exchange (NSE), the issuing houses and the stock-broking firms. To encourage small as well as large-scale enterprises gain access to public listing, the NSF operates the main exchange for relatively large enterprises and the Second-Securities Market (SSM), where listing requirements are less stringent, for small and medium scale enterprises.

Given its operations both in the primary and secondary markets, the Nigerian Capital Markethas recorded phenomenal growth in the first twenty years of its formal existence. The equity market capitalisation of N1.70 billion and listed equities of 92 in 1980 have risen to N472.9 billion and 196 listed equities at the end of 2000. 21 new issues valued at N16.71 billion were raised from the market to fund various expansion and developmental projects in the country in the year 2000.

Unit Trusts Scheme alsooperates on the market for the purpose of mobilising the financial resources of small and big savers and managing such funds to achieve maximum returns with minimum risk.

3.3.1 Major Participants in the Nigerian Capital Market

- The Securities and Exchange Commission (SEC), which is responsible for the overall regulation of the entire market.
- The Nigerian Stock Exchange (NSE), a self-regulatory organization in NCM that supervises the operations of the formal quoted market.
- Market Operators, this consists of the Issuing Houses (Merchant Banks and Stock broking firms), Stockbrokers, Trustees, Registrars, etc.
- Investors, Insurance Companies, Pension Fund, Unit Trusts (Institutional Investors) and Individuals.
- The Central Bank of Nigeria (CBN).
- The Federal Ministry of Finance

3.3.2 How to Access the Nigerian Capital Market

When a company or government wants to use the Capital Market to raise long-term funds, it must consult an issuing house or stockbroker. These specialists provide the company/government with financial advisory services. It is their duty to study the company’s performance over the years in order to determine its financial needs. More so, they do not only advise on the best option, they undertake total financial restructuring of the company before introducing the facility to the company.

The issuing house and the stockbroker liaise with the other parties – Registrars, Trustees, Auditors, Reporting Accountant, and Solicitors etc. to produce a marketing document known as the **Prospectus.** The Prospectus is the document the public relies on for making investment decision. Necessary approvals from SEC and other bodies are obtained. If the financial option involves listing on the Stock Exchange, the brokers to the issues ensures that all necessary approval with the Exchange are also obtained since only stockbrokers can introduce issues to the Exchange.

On the completion of the offer, the proceeds of the issue are handed over to the company for executing the proposed business programme on long-term investment and the securities is listed on the Daily Official list of the Exchange. For individuals wishing to invest in the Capital Market in form of buying shares, what they need do is to consult a Stock broking firm and register with the broking firm.

3.4 Development Finance Institutions (DFIs)

Specialised banks or development finance institutions (DFIs) were established to contribute to the development of specific sectors of the economy. In order to enhance their operations and make their efforts felt in the economy, most of the former DFIs in the country have been merged and restructured. The DFIs are regarded as State-owned banks because of their Developmental or Specialised financial role. They include: Bank of Industry, Federal Mortgage Bank of Nigeria, Bank of Agriculture, The Nigeria Export Import Bank, The Infrastructure Bank and The National Economic Reconstruction Fund.

3.5 Other Financial Institutions and Funds

There are other institutions and funds within the financial system that play important intermediating roles. The institutions include:

3.5.1 Insurance Companies

There are many insurance companies, consisting of life and non-life as well as those, which engage in both activities, and reinsurance firms. They mobilize relatively long-term funds and act as financial intermediaries. Their investments are mainly in government securities and mortgage industry.

The Nigerian insurance industry has grown tremendously over the years. The funds were sourced mainly through reduction in outgoing and other assets which together account for 80.8 per cent of total funds.

The National Insurance Commission was established to provide insurance cover for insurance companies. In addition, the Commission is expected to assist the government in achieving its economic and social objectives in the field of insurance and re-insurance. All registered insurance companies in Nigeria are required to reinsure 20% of premium collected with the National Insurance Commission. The potential investors in insurance business should contact Nigerian Insurance Commission (NAICOM) for the licensing procedures.

3.5.2 Finance Companies

Finance companies are institutions that specialise in short-term, non-bank financial intermediation. They mobilise funds from the investing public in form of borrowing and provide, among others, facilities for Local Purchase Order (LPO) and project financing, equipment leasing and debt factoring. The BOFI Act brought finance companies under the direct control and supervision of the CBN.

3.5.3 Bureaux de Change

In order to broaden the foreign exchange market and improve access to foreign exchange, especially for small users, bureaux de change have been authorised since 1989.

A total of 240-bureau de changes have been licensed and they are supervised by CBN.

3.5.4 Exchange Control Regulations

Unconditional repatriation of Capital, profit and dividends is allowed, while technical fees and royalties on imported technical services and technologies are payable. Repatriation of proceeds from disposal of assets is allowed. Foreign Exchange transactions are carried out at the Autonomous Foreign Exchange Market.

3.5.5 Primary Mortgage Institutions (PMIs)

Primary mortgage institutions operate within the framework of Act No. 53 of 1989. PMIs mobilize savings for the development of the housing sector. Their total assets/liabilities rose to N7248.2 million in 1999. In reaction to distress in the sector, the Federal Mortgage Bank of Nigeria tightened its surveillance of the institutions by issuing “clean bill of health” to 116 mortgage institutions. The share capital requirement for new primary mortgage institutions has been raised to N20 million.

3.5.6 Nigerian Social Insurance Trust Fund (NSITF)

The main objective of the Fund is to adopt a more comprehensive social security scheme for Nigerian private sector employees. The scheme was established to replace the defunct National Provident Fund (NPF) as a compulsory pension scheme for non-pensionable public servants and employees in the organised private sector. Nigerian private sector employees are required to contribute 2.5 percent, while their employers are to contribute 5 per cent of the gross monthly emolument to NSTIF. Workers in enterprises employing more than 25 persons are to be automatically registered by their employers.

The Nigerian financial System has undergone some remarkable changes in recent times. Some of these developments include the promulgation of the Failed Banks (Recovery of Debt) and Financial Malpractice in Banks Decree No. 18 of 1994. This is to facilitate the prosecution of those who contributed to the failure of banks and to recover the debt owed to the failed banks. Another major development was the inauguration of a Financial Services Regulatory Coordinating Committee (FSRCC) by the CBN in 1994. The aim is to coordinate and standardize the regulatory policies of all financial institutions in the system with a view to evolving coherence and comprehensiveness. The CBN also granted forbearance to finance companies operating in Nigeria whereby they were given a maximum of four years to amortize their classified assets portfolio against their current profits.

4.0 CONCLUSION

The unit described the Nigerian financial system, its key participants and their role in the economic development of the nation.

5.0 SUMMARY

In this unit, we enumerated the regulatory authorities and briefly describe their role; discussed money market, its participants and their roles; listed the capital market operators and briefly describe their functions; and discussed the development finance and other non-financial institutions.

By this development, we have come to the end of the first module of this course.

6.0 TUTOR-MARKED ASSIGNMENT (TMA)

1. List the key regulators in the Nigeria's financial system.
2. What is the difference between money market and capital market?
3. Who are the key participants in the money market?
4. What is the role of capital market in an economy?

Suggested answers:
The key regulators in Nigeria's financial systems are:

- Federal Ministry of Finance (FMF),
- Central Bank of Nigeria (CBN),
- Nigeria Deposit Insurance Corporation (NDIC),
- Securities and Exchange Commission (SEC),
- National Insurance Commission (NAICOM),
- Federal Mortgage Bank of Nigeria (FMBN) and
- National Board for Community Banks.

The money market is the market where short term funds are raised by individuals, groups and corporate organisations while the capital market is where long term finances are raised by the governments, individuals, corporate organisations, etc.

The key participants in the money market are listed below:

1. Banks:
    a. Commercial Banks
    b. Merchant Banks
    c. Universal Banks
    d. Community Banks
    e. Micro Finance Banks
    f. Non-interest Banks
2. Discount Houses

The role of capital market in the economy of a nation is as follows:

- to help government to raise funds for financing government projects;
- to help corporate organisations to finance long-term projects;
- to facilitate expansion of existing corporate organisations and raise capital for new ones;
- mobilise funds from the surplus sector and lend to deficit sector for economic development.

7.0 REFERENCES/FURTHER READINGS

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MODULE 2 LEGISLATION AND REGULATORY FRAMEWORKS

This is the second module in this course. It deals with those agencies charged with the responsibility of regulating the activities of the banking sector in Nigeria. Specifically, the regulatory agencies discussed in the module are the Central Bank of Nigeria (CBN), the Nigeria Deposit Insurance Corporation (NDIC) and the Financial Services Regulatory Coordinating Committee (FSRCC). We also have legislations that confer powers on the regulatory authorities to perform their assigned roles and functions.

Starting with the historical evolution of the Central Bank of Nigeria, the regulatory and supervisory framework of the CBN as well as regulatory measures adopted by the Central Bank of Nigeria in controlling the activities of the banking sector are discussed. The regulatory activities of the Nigeria Deposit Insurance Corporation are also discussed, starting with its historical evolution. The study further discussed the objectives and regulatory functions of the NDIC. The module concludes with a discussion on the Financial Services Regulatory Coordinating Committee, a body established to coordinate the regulatory activities in the financial sector where banking is a major player.

UNIT 1 LEGISLATION AND REGULATION

1.0 INTRODUCTION

Welcome to the first unit of module 2. In this unit, you will be taken through the legal framework for banking regulation, regulatory authorities for banking regulation, procedures for the issuance of bank licences, types or forms of banks, organisation and corporate governance. You will also learn about liquidity and capital adequacy in financial institutions, consolidated supervision of banks and other related matters.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- explain the legal framework for banking regulation;
- discuss the regulatory authorities for banking;
- enumerate the procedures for issuance of bank licence;
- list the forms or types of banks available;
- discuss the organisation of banks and incidental corporate governance;
- explain the role of liquidity and capital adequacy in financial institutions;
- discuss consolidated supervision of banks and other related matters.

3.0 MAIN CONTENT

3.1 Legal Framework for Banking Regulation

The primary legislation for the regulation of banks in Nigeria is the Banks and Other Financial Institutions Act (BOFIA), which with the Central Bank of Nigeria (Establishment) Act 2007 (CBN Act) gives the CBN the powers to supervise and regulate banks and other financial institutions in Nigeria (Aluko and Oyebode, 2017). Other relevant legislations include:

- Companies and Allied Matters Act (Cap 59, Laws of the Federal Republic of Nigeria, 1990 {CAMA}), which regulates companies generally.
- Nigeria Deposit Insurance Corporation Act (NDIC), which is responsible for insuring all deposit liabilities of licensed banks.
- Foreign Exchange (Monitoring and Miscellaneous Provisions) Act, which established the Autonomous Foreign Exchange Market and provides the regulatory framework for foreign exchange market in Nigeria.

Before these, we had the following other laws/decrees:

3.1.1 Central Bank of Nigeria (CBN) Decrees/Acts

(a) The 1958 CBN Act

The 1958 CBN Act not only established the Central Bank of Nigeria but also conferred on it the powers to discharge its responsibilities. These responsibilities include issuance of legal tender currency, maintenance of low inflation rate, banker and financial adviser to the government, bankers' banker or banker of last resort (banker to deposit money banks), regulation of flow of credit, supervision of the banking sector, exchange rate management, management of external reserve, etc. Under the Act, the Board of the CBN had full responsibility for the internal administration of the Bank (CBN). With regard to capital requirements, the Banking Act 1958 raised minimum bank capital from £12,500 to £25,000 for indigenous banks and from £100,000 to £200,000 for foreign banks.

The CBN Act 1958 has been amended severally in response to changing economic conditions in order to enhance its capacity to deal with such changes. For instance, the adoption of the structural adjustment programme (SAP) in 1986 which led to sharp increase in the number of banks (from 40 in 1985 to 120 in 1992 and the adoption of the Universal Banking model rendered existing legislation grossly inadequate. Amendments to the CBN Act 1958 in 1962 and 1967, for instance, were designed to strengthen the powers of the bank in the performance of its statutory responsibilities. The CBN (Amendment) Decree No. 3 of 1968 placed the CBN under the supervisory responsibilities of the Federal Ministry of Finance.

(b) The CBN Decree No. 24 of 1991

The CBN Decree No.24 of 1991 was meant to streamline the monetary policy formulation and implementation capacity of the CBN and thereby enable it to effectively monitor the activities of all operators in the financial system. It substantially enhanced the powers of the CBN. The Decree which repealed the CBN Act 1958 laid a solid foundation for the evolution of a more stable monetary and credit system as well as an efficient and sound banking and other financial services industry. However, the Decree only granted limited autonomy to the CBN. Under the Decree, the CBN reports directly to the President and Commander-in-Chief of the federation but the President has the veto power on monetary and banking policy matters.

Specifically the Decree strengthened the powers of the CBN to manage monetary stability by substantially reducing the level of permissible annual deficit financing it can extend to the federal government each year and also contained various provisions to facilitate the use of market-based instruments of monetary control.

(c) The CBN (Amendment) Decree No. 3 of 1997

The 1997 Decree brought the CBN back under the supervisory authority of the Federal Ministry of Finance. It also changed the composition of the board of directors by enthroning a part-time director as Chairman who is to preside at every meeting of the Board. The amendment further stipulated that in the absence of the Chairman, any of the four other part-time members should preside. The 1997 amendment left the CBN with subjugated role in the monitoring of the banking system with little or no room for the Bank to exercise discretionary powers.

(d) The CBN (Amendment) Decree 37 of 1998

This Decree repealed the CBN (Amendment) Decree No. 3 of 1997. It provides some degree of operational autonomy for the CBN to execute its traditional functions and enhances its versatility. The Decree specifically restores the chairmanship of the Board to the Governor of the Central Bank of Nigeria. It also reconstitutes the Financial Services Regulation Coordination Committee (FSRCC) for the purpose of coordinating the supervision of financial institutions, especially conglomerates, with the Governor of the CBN as its Chairman.

(e) The CBN Act 2007

The 2007 CBN Act granted full autonomy to the Central Bank of Nigeria. Under the Act, the Monetary Policy Committee (MPC) was created with the Governor as Chairman. The MPC has full responsibility for formulating monetary and credit policy for the country. Article 3 of the CBN Act of 2007 specifically states that, “In order to facilitate the achievement of its mandate under the Act and the Banks and Other Financial Institutions Act (BOFIA), and in line with the objectives of promoting stability and continuity in economic management, the Bank shall be an independent body in the discharge of its function”. Article II further underscored the independence of the CBN thus, “…. the removal of the governor shall be supported by two-thirds majority of the senate praying that he be so removed”.

The CBN Act of 2007 granted the CBN the legal authority to set its policy goals (in the areas of interest rate, exchange rate, inflation rate, etc.) without seeking the approval of the Government. However, to enhance the credibility of such economic goals the CBN has always, out of its volition, consulted with the government in setting goal targets. The Act also granted the CBN freedom to run its operation (freedom to set and approve its budget, appoint and promote competent staff, etc.) without interference from either the executive or legislative arm of the government. Under the Act also, the CBN had power to exercise discretion in choosing the appropriate mix of monetary policy instruments required to achieve its goals.

3.1.2 Banks and Other Financial Institutions (BOFI) Decrees/Acts.

(a) The 1952 Banking Ordinance

The 1952 Banking Ordinance was a water-shed in the annals of Nigeria's banking history because it marked a clear departure from the free or unregulated banking era to a modern or regulated banking system. Among other things, the Ordinance provided for restriction on the issuance of bank operating licenses thereby limiting the establishment of banks only to those that hold valid licenses. It also laid down procedures and standards for the conduct of banking business. The requirement for minimum capital and reserve structures were also provided for in the Ordinance. Under the Ordinance, the financial secretary had supervisory responsibilities over the banking system as well as the discretion to issue bank licenses.

The Ordinance provided for minimum capital requirement of £12,500 for indigenous banks and £100,000 for foreign banks. A compliance period of three years period was allowed and by December 1953, only three expatriate banks (the present day First Bank, Union Bank, and UBA) and three indigenous banks (National Bank of Nigeria, Agbonmagbe Bank and African Continental Bank) held valid operating licenses.

(b) The 1969 Banking Decree

The 1969 Banking Decree consolidated existing banking legislation since 1952 in order to strengthen the capacity of the banking industry to promote growth and development. The Decree specifically provided that any company undertaking banking business must be duly incorporated in Nigeria. The Decree further provides that no bank can open or close any of its branch offices within or outside Nigeria without the written consent of the Central Bank of Nigeria.

The Banking Decree of 1969 raised the share capital for indigenous commercial banks from £250,000 in 1962 to £300,000 and for expatriate banks, from £400,000 in 1962 to £750,000. Under the Decree, the CBN was authorized to revoke or withdraw the operating license of any bank that failed to conduct its operation within the provisions of the Decree. However, to execute this mandate, the Decree requires the CBN to secure the approval of the Federal Executive Council. The Banking Act of 1969 was amended in 1972. The amendment provided for compulsory incorporation of all banks operating in Nigeria.

(c) The 1979 Banking Decree No. 88

The 1979 Decree formally introduced merchant banking in Nigeria. To distinguish between commercial (retail) and merchant (wholesale) banking operations, the Decree prohibited merchant banks from accepting deposits lower than N50,000. Also, section 6 of the Decree specified minimum capital requirement of 2 million naira for this category of banks. In addition, the Decree provided for minimum capital requirement of N600,000 for indigenous and N1.5

million for foreign banks. Owing to low level of patronage for merchant banks' services and subsequent clamour for a level playing ground for all categories of banks, the minimum deposit merchant banks were allowed to receive was reduced to N10,000 in 1994.

(d) The 1988 Banking Decree

The amendments to the Banking Act up to 1979 specified different capital requirements for indigenous and expatriate banks. The 1988 Act brought an end this duality by specifying a uniform capital requirement of 5 million naira for all commercial banks and 3 million naira for merchant banks operating in Nigeria. The capital requirement was further increased, through another amendment also in 1988, to 10 million naira and 6 million naira for commercial and merchant banks respectively.

(e) The 1989 Banking Decree

A major provision of the 1989 Decree was the review of minimum bank capital from N10 million to N20 million for commercial banks and N6 million to N12 million for merchant banks.

(f) The Banks and Other Financial Institutions (BOFI) Decree 25 of 1991

This Decree repealed the Banking Decree of 1969. It embodied enabling provisions to drive banking sector development in a deregulated environment. The Decree brought all other financial institutions in Nigeria under the regulation and supervision of the CBN. By the provisions of the Decree, licensing, regulation and supervision of all financial institutions were consolidated or centralized in the Central Bank of Nigeria thereby enhancing efficiency, stability and prudence in the operations of the financial sector. BOFI Decree No. 25 strengthened the regulatory powers of the CBN in ensuring that proper books of account are maintained as well as control of ailing financial institutions and management of the process of winding up of failed institutions.

The Decree strengthened the regulatory powers of the CBN over banks in such matters as distress resolution and winding up of banks and further enhanced the authority of the Bank to enforce decisions and directives that emerge from inspection reports on banks by authorized regulators. It also addressed corporate governance issues in banks by making specific provisions on conflict of interest and insider abuse by members of boards and management of banks.

With regard to minimum capital requirements, the BOFI Decree of 1991 specified minimum bank capital of 50 million naira and 40 million naira for commercial and merchant banks respectively.

BOFI Decree of 1991 created a four-pillar banking structure comprising commercial banks, merchant banks, profit and loss sharing banks (the platform on which Islamic banking was established) and community banks which later transformed to Microfinance banks.

(g) Banks and Other Financial Institutions (Amendment) No. 4 of 1997

The BOFI (Amendment) Decree of 1997 also made the CBN directly responsible to the Federal Ministry of Finance with respect to the supervision and control of banks and other financial institutions. It also extended the supervisory role of the CBN to other specialized banks and financial institutions. The Decree simply extended the responsibility of the central bank but failed to match the expanded with requisite authority to discharge it.

The BOFI (Amendment) Act 1997 effectively removed the different requirements for commercial and merchant banks by specifying a uniform capital requirement of 500 million naira for both categories of banks. This was further raised to 1 billion naira in 1999.

(h) The BOFI (Amendment) Decree No. 38 of 1998

The BOFI (Amendment) Decree No. 38 of 1998 repealed the BOFI Decree No. 4 of 1997. It further strengthened the regulatory powers of the CBN. Under the Decree, the CBN may vary or revoke any condition subject to which a license was granted or may impose fresh or additional conditions for grant of bank operating license in the country. The Decree also empowers the bank to ensure compliance with minimum paid-up share capital requirement of each category of banks licensed under the Decree. It further empowers the CBN to examine the books of specialized banks and other financial institutions. It can be said again that the Decree only increased the Bank's responsibility without additional powers to take any holding action to correct observed lapses in the operations of the specialized banks.

3.1.3 NDIC Decrees/Acts

The NDIC Decree No. 22 of 1988 and NDIC (Amendment) Decrees of 1997 and 1998

The NDIC Act No. 22 established the Nigeria Deposit Insurance Corporation to provide protection for bank deposits in order to enhance public confidence in the banking industry. Under the Decree, the NDIC was to complement the regulatory activities of the CBN. The NDIC Decree of 1988 was amended in 1997. However, the 1997 amendment to the 1988 Decree provides for coordinate responsibility in banking regulation and management of distressed banks. The Amended Decree which repealed the NDIC Decree No.22 of 1988 was promulgated to give more powers to the NDIC in the discharge of its supervisory functions. It also granted the NDIC autonomy from the CBN. By the provisions of the Decree, the NDIC was granted the power to liquidate and act as liquidator of distressed banks without reference to the CBN.

The 1977 amendment Decree created some level of confusion in the discharge of regulatory activities by these institutions. The 1997 Decree was subsequently amended in 1998. The amended Decree No. 39 of 1998 restored the powers of the CBN with respect to withdrawal of licenses of distressed banks and appointment of liquidators of these banks, including the NDIC. The amendment was necessitated by the need to reduce or possibly eliminate role conflicts between the CBN and the NDIC in relation to insured banks.

3.1.4 Special Directives/Guidelines from the Regulatory Agencies

(a) The Prudential Guidelines for Licensed Banks 1990

To ensure that reported values of risk assets truly reflect their realizable values, the Central Bank of Nigeria, in November 1990, through its Banking Supervision Department (BSD), issued Circular Letter No. BSD/DO/23/VOL.1/11 to all licensed banks in Nigeria and their auditors. The Circular titled 'Prudential Guidelines for Licensed Banks' contained a set of guidelines on asset classification and income recognition. The Circular aimed at enhancing the quality of bank assets. Specifically, the guidelines clearly spelt out the criteria for classifying loans and advances, minimum loan loss provisioning for each category of loans and advances, conditions attached to interest recognition in respect of classified loans, criteria for classifying other bank assets, and treatment of off-balance sheet engagements of banks. The imperative for the CBN guidelines on asset classification and income recognition derived from the near distress or chaotic situation that characterized the banking sector in 1989/1990 following the Federal Government directive that public sector funds in commercial/merchant banks be withdrawn and domiciled at the Central Bank of Nigeria. The implementation of this directive almost led to the collapse of the banking sector as virtually all banks recorded operating losses, an indication that profits have been over stated over the years and that the banks have been surviving, largely, on public sector funds.

Specific provisions of the Guidelines include: Classification of credit facilities into performing and non-performing loans as follows:

(i) Performing Loans: Where payment of principal and interest are up-to-date in accordance with agreed terms.

(ii) Non-Performing Loans: Characterized by the following conditions:
   (i) Interest or principal is due and unpaid for 90 days or more.
   (ii) Interest payments equal to 90 days interest or more have been capitalized, rescheduled or rolled over into a new loan.

However, the guidelines specifically provide that a non-performing loan can only be reclassified as performing when the borrower has effected cash payment such that outstanding unpaid interest does not exceed 90 days.

Non-Performing Loans: Classified into:

i. Sub-standard: Objectively defined as facilities on which unpaid principal and/or interest remain outstanding for more than 90 days but less than 180 days and subjectively defined as facilities that display well defined weaknesses which could affect the borrower's ability to repay the loan. For sub-standard facilities, a loan loss provision of 10% of outstanding balance is required.

ii. Doubtful: Objectively defined as facilities on which unpaid principal and/or interest remain outstanding for at least 180 days but less than 360 days and are not secured by legal title to leased assets or perfected realizable collateral in the process of collection or realization. Also subjectively defined as facilities which in addition to the weaknesses associated with sub-standard credit facilities, reflect that full repayment of the debt is not certain or that realizable collateral values will be insufficient to cover bank's exposure. For this category of credits, a provision of 50% of outstanding balance is required.

iii. Lost: Objectively defined as facilities on which unpaid principal and/or interest remain outstanding for 360 days or more and are not secured by legal title to leased assets or perfected realizable collateral in the process of collection or realization. Subjectively defined as facilities which in addition to the weaknesses associated with doubtful credit facilities, are considered uncollectable and are of such little value that continuation as a bankable asset is unrealistic. A provision of 100% of outstanding facilities is required for this category of credits.

Finally, a general provision of at least 1% of risk assets not specifically provided for is required because it is assumed that these facilities may harbour some risk of loss.

(b) The Universal Banking Model

The face of banking practice in Nigeria was drastically changed in 2001 with the removal of the dichotomy between commercial and merchant banking. The emerging universal banking model provided a level playing ground as the merchant banks converted to deposit money banks. The adoption of the universal banking model was based on the CBN policy guideline BSD/DO/CIR/ Vol.1/10/2000 of December 22, 2000 titled "Guidelines for the Practice of Universal Banking in Nigeria" issued to all licensed banks in Nigeria. The universal banking model redefined banking business to include not only the traditional banking functions and products but also incorporated clearing house activities, capital market activities (like underwriting/issuing house functions) and insurance services. Indeed the model offered a one-stop shop for financial services (or a financial super market). The primary motivation for the adoption of the universal banking model was to enhance the competitiveness of banks in the financial services industry by allowing them to diversify into non-core banking financial services. In view of the expanded scope of services offered by universal banks, the minimum share capital was raised from N1 billion to N2 billion.

(c) The 2004 Share Capital Review

In the exercise of its regulatory functions over the banking financial services sector the CBN, through a directive in 2004, raised the minimum paid up capital for banks operating in Nigeria from N2bn to N25bn with an implementation period of July 6, 2004 to December 31, 2005 (18 months). Owing to the difficulty associated with its implementation, at the end of the exercise, only 25 emerged out of the 89 that existed before the exercise. The operating licenses of 14 banks which could not meet the recapitalization deadline were withdrawn. The 25 banks that emerged from the exercise was the result of successful mergers and acquisitions that took place among 75 banks.

A major objective of the 2004 bank capital review was to develop a diversified, strong and reliable banking sector capable of playing active developmental roles in the local economy and of being competent and competitive players in the African regional and global financial system. For the domestic economy, the exercise was specifically designed to enhance banking sector competitiveness and improve the capacity of the sector to support real sector growth through efficient banking services delivery.

(d) The Microfinance Policy 2004

The microfinance banking model was introduced in Nigeria through the instrument of the Microfinance Policy, 2004. Under the policy, two categories of microfinance banks (MFBs) namely state-wide MFBs and local government area MFBs were introduced. The policy specified minimum paid-up capital of N1bn for state-wide MFBs and N20 million for local government area MFBs. The state-wide MFBs are free to open branches in any part of the state where they choose to operate while local government area MFBs are restricted to the local government area of operation. The specific objectives of the microfinance policy are to:

(1) Make financial services accessible to a large segment of the potentially productive Nigerian population which otherwise would have little or no access to financial services;

(2) Promote synergy and mainstreaming of the informal sub-sector into the national financial system;

(3) Enhance service delivery by microfinance institutions to micro, small and medium entrepreneurs;

(4) Contribute to rural transformation; and

(5) Promote linkage programmes between universal/development banks, specialized institutions and microfinance banks.

(e) The 2010 Amendment/Repeal of the Universal Banking Model

The sub-optimal performance of the banking sector in the immediate post-consolidation period due, largely, to consolidation challenges and operational abuses led to the repeal of the universal banking model, effective November 15, 2010, leading to the introduction of a three-pillar structure through the issuance of CBN regulation No.3 of 2010 namely commercial banks, merchant banks and specialized banks (made up microfinance banks, non-interest banks, development banks and mortgage banks). Commercial banking was further broken down into Regional, National and International with different authorizations based on capital limits. The 2010 amendment specified a minimum capital requirement of N10 billion for banks with regional mandate, N25 billion for banks with national mandate, and N50 billion for banks with international mandate.

Regulation No.3 of 2010 aimed at promoting financial services delivery, creating healthy environment for future evolution of the banking sector and enhancing the contribution of the banking sector to real sector growth and development. In more specific terms, the directive was meant to address structural and operational weaknesses emerging from the consolidation of banks, particularly in the areas of liquidity, asset quality and capital erosion. It also aimed at promoting banking sector efficiency and competitiveness through banking product specialization.

(f) Codes of Corporate Governance for Nigerian Banks

Code of corporate governance defines the relationship between company management, their boards and their shareholders as well as requires that management and directors carry out their duties within a framework of accountability. The high rate of financial crisis globally occasioned by weak or lack of corporate structures has greatly shifted the attention of regulators away from issues of bank capitalization to corporate governance. For instance, in spite of the massive injection of funds into the Nigerian banking system following the successful implementation of the 2004/2005 bank capital review, serious signs of systemic capital inadequacy and illiquidity crept up in the sector within three years of the exercise. Also, there is substantial evidence that poor corporate governance has been identified in most known cases of distress in the Nigerian banking sector. To regulate the practice of corporate governance in the Nigerian banking sector, the following codes have been produced:

(g) SEC Corporate Governance Code 2003

The Securities and Exchange Commission in 2003 issued a Code of Best Practices on Corporate Governance for public companies quoted on Nigerian Stock Exchange. The guidelines of the 2003 code however did not apply to all banks operating in the country. It applied to only those that are quoted on the stock exchange. One obvious weakness of the 2003 code was that it was not designed with the banking industry in mind and could therefore not deal with the peculiarities of the sector.

(h) CBN Code of Corporate Governance for Banks 2006

The 2006 CBN Code of Corporate Governance is a comprehensive code designed to guide corporate governance practices in the banking system. The code specified the core elements of corporate governance for banks and in addition dealt with issues like attributes of good corporate governance practices, risk management and duties of internal and external auditors.

(i) Prudential Guidelines 2010

Essentially, the 2010 prudential guidelines serve to reinforce and/or complement provisions in the 2006 CBN Code of corporate governance for banks. Specific areas that relate to corporate governance covered in the guidelines include tenure limitations, compensation of executive directors, and limitations on eligibility of former top level (management) staff of the CBN and the NDIC to serve in banks. The 2010 guidelines also provide operational directives for banks in the areas of risk management, corporate governance, know your customer (KYC), money laundering and terrorism financing as well as loan loss provisioning.

On corporate governance, specific provisions of the 2010 guidelines include:

- (i) Maximum of 10 years tenure for bank CEOs.
- (j) A person who has served his maximum term of 10 years shall not be re-appointed in any capacity in the same bank or its subsidiaries until after 3 years.
- (k) A governor/deputy governor of CBN and CEO of NDIC as well as executive directors of NDIC shall not be appointed in any capacity in any bank until after 5 years of exit from office.
- (l) Departmental Directors of the NDIC and the CBN shall not qualify for appointment in banks in any capacity or any subsidiary of banks under the supervision of the NDIC and the CBN until after 3 years of exit from the NDIC or the CBN.
- (m) Banks' external auditors shall serve a maximum of 10 years at the end of which they (the audit firm) shall not be reappointed in the same bank until after a period of 10 years.
- (n) Executive Directors' compensation and bonuses, including profit sharing arrangements shall be fully disclosed in the Annual audited financial statements as separate component of operating expenses.

For risk management, the 2010 guidelines dealt with issues of credit policy and loan exposure limits. It also specified stipulated risk-related ratios namely, liquidity, loan to deposits, cash, capital adequacy, and non-performing to total loan ratios.

For loan loss provisioning, all loans are to be classified into performing and non-performing based on level of borrowers' compliance to loan agreement. Specifically, loans are classified as performing if payments of both interest and principal repayments are up-to-date in line with the terms of the loan. Non-performing loans are defined as those whose interests and principal repayments fall due but remain unpaid for 90 days or more or interest payment equal to 90 days pro-rated interest or more have been capitalized, rescheduled, or rolled over into a new loan. Non-performing loans are further classified into:

i. Sub-standard: Objectively defined as where interest and/or principal repayments which fall due remain unpaid for more than 90 days but less than 180 days and subjectively defined as loans that show defined weaknesses capable of jeopardizing the capacity of the borrower to pay back. For this category of loans, a loan loss provision of 10% is to be made for the outstanding balance.

ii. Doubtful: Here interest and/or principal repayment remain unpaid for up to 180 days but less than 360 days and subjectively defined as loans with identified weaknesses as in (i) above which in addition indicate that full repayment is uncertain or whose expected realizable value of collateral will be inadequate to off-set the bank's exposure. For this category of facilities, a loan loss provision of 50% is required.

iii. Lost: Where accrued interest and/or principal repayment remain unpaid for 360 days or more and are not appropriately secured and subjectively defined as those that harbour the weaknesses associated with doubtful facilities and in addition whose collaterals are deemed unrealizable and/or are of such value that continuation as bankable assets are not realistic. For this category of loans, a loan loss provision of 100% should be made.

Finally, the 2010 guidelines specified that a loan loss provision of 2% should be made for all performing facilities. This is a conservative approach to loan management based on the assumption that even the performing facilities may have some latent weaknesses which may impair their realisability.

3.2 Regulatory Authorities for Banking Regulation

Lead Bank regulator

The lead bank regulatory is the Central Bank of Nigeria (CBN) which was established by the Central Bank of Nigeria (Establishment) Act 2007.

The principal objectives of CBN Act are to (Section 2, CBN Act):

- Ensure monetary and price stability.
- Issue legal tender currency.
- Maintain external reserve to safeguard international value of the currency.
- Promote a sound financial system.
- Act as banker and provide economic advice to the Federal Government.

Under the Banks and Other Financial Institutions Act (BOFIA), the CBN is responsible for granting banking licenses to carry on the business of banking and for supervising and regulating banks and other financial institutions in Nigeria.

The CBN is also responsible for the monitoring and regulation of the Autonomous Foreign Exchange Market and has the power to issue guidelines Foreign Exchange (Monitoring and Miscellaneous Provisions) Act. The CBN regularly issues circulars and guidelines in line with its oversight responsibilities over banks and other financial institutions the foreign exchange market in Nigeria.

The CBN also has powers to intervene when as a result of its various examinations and supervisory powers it considers that a bank is failing by directing that the management and control of the bank be turned over to the Nigeria Deposit Insurance Corporation (NDIC).

Other Authorities

The Monetary Policy Committee (MPC) – was established pursuant to section 12 of the CBN Act. The role of the MPC is to facilitate price stability and to support the economic policy of the Federal Government. It is also responsible for formulating monitoring and credit policy for the Nigerian financial system.

The Nigeria Deposit Insurance Corporation (NDIC) – the NDIC is responsible for insuring all deposit liabilities for all licensed banks and other deposit taking financial institutions operating in

Nigeria and assisting monetary authorities in formulating and implementing banking policy to ensure sound banking practice and fair competition among financial institutions.

Others
The Corporate Affairs Commission (CAC) –Under the Companies and Allied Matters Act, the CAC has regulatory powers over all registered companies in Nigeria including banks and other financial institutions particularly in respect of certain statutory filings required by them.
The Financial Reporting Council of Nigeria (FRCN) – the FRCN was established under the Financial Reporting Council of Nigeria Act and has the power to enforce compliance with accounting, auditing, corporate governance and financial reporting standards.

Financial Services Regulations Coordinating Committee (FSRCC) – the Committee was established by the CBN Act to coordinate the supervision of financial institutions and to articulate the strategies for the promotion of safe, sound and efficient practices by financial intermediaries.

The members of the Financial Services Regulations Coordinating Committee are:

- The Governor of CBN who chairs the Committee;
- The Managing Director of NDIC;
- The Director-General of Securities and Exchange Commission (SEC);
- The Commissioner for Insurance;
- The Registrar-General of the Corporate Affairs Commission (CAC);
- A representative of the Federal Ministry of Finance not below the rank of a Director.

Auditors
The role of auditors (internal and external) include financial checks, operational accounting, evaluation and review of the system of internal control of the banks to ensure they are in line with applicable standards set by the CBN and other regulatory authorities.

3.3 Issuance of Bank Licences

No person is permitted to carry out any banking business unless it is a company duly incorporated in Nigeria and holds a valid banking license issued under the Banks and Other Financial Institutions Act (BOFIA).

A banking license is issued by the Central Bank of Nigeria (CBN) and authorises a company duly incorporated in Nigeria to carry out banking business in the country. A banking license can be a commercial banking license, merchant banking license or a specialised banking license, as follows:

- **Commercial Banking License –** This licenses commercial banking operations on a national, regional or international basis, and authorises banks to (*paragraph 3, CBN Scope, Conditions and Minimum Standards for Commercial Bank Regulations No. 01, 2010*):

- take deposits and maintain savings and current accounts from natural and legal persons;
- provide retail banking services including mortgage products;
- provide finance and credit facilities;
- deal in foreign exchange and provide foreign exchange services, subject to such a bank having a Foreign Exchange Authorised Dealership License;
- act as a settlement bank, subject to CBN approval;

- provide treasury management services, including but not limited to the provision of money market, fixed income, and foreign exchange investment on behalf of clients, subject to approval of the CBN;
- provide custodial services;
- provide financial advisory services incidental to commercial banking business which do not required regulatory filings with the Securities and Exchange Commission (SEC);
- invest in non-convertible debt instruments and, subject to CBN approval, enter into derivative transactions permitted under CBN circulars and directives;
- undertake fixed income trading, where duly licensed to act as a primary dealer or market maker to trade in securities such as federal government bonds, treasury bills, treasury certificates;
- provide non-interest banking services subject to CBN approval;
- other activities prescribed in writing by the CBN.

2. **Merchant Banking License –** This license allows financial institutions to provide specialist services such as wholesale banking or investment banking services as set out in the guidelines made under *CBN Scope, Conditions and Minimum Standards for Merchant Bank Regulations No. 02, 2010.* Activities permitted by a merchant banking license include:

- taking deposits from any natural or legal persons of at least NG₦100m per tranche, or such other minimum amount prescribed by CBN;
- providing finance and credit facilities to non-retail customers;
- dealing in foreign exchange and provide foreign exchange services, subject to the requirements of Foreign Exchange (Monitoring & Miscellaneous Provisions, etc.) Act and CBN regulations made under it;
- acting as issuing house, or otherwise managing, arranging or coordinating the issuance of securities, subject to the provisions of BOFIA;
- providing underwriting services for the issuance of securities, subject to the provisions of BOFIA, and to prior notification in writing to the CBN;
- providing treasury management services, including money market, fixed income and foreign exchange investment on behalf of clients;
- providing financial, consulting and advisory services relating corporate and investment matters;
- providing asset management services, including fund and portfolio management services, act as a dealer of securities for its own account, and for clients, or otherwise make or manage investments on behalf of clients;
- engaging in proprietary trading, such as investing in debt instruments, subject to the provisions of BOFIA and CBN rules, and guidelines;
- trading in fixed income securities, where duly licensed;
- providing custodial services;
- issuing, discount and rediscount negotiable instrument;
- providing debt factoring services;
- any other services prescribed in writing by the CBN.

3. **Specialised Banking License –** this include non-interest banks, microfinance banks, development banks, mortgage banks, and any other banks designated by the CBN.

4. **Foreign Exchange Authorised Dealership License –** this is issued by the CBN and permits the holder to deal in foreign currency and provide foreign exchange services in the Nigerian foreign exchange market subject to the requirements of Foreign Exchange (Monitoring & Miscellaneous Provisions, etc.) Act among others, and CBN regulations made under it.

5. **Certificate of Registration as a Capital Market Operator –** this is issued by the Securities & Exchange Commission (SEC) and permits the holder to operate in the Nigeria capital market and carry on investment and securities business in Nigeria. However, a bank licensed as a commercial bank cannot be registered as capital market operator, while a merchant bank can be so registered.

a. **Application**

The process for applying for banking license is in two phases, namely:

- Applying for the grant of approval in principle; and
- Applying for the grant of a final banking license.

b. **Grant of approval in principle**: An approval for banking license should be addressed to the Director of Banking Supervision Department at the Central Bank of Nigeria (CBN) and submitted with the following:

- Non-refundable application fee of NG₦500,000.00;
- Deposit of the applicable minimum share capital with the CBN, with evidence of deposit by each shareholder;
- Feasibility report of the proposed bank including the ownership structure of the proposed investors and percentage of their proposed shareholding, the objectives of the proposed banks, services to be rendered, the branch expansion programme and a five-year financial projection;
- List of shareholders, proposed directors and principal officers of the proposed bank and their particulars;
- Shareholders agreement (where applicable);
- Any other document/information that may be demanded by the authority.

c. **Grant of final license**: Not later than six months after the grant of approval in principle, the promoters of a proposed bank must submit application for the grant of final banking license addressed to the Director of Banking Supervision Department at the Central Bank of Nigeria (CBN) and submitted with the following:

- Non-refundable fee of NG₦5,000,000.00 in bank draft payable to CBN;
- Three copies each of:
    - Certified copy of the certificate of incorporation of the bank;
    - Certified copy of the memorandum of association;
    - Certified copy of Form CO2 (allotment of shares) and CO7 (particulars of directors)

- Evidence of location of head office of branch building (rented or owned) for the take-off of the banking business;
- Changes, if any, of the board, management and shareholding must be clearly stated for necessary appraisal;
- Evidence of strong room, loading bay, and banking hall facilities;
- Bullion lorries with necessary security equipment;
- Evidence of IT facilities/computerisation;
- Copies of offers of letters and acceptance of employment in respect of the management team.

d. **Requirements**

Minimum paid-up capital requirement, the minimum paid-up capital requirements for the different categories of banks are as follows:

- Regional commercial banking license: NG₦10 billion or other prescribed amount.
- National commercial banking license: NG₦25 billion or other prescribed amount.

- International commercial banking license: NG₦50 billion or other prescribed amount.
- Merchant banking license: NG₦15 billion or other prescribed amount.

For an applicant meeting all the requirements, the Governor of the CBN may issue the license with or without conditions, or refuse to issue a license, and does not need to give any reason for his refusal. An applicant must submit all documents for both stages of approval as prescribed above.

e. **Foreign Applicants**

A foreign applicant must incorporate a company in Nigeria, apply for a business permit, register with the Nigerian Investment Promotion Commission (NIPC) and obtain a banking license.

f. **Timing and basis of Decision**

The BOFIA is silent on the timelines for the grant of a banking license. The CBN makes its decision based on the information provided by the applicants and based on its independent examination of applicant. An applicant for a banking license must provide evidence that it meets all the requirements for the grant of a license. As stated, the CBN can refuse to issue a license and need not give any reasons for its refusal.

g. **Cost and Duration**

The applicant pays a non-refundable fee of NGN500,000.00 for an approval in principle and a non-refundable licensing fee of NGN5,000,000.00 at the final approval stage.

There are no renewal fees charged by the CBN for licenses except for the foreign exchange authorised dealership license which is subject to an annual renewal fee. A banking license is not issued subject to any time limits, but the CBN may suspend or revoke the license if it is satisfied that the bank:

- ceases to carry on the type of banking business for which the license was issued for any continuous or aggregate period of six months during a continuous period of 12 months;
- goes into liquidation or is wound up or otherwise dissolved;
- fails to fulfill or comply with any condition subject to which the license was granted;
- has insufficient assets to meet its liabilities;
- fails to comply with any obligations imposed on it by or under the Banks and Other Financial Institutions Act (BOFIA) or the Central Bank of Nigeria (Establishment) Act, 2007 (CBN Act);
- fails to comply with the minimum capital requirements by the CBN.

Nigeria does not have a framework similar to the passporting rights to financial or credit institutions operating within the European Union. A foreign bank cannot carry out banking services in Nigeria unless it has incorporated a local entity and obtained a valid banking license.

There are no exemptions from licensing requirements available to foreign banks who wish to carry on banking business in Nigeria. However, foreign banks may open a representative offices in Nigeria subject to obtaining the prior approval of the Central Bank of Nigeria (CBN) provided that such representative offices will not be licensed to carry out banking activities in Nigeria and will only be permitted to act as liaison offices for the customers of the foreign bank and to carry out research activities.

3.4 Forms of Banks

3.4.1 State-owned banks

The Central Bank of Nigeria (CBN) generally regulates all banks in Nigeria, and regularly issues guidelines, circulars and directives regulating each of the different types of bank.

The only State-owned banks are the Developmental or Specialised financial Institutions, which include:
- Bank of Industry
- Federal Mortgage Bank of Nigeria
- Bank of Agriculture
- The Nigeria Export Import Bank
- The Infrastructure Bank
- The National Economic Reconstruction Fund

The CBN issued the Regulatory and Supervisory Guidelines for the Development Finance Institutions in Nigeria in February, 2015 to regulate Development Finance Institutions.

3.4.2 Universal banks, commercial and retail banks

Under a Circular dated 4 October 2010, (on the Regulation on the Scope of Banking Activities and Ancillary Matters), the CBN repealed the Universal Banking Guidelines which had introduced a regulatory framework, whereby a licensed bank in Nigeria, could carry out all categories or types of banking activities. Pursuant to this circular, the CBN made it mandatory that the different types of banking activities needed to be done under different legal structures, thus a single legal entity could not carry out investment banking, merchant banking and commercial banking activities.

The only banks permitted to carry on business in Nigeria under the Circular are commercial banks, merchant banks and specialised banks which include non-interest banks, micro finance banks, development banks and mortgage banks.

The CBN also released the Prudential Guidelines for Deposit Money Banks in Nigeria, 2010 to regulate commercial banking activities in Nigeria.

3.4.3 Investment banks

The CBN Prudential Guidelines for Deposit Money Banks in Nigeria, 2010 also regulates investment and merchant banks in Nigeria. The Securities and Exchange Commission also has oversight and regulatory purview over investment banks in Nigeria, to the extent that it relates to their capital market activities.

3.4.4 Other banks

Other types of banks include:
- Micro-finance banks: regulated by the CBN pursuant to its Revised Regulatory and Supervisory Guidelines for Micro-finance Banks.
- Non-interest banks: regulated pursuant to the Guidelines for the Regulation and Supervision of Institutes Offering Non-Interest Financial Services in Nigeria.

- Primary mortgage banks: regulated pursuant to the Revised Guidelines for Primary Mortgage Banks in Nigeria.

3.4.5 Regulation of systematically important financial institutions (SIFIs)

The CBN's Framework for the Regulation and Supervision of Domestic Systematically Important Banks became effective on March 1, 2015.

The main objectives of the regulation is to create stronger risk management practices in Domestic Systematically Important Banks (D-SIBs) and reduce any systematic risks posed to the financial system in line with the requirement of the Basel Committee on Banking Supervision.

3.5 Organisation of Banks and Corporate Governance

Under the Banks and Other Financial Institutions Act (BOFIA0 only companies duly incorporated in Nigeria can carry on banking business in Nigeria. This means that the company must be incorporated in accordance with Companies and Allied Matters Act (Cap 59, Laws of the Federal Republic of Nigeria 1990 {CAMA}). The CBN Code of Corporate Governance for Banks and Discount Houses is mandatory for all banks and discount houses. The SEC Code of Corporate Governance for Public Companies also applies where the bank is a public company.

Generally, there are no special rules on corporate governance that applies to SIFIs.

All banks must have the following organisational systems and policies in place:
- Risk management framework specifying the governance architecture, policies, procedures and processes for the identification, measurement, monitoring and control of the risks inherent in its operations.
- Whistle-blowing policy containing mechanisms including assurance of confidentiality that encourage stakeholders to report any unethical conduct to the bank or the Central Bank of Nigeria (CBN).
- Code of Conduct committing the bank, board and management to the highest standards of professional behaviour, business conduct and sustainable business practices.
- Conflict of interest policy to guide the board in managing conflicts of interest.

At the board level, the Code of Corporate Governance for Banks and Discount Houses requires each board to have a risk management and board audit committee headed by non-executive directors.

SIFIs are among other things required to (*Framework for the Regulation and Supervision for Systematically Important Banks*):

- Carry out quarterly stress tests of their capital and liquidity the results of which must be reviewed by the CBN.
- Develop specific recovery plans to be submitted to the CBN and Nigeria Deposit Insurance Corporation by 1 January every year.
- Make monthly and quarterly reports to the CBN on their financial condition and risk management activities.

The appointment of auditors for banks must be approved by the Central Bank of Nigeria (CBN) (*CBN Code of Corporate Governance for Banks and Other Financial Institutions, 2014*). External auditors must render reports to the CBN on banks' risk management practices, internal controls and level of compliance with regulatory directives. The Code stipulates that the tenure of auditors for any given bank is a maximum of ten cumulative years after which the auditor cannot be reappointed to audit the bank until after another ten consecutive years has expired.

An audit firm must not provide audit services to a bank if one of the bank's senior officials (such as directors, chief finance officer, chief audit officer) was employed by the firm and worked on the bank's audit in the immediate past two years.

There are no special rules for SIFIs.

The Central Bank of Nigeria's (CBN) Revised Assessment Criteria for Approved Persons' Regime for Financial Institutions (issued in October 2015) specifies the minimum requirements for candidates occupying or intending to occupy management positions in banks, discount houses, development finance and other financial institutions.

There are no special rules applicable only to SIFIs.

Every bank is required to have a remuneration policy, which is established by the Board of Directors of that bank, and disclosed to the shareholders in the bank's annual report (*paragraph 2.7, CBN Code of Corporate Governance for Banks and Discount Houses in Nigeria*). The level of remuneration must be sufficient to attract, retain and motivate executive officers of the bank while not amounting to excessive remuneration. Banks must also have a committee of non-executive directors who determine the remuneration of executive directors.

Non-executive directors' remuneration is limited to director's fees, sitting allowances for board and board committee meetings and reimbursable travel and hotel expenses. Non-executive directors are not entitled to receive benefits, salaries and so on whether in cash or in kind, other than those mentioned above.

Executive directors do not receive sitting allowances and directors' fees.

There are no special rules applicable only to SIFIs.

Every bank must have a committee responsible for oversight of risk management and audit functions (*paragraph 2.5.1, CBN Code of Corporate Governance for Banks and Discount Houses*). The board risk management committee must include two non-executive directors and the executive director in charge of risk management but chaired by a non-executive director.

Every bank must have a risk management framework specifying the governance architecture, policies, procedures and processes for the identification, measurement, monitoring and control of the risks inherent in its operations.

The board of directors of the bank is responsible for preparing the bank's risk management framework and has overall responsibility for the implementation of the bank's policies on risk management and must satisfy itself that the bank's management has developed and implemented a sound system of risk management and internal control.

In addition, the Companies and Allied Matters Act (CAMA) provides that all public companies must have audit committees consisting of an equal number of directors and shareholders and representatives (subject to a maximum number of six members) which are responsible for examining the auditor's report. Members of the audit committee are not entitled to any remuneration for the discharge of their responsibilities and members of the committee and are subject to re-election annually. This only statutorily applies to only a bank that is a public company.

There are no special rules applicable only to SIFIs.

3.6 Liquidity and Capital Adequacy

On December 10, 2013, the Central Bank of Nigeria (CBN) issued guidance notes for the implementation of Basel II/III in Nigeria (Guidance notes on Regulatory Capital Measurement and Management for the Nigerian Banking System {Basel Guidance Notes}).

The Basel Guidance Notes sets out basic approaches to be adopted by banks for the computation of credit risk, market risk and operational risk.

The Framework for the Regulation and Supervision of Domestic Systematically Important Banks in Nigeria was also issued in the light of the Basel Committee on Banking Supervision (BCBS) and the Financial Stability Board (FSB) developing a framework for Domestic Systematically Important Banks (D-SIBs) and Global Systematically Important Financial Institutions (G-SIFIs).

The implementation of the Basel II/III standards by the CBN in Nigeria is an ongoing process and a target date for full implementation of the Basel III standards is yet to be set.

The Central Bank of Nigeria (CBN) is responsible for prescribing the minimum liquidity ratio for banks in Nigeria from time to time in line with its monetary policy's directions. SIFIs must comply with the minimum liquidity ratio requirement for banks.
There are no special rules applicable only to SIFIs.

Banks must maintain healthy leverage ratios to ensure their ability to meet financial obligations (*Guidance Notes on the Calculation of Regulatory Capital issued by the CBN*). Specifically, Development Finance Institutions (DFIs) must maintain a minimum ratio of Tier 1 capital to total assets at 5 percent (*paragraph 8.1.3, Regulatory and Supervisory Guidelines for Development Finance Institutions*).
All banks must apply the rules in the Central Bank of Nigeria (CBN) Guidance notes on Regulatory Capital (which govern the capital adequacy levels of all banks) for assessment of qualifying capital.

The Framework for Regulation and Supervision of Domestic Systematically Important Banks sets out additional regulatory requirements for capital adequacy ratios for SIFIs.

SIFIs must also set aside an additional loss absorbency or additional capital surcharge of 1 percent to their respective minimum required capital adequacy ratio.

The aim of the additional loss absorbency requirement is to ensure that the SIFIs have a higher share of their balance sheet funded by instruments that reinforce the resilience of the institution as a going concern.

3.7 Consolidated Supervision of Banks

The Central Bank of Nigeria (CBN) released a draft framework for the Consolidated Supervision of Banks in Nigeria in 2007 and requested for comments from the public or relevant persons that would be affected. The draft framework is not yet effective and is yet to be published as a substantive regulation.

However, the CBN in line with its objective of promoting a sound financial system in Nigeria supervises banks and other financial institutions in Nigeria. This is done in conjunction with other stakeholders in the banking including the Securities and Exchange Commission (SEC).

Nigeria, through the Central Bank of Nigeria (CBN), has signed up to a number of international standards, such as the Financial Action Task Force (FATF) Recommendations on Combating Money Laundering and the Financing of Terrorism and Proliferation.

In 2010, the CBN signed a strategic partnership memorandum of understanding with Bank Negara (the Central Bank of Malaysia) to share expertise and exchange relevant information in the areas of:

- Bank Supervision
- Small and Medium Enterprises (SMEs)
- Microfinance
- Islamic Finance
- Monetary Policy
- Development Finance Institutions
- External Reserve Management
- Institutional arrangement for financial crisis management and resolution
- Foreign Exchange Administration
- Performance Management and Corporate Strategy
- Leadership Development and Talent Management

The acquisition of an equity holding of 5 percent and above by any investor in a bank is subject to Central Bank of Nigeria (CBN's) prior approval (*paragraph 3, Code of Corporate Governance for Banks and Discount Houses in Nigeria*). Where such shares are listed securities and are acquired through the stock exchange, the bank must apply for a no objection letter from the CBN immediately after the acquisition. No single shareholder can acquire more than 5 percent in the share capital of any bank without the approval of CBN.

The approval of the Securities and Exchange Commission (SEC) is required for the acquisition of controlling interest in the shareholding in banks. Further, to discourage government (including its agencies) from having majority shareholding in banks, government's equity holding in any bank is limited to 10 percent.

3.8 Regulatory Developments and recent Trends in Bank Regulation

The Code of Corporate Governance for Banks and Discount Houses in Nigeria states that an equity holding of 5 percent and above by any investor will be subject to Central Bank of Nigeria (CBN's) prior approval. Where such shares are listed securities and are acquired through the capital market, the bank must apply for a no objection letter from the CBN immediately after the acquisition. Where the CBN refuses to grant its "no objection" such shares will need to be sold.

Further, to discourage government (including its agencies) from having majority shareholdings in banks, government's equity holding in any bank is limited to a maximum of 10 percent.

The approval of the Securities and Exchange Commission (SEC) is required for the acquisition of controlling interest in the shareholding of a bank. Save for the requirement of the prior approval of the Central Bank of Nigeria (CBN) for the acquisition of an equity holding of 5 percent by any investor in a bank, there are no restrictions on foreign shareholdings in banks in Nigeria.

The liquidation of banks is largely governed by the:

- **Nigerian Deposit Insurance Corporation Act:** this ensures that the liquidation process involves orderly and efficient closure of the failed institutions with minimum disruption to the banking system, cost-effective realisation of assets and settlement of claims to depositors, creditors and where possible, shareholders.

- **Companies and Allied Matters Act:** this sets out the qualifications of a receiver and the procedure for the appointment of a receiver.

- **Banks and Other Financial Institutions Act:** this Act approves the control of a failing bank by the Nigerian Deposit Insurance Corporation (NDIC).

- **Investment and Securities Act:** empowers the Securities and Exchange Commission (SEC) to intervene before an intermediary becomes insolvent or when effectively insolvent.

Section 36 of Banks and Other Financial Institutions Act (BOFIA) empowers the CBN to intervene when a bank is failing and to turn over the management and control to the Nigerian Deposit Insurance Corporation (NDIC).

Where a bank is failing or its licence has been revoked, the Nigerian Deposit Insurance Corporation will take over the management and act as liquidator of the bank (section 38 and 41, NDIC Act). When this occurs, the powers of the NDIC include:
- directing specific changes in the management of the bank;
- arranging a merger with or an acquisition by another insured institution;
- contracting to have deposit liabilities assumed by the other institution.

The NDIC can also:
- Organise and incorporate a bridge bank (this will be issued a licence by the Central Bank of Nigeria {CBN}) to assume the deposits or liabilities and to purchase the assets of the failing bank.
- Realise the assets of the bank, enforce the liabilities of the shareholders and directors and wind up the bank.

Generally, the NDIC Act provides that a bank in liquidation must pay its liquidation expenses first and then pay depositors and creditors. However, section 54 of the BOFIA gives statutory priority to local deposits over any other claims.

The Standards on Total-Loss-Absorbing Capacity (TLAC) requirements have been implemented in Nigeria as CBN's Guidance Notes on Supervisory Review Process.

In the Supervisory Review and Evaluation Process (SREP), the CBN reviews and assesses the Internal Capital Adequacy Assessment Process (ICAAP), analyses the bank's own assessment of its risk profile, the corporate governance system as it relates to the ICAAP and the internal control system, and verifies overall compliance with prudential rules in calculating internal capital. Specifically, banks must conduct stress testing of their risk mitigation and control systems and, where necessary, the adequacy of their internal capital, to enhance the assessment of their exposure to risks. This is applicable to all bank structures in Nigeria.

Nigeria's economy is highly dependent on the revenue generated from the exploration and export of crude oil, which constitutes a major source of the country's foreign exchange earnings and government revenue. As a result of the decline in oil prices, which significantly impacted the foreign currency reserves in Nigeria and contributed to widening of the disparity between the exchange rates in the official and the parallel foreign exchange markets, the Central Bank of Nigeria (CBN) has taken several significant steps to moderate and intervene in the foreign exchange market in a bid to defend the Naira and protect the foreign currency reserves.

An example of such intervention was the introduction of the Revised Guidelines for the Operation of the Nigerian Inter-Bank Foreign Exchange Market (Revised Guidelines), which was issued on 15 June 2016. These guidelines introduced a single market structure through the autonomous/inter-bank market, and stated that the exchange rate would be purely market-driven and allowed the CBN to participate in the market through periodic interventions to either buy or sell FX as the need arises. In addition, there was an introduction of FX Primary Dealers (FXPD) who would be registered to deal directly with the CBN for large trade sizes on a two-way quotes basis.

In addition, the CBN introduced non-deliverable, over-the-counter (OTC) Naira-settled Futures, with daily rates on the CBN-approved FMDQ Trading and reporting System in order to moderate volatility in the exchange rate by moving non-urgent FX demand from the Spot to the Futures market. In addition, several special windows for the trading of foreign currency for specified purposes have been introduced by the CBN so as to promote the liquidity and ensure the stability of the Naira.

Pursuant to the Revised Guidelines and subsequent guidelines, the CBN has been seen to exercise more oversight powers over the Nigerian foreign exchange market. In addition, significant development has included the introduction of regulations to encourage electronic based transaction by reducing the amount of physical cash in circulation. The CBN introduced a policy to discourage and penalise cash-based transactions by stipulating a cash handling charge on daily cash withdrawals that exceed NGN500,000 for individual and NGN3 million for corporate bodies.

3.9 The Money Laundering Regulation in Nigeria

The phrase money-laundering was not in the Nigerian dictionary, until in the 1980's which was when it was recognised and efforts were made to deal with the problem by the government. Therefore, there were decrees set by the government of Generals Muhammad Buhari, Ibrahim Babangida and Sani Abacha as heads of state and military president respectively, prohibiting activities related to money-laundering (Exchange Control (Anti Sabotage) Decree No 7 of 1984, National Drug Law Enforcement Agency Decree No 48 of 1989, now Caps No 29 Laws of the federation of Nigeria, 2004; Okogbule, 2007).

1995 decree corrected one of the defects of these laws which limited the activities to Drug traffickers in order to avoid loophole which gave way for the accused person to escape justice when the case is not drug trafficking; (Adekunle, 1999; Okogbule, 2007). It was in this recognition of the defect or inadequacy of the previous Decrees to cover all the aspects of money laundering that gave birth to the enactment of the money-laundering (prohibition) Act, 2003 which covers everything relating to the offence. And after One year of its enactment it was amended through the money-laundering prohibition (Amendment) Act 2004, in order to give the agencies more power to institute an investigation and prosecute offenders (Okogbule, 2007).

However, the amendment was based on two philosophies. Firstly, it was on the need to control the practice of huge financial transactions in Nigeria, since the country is known as a cash society. In the amended Act, it states that no person or corporate body shall make or accept cash payment of sum exceeding N500, 000 or its equivalent in the case of individuals, while in the case of corporate bodies the amount is N2, 000,000, unless the transaction is done through a financial institution, the provision is design to enhance the monitoring capabilities of the regulatory institutions over huge financial transactions and encourage the use of financial institutions (Okogbule, 2007).

However in the second philosophy in the act, it is a directive requiring disclosure of any financial transaction exceeding a certain sum of money.

"Section 2(1) of the Act, state that: A transfer to or from a foreign country funds or security exceeding the sum of $10,000 or its equivalent shall be reported to the central bank of Nigeria".

And it further said that a report should be made pursuant to the above provision to indicate the nature and amount of transfer, the names and addresses of the sender and receiver of the funds or securities (Okogbule, 2007).

3.9.1 Money Laundering Regulation in relation to Institutions in Nigeria

The money laundering (Prohibition) Act 2004, of Nigeria in section 1 states that no person or corporate body shall, except through transactional institutions, make or accept deposit of a sum exceeding,

A, for an individual the sum of N500, 000 or its equivalent in other currency and
B, the sum of 2,000,000 for a corporate body, that anything above this should be made through the financial institution likewise for the individual costumer.

In section 2 of the prohibition of money laundering act states that any transaction from or to foreign country of funds or securities exceeding the sum of US $10,000 shall be reported to the central bank of Nigeria (in the act refer to Central Bank) or security and exchange commission.

Again in section 2 sub section 1, states that the report should indicate the nature and the amount of the transfer, the names and addresses of the sender and receivers of the funds or securities.

3.9.2 Customer Due Diligence

However, it is provided in section 5(1) of the Act that before opening an account for or issuing passbook or even entering into any business relationship with a potential customer, the financial institution shall verify the customer's identity and address.

For individual, he is required to provide proof of his identity by presenting to the financial institution a valid original copy of an official document bearing his names and photograph; Secondly, he is to show proof of his address, by presenting to the financial institution the

originals of receipts his/her utilities issued within the last three months by public institution (example, electricity or water bill).
In the case of a body corporate, its proof of identity shall be provided by the presentation of its certificate of incorporation and other valid official documents attesting to the existence of the body corporate. Where a manager, employee, or assignee is delegated by a body corporate to open or operate an account, such a person shall in addition to the requirements specified for private individuals also show proof of a power of attorney granted to him for that purpose.

One important provision in the Act designed to facilitate the detection of money laundering activities is section 6(1). It provides as follows:

When a financial institution is requested to carry out a transaction, whether or not it relates to the laundering of the proceeds of a crime or an act, the financial institution shall seek information from the customer as to the origin and the destination of the funds, the aim of the transaction and the identity of the beneficiary.

In order to make this surveillance function more effective, financial institutions are required within seven days of the transaction to carry out the following actions:

1. Draw up a written report containing all relevant information about the transaction as well as the identity of the principal and where applicable, those of the beneficiary.
2. Take appropriate action to prevent the laundering of the proceeds of a crime or an illegal Act.
3. Send a copy of the report and action taken to the Central Bank, the Commission, the Securities and Exchange Commission, or such other appropriate regulatory authority, as the case may be.

Significantly, any financial institution which fails to comply with the above provisions is guilty of an offence and liable upon conviction to a fine of N1, 000,000 each day for as long as the offence continues.

In order to emphasize the importance of records of transactions, it is provided that these records are to be kept and preserved for at least a period of 10 years, and that the records shall be communicated to the Central Bank, National Drug Law Enforcement Agency (NDLEA), judicial authorities, Customs Officers, and such other persons as the Central Bank may from time to time specify.

However, the mandatory disclosure requirement concerning financial transactions is contained in section 10 of the Act. It is to the effect that a financial institution or casino shall report to the Agency in writing, lodgement or transfer of funds in excess of One million (N1, 000,000) Naira or its equivalent in the case of an individual and Five million (N5, 000,000) Naira or its equivalent in the case of a body corporate. This report is to be submitted within seven days of any single transaction.

And even an ordinary citizen other than a financial institution may voluntarily give information on any transaction, lodgement, or transfer of funds involving the amounts set out above. This ensures that even when a financial institution fails to report as required, information about the transaction still gets to the Agency (See Chukuemerie, 2004, Okogbule, 2007b).

The intent of the provisions is to enable the Agency ascertain the origin of the funds and determine whether to direct a stoppage of the transaction or not. This it can do when acknowledging receipt of such disclosure, report or information received in furtherance of the provisions. If the Agency is unable to ascertain the origin of the funds within a period of 72 hours, it may make a request to the Federal High Court for an order that the funds, accounts, or securities referred to in the report be blocked, and an order made by the Court in pursuance of this provision shall be enforced forthwith.

Section 9(1) of the Act provides that every financial institution shall develop programmes to combat the laundering of proceeds of a crime or other illegal act. These shall include:

- The designation of compliance officers at management level at its headquarters and at every branch and local office;
- Regular training programmes for its employees;
- The centralization of the information collected;
- The establishment of an internal audit unit to ensure compliance with and ensure the effectiveness of the measures taken to enforce the provisions of the Act.

In order to ensure compliance with this provision, the Governor of the Central Bank of Nigeria is empowered to impose a penalty of not less than one million Naira on any financial institution which fails to comply with the above provisions. And that makes it a very important provision since the threat of immediate sanction which could be suspension of the bank's operating license can engender compliance with the statutory provision.

3.9.3 The Money Laundering Offence in Nigeria

The actual money laundering offences are provided for in sections 14 – 18 of the Act which also specify the penalties for such offences. Thus, section 14(1) provides as follows:
Any person who:

- converts or transfers resources or property derived directly or indirectly from illicit traffic c in narcotic drugs or psychotropic substances or any illegal act, with the aim of either concealing or disguising the illicit origin of the resources or property or aiding any person involved in the illicit traffic c in narcotic drugs or psychotropic substances or any other crime or illegal act to evade the legal consequences of his action; or

- collaborates in concealing or disguising the genuine nature, origin, location disposition, movement or ownership of the resources, property or rights thereto derived directly or indirectly from illicit traffic c in narcotic drugs or psychotropic substances or any other crime or illegal act, commits an offence under this section and is liable on conviction to imprisonment for a term of not less than 2 years or more than 3 years.

Significantly, a person who commits an offence under this subsection shall also be subject to the same penalty notwithstanding the fact that the various acts constituting the offence were committed in different countries or places. It is not difficult to ascertain the rationale behind this provision since, very often; money laundering entails the perpetration of some of the acts in one country and the others in other countries. This brings to the fore the transnational nature of money laundering which has given rise to international concern for its regulation.

Section 16 of the Act provides that any person who:

Whether by concealment, removal from jurisdiction, transfer to nominees or otherwise retains the proceeds of a crime or an illegal act on behalf of another person knowing or suspecting such other person to be engaged in a criminal conduct or has benefited from a criminal conduct; or
Knowing that any property either in whole or in part directly or indirectly represents another person's proceeds of a criminal conduct, acquires or uses that property or has possession of it, commits an offence under this Act and is liable on conviction to imprisonment for a term of not less than 5 years or to a fine equivalent to 5 times the value of the proceeds of the criminal conduct or to both such imprisonment and fine.

It is difficult to fashion the rationale for this marked variation in the punishment specified under this section and that provided for in section 14 of the Act relating to the actual conversion or transfer of funds from such criminal or illegal activities which is stated to be not more than three years. Although it may be said that the opportunity created by a willing receptacle could have emboldened the suspect and thus facilitated the commission of the offence, it is nevertheless incongruous to have such marked disparity in the punishment for both kinds of offences, when the level of moral reprehensibility is more for the actual converter or transferor of such illegal funds than the receiver.

3.9.4 The Effectiveness of Money Laundering Regulation in Nigeria

The government of former president Obasanjo, of Nigeria was able to start the fight against corruption and money laundering, by presenting the bill Money laundering (Prohibition) Act 2004, before the national assembly which was accented by the government and put into use immediately in order to fight the menace in the country.

However, by the year 2006, the EFCC was able to secure the conviction of the former inspector general of police, Mr Tafa Balogun for several offence mostly on money laundering, by showing that ACT that no one is above the law in the country and it shows that it has the political will to tackle the canker worm of money laundering in all its ramifications (Okogbule, 2007, Chukwuemerie, 2006).

Furthermore, within the first two years of creating the Economic and Financial Crimes Commission in Nigeria, they proved effective and were able to "recovered [sic] more than $1.5bn (N203.5bn) of looted funds and arrested more than 200 people" and out of the 200, 50 people were convicted and recovered $37.1M (N5bn) from import malpractices (Malgwi, 2004).

Again the EFCC was able to secure a plea bargain with a former governor of Edo State of Nigeria, Mr. Lucky Igbinedion, which in the agreement consented in refunding the sum of N500M stolen funds and forfeit some of his properties. It was not only Igbinedion that got the plea bargain, Mr. Nwude, Mr. DSP Alamieyeseigha former governor of Bayelsa State of Nigeria, also enjoy the gesture (Alli, 2008).

However, recently the Chairman of the financial crimes commission in Nigeria, admit that they are not fully enforcing the money laundering regulation in the country while hosting stock broking firms in her office. Waziri said the anti-graft agency would start the immediate enforcement of the provisions of the Money Laundering (Prohibition) Act 2004, and prosecute all stock broking firms that default in their obligation to the suspicious transactions reports and currency transaction reports (Akinsunyi, 2009).

"Under Section 23 of the Money Laundering Act, firms carry on the business of investment and securities (this includes stock broking firms) are designated as financial institutions and there is an obligation on them to file with the Nigerian Financial Intelligence Unit all suspicious transactions, and file with the Nigerian Financial Intelligence Unit all currency transactions above N500, 000 for individuals and the N2 million for companies."

But all that is done by stock broking firms in the country. And up to extent a an investment firm took a loan of N90 Billion from a bank in order to manipulate the market, but that is between Bank and it is customer, but the utilization of the loan is different which is contrary to Section 20 of the BOFIA and the regulations of the Central Bank of Nigeria (CBN) and carries a jail term of between two and three years. It is also a breach of the Investment and Securities Act (see Thisday Newspaper, August, 2009).

However, this bring us to the issue of reporting system adopted by the Financial Action Task Force and was even part of the Nigerian Money Laundering (Prohibition) Act 2004, which is in section 6 sub-section 1(a) that direct financial and non – financial institutions to draw up a written report on any illegal transaction and submit within seven days to the relevant authorities. That means the Act, is not been followed by the Banks and stock broking firms.

3.9.5 Factors for and against Money Laundering Regulation in Nigeria

There is no doubt that with the enactment of the Money Laundering Act 2004 the Nigerian Government has taken a bold step in its efforts to fight against money laundering in the country. However, it is effort and resourcefulness may not bear the required results if the well-known problems of enforcement of law in the country are not adequately addressed in the provisions.
It is a common feature in Nigeria that individuals and institutions prefer to subvert laid down rules rather than comply with them, for example the recent banks audit conducted by the new Central Bank Governor, it shows how reckless the banks are operating, given out a loan of N490 Billion without a collateral, which form part of analysis in given out to loan to any customer by a bank and is used to settle out the debt in case the loan goes bad, but they ignore that and give out the money without following the laid down rules. The assurance being that even when they fail to comply, officials from the regulatory institutions will always compromise their positions. This brings to the fore the popularity of corruption in the country as such officers are often 'settled' to overlook noncompliance with statutory provisions (Okogbule, 2007).

In such situation, there is usually an unethical alliance between regulatory officers on the hand and the defaulting financial institutions. Therefore, there will be inadequate or ineffective enforcement of the rules, to the detriment of the country.

However, recently an upright officer (Barrister Abubakar Abba Umar) with the Corporate Affairs Commission (CAC) in Nigeria lost his life in the course of his duty. He was involved in making the organisation a very good place that it supposed to be, because to get a company registered in Nigeria, it might take you two to three months, but with his coming within a day after full verification you can get your company registered. While in course of investigation of certificate fraud in the organisation, he was forced to hand over some lawyers involved to EFCC for prosecution (see Leadership newspaper, 2009), seeing all this thing happening nobody will like to give himself up in order to do a good job in fighting money laundering in Nigeria.

According to Andrew (2004, pp 173), he argues that the Act "is faithfully implemented by Economic and Financial Crimes Commission, the Central Bank of Nigeria, the National Drug

Law Enforcement Agency and the Minister of Commerce", these relevant authorities are the ones in positions to see the implementation of the Act to the letter. However, if they did not enforce the implementation concurrently, there is every chance that the Act, will not be effective as it supposed to be in checkmating the money laundering activities in the country.

There is also problem of regular monitoring of the activities of these financial institutions. Inspectorate and Compliance Officers are known to be lax in their monitoring of the operations of these institutions, due to the fact that they are conniving to subvert the law regulating the institutions (see Okogbule, 2007).

The bankers are not reporting illegal transaction to the relevant authorities even if they knew where or how the money came about; all they are after is to have a customer with a large amount to deposit with their bank due to stiff competition in the banking sector of the country. According to Andrew (2004), some "banks might count themselves lucky to have large volume of illicit funds deposit with them" (Andrew, 2004, pp 179) and such banks collude with the money launderers in order to keep the money safe and will even keep it away the regulatory agency, which they are directed to report to on such illegal activities, for example the sum of N7.5 Billion, was found in one account of the former Inspector General of Police in a bank. The banks really don't report any illegal activities within their businesses, but recently the Central Bank of Nigeria issued a circular directing all the banks to appoint a reporting officer who will be reporting any irregular activity within the banks (see Dailytrust Newspaper).

One of the effective regulations is the provision of Section 12, which empowers the commission to tap any telephone line or place it under surveillance, obtain access to computer system, place any bank account under surveillance or obtain communication of any authentic instrument or private contract together with bank, financial and commercial records. All these can be used if the person is suspected to use account, telephone, computer to perpetrate his/her crimes (Andrew, 2004).

4.0 CONCLUSION

Without a legal and regulatory framework there cannot be any regulation. So what we have detailed here is a set of answers to questions posed on each regulatory framework designed as a result of the CBN, NDIC and BOFI Acts.

5.0 SUMMARY

In this unit, efforts were made to discuss the legal framework for banking regulation; regulatory authorities for banking; procedures for issuance of bank licence; forms or types of banks available; organisation of banks and incidental corporate governance; role of liquidity and capital adequacy in financial institutions; and consolidated supervision of banks and other related matters.

In this next unit, we shall examine the regulatory authorities and agencies, their roles, powers, functions and responsibilities.

6.0 TUTOR-MARKED ASSIGNMENT (TMA)

1. What is the legal framework for regulation of the banking industry?
2. Who are the regulatory authorities or agencies of the banking industry?
3. List and discuss the types of banks and their role in the economy.

4. What are the procedures for obtaining a bank licence?
5. What is the organisation and corporate governance for banks?
6. How do you assess the capital adequacy and requirement of a bank?

Suggested answers

The primary legislation for the regulation of banks in Nigeria is the Banks and Other Financial Institutions Act (BOFIA), which with the Central Bank of Nigeria (Establishment) Act 2007 (CBN Act) gives the CBN the powers to supervise and regulate banks and other financial institutions in Nigeria (Aluko and Oyebode, 2017). Other relevant legislations include:

- Companies and Allied Matters Act (Cap 59, Laws of the Federal Republic of Nigeria, 1990 {CAMA}), which regulates companies generally.
- Nigeria Deposit Insurance Corporation Act (NDIC), which is responsible for insuring all deposit liabilities of licensed banks.
- Foreign Exchange (Monitoring and Miscellaneous Provisions) Act, which established the Autonomous Foreign Exchange Market and provides the regulatory framework for foreign exchange market in Nigeria.

The lead bank regulatory is the Central Bank of Nigeria (CBN) which was established by the Central Bank of Nigeria (Establishment) Act 2007.

The principal objectives of CBN Act are to (Section 2, CBN Act):

- Ensure monetary and price stability.
- Issue legal tender currency.
- Maintain external reserve to safeguard international value of the currency.
- Promote a sound financial system.
- Act as banker and provide economic advice to the Federal Government.

Under the Banks and Other Financial Institutions Act (BOFIA), the CBN is responsible for granting banking licenses to carry on the business of banking and for supervising and regulating banks and other financial institutions in Nigeria.

The CBN is also responsible for the monitoring and regulation of the Autonomous Foreign Exchange Market and has the power to issue guidelines Foreign Exchange (Monitoring and Miscellaneous Provisions) Act. The CBN regularly issues circulars and guidelines in line with its oversight responsibilities over banks and other financial institutions the foreign exchange market in Nigeria. The CBN also has powers to intervene when as a result of its various examinations and supervisory powers it considers that a bank is failing by directing that the management and control of the bank be turned over to the Nigeria Deposit Insurance Corporation (NDIC).

Other Authorities

The Monetary Policy Committee (MPC) – was established pursuant to section 12 of the CBN Act. The role of the MPC is to facilitate price stability and to support the economic policy of the Federal Government. It is also responsible for formulating monitoring and credit policy for the Nigerian financial system.

The Nigeria Deposit Insurance Corporation (NDIC) – the NDIC is responsible for insuring all deposit liabilities for all licensed banks and other deposit taking financial institutions operating in Nigeria and assisting monetary authorities in formulating and implementing banking policy to ensure sound banking practice and fair competition among financial institutions.

Others

The Corporate Affairs Commission (CAC) –Under the Companies and Allied Matters Act, the CAC has regulatory powers over all registered companies in Nigeria including banks and other financial institutions particularly in respect of certain statutory filings required by them.
The Financial Reporting Council of Nigeria (FRCN) – the FRCN was established under the Financial Reporting Council of Nigeria Act and has the power to enforce compliance with accounting, auditing, corporate governance and financial reporting standards.

Financial Services Regulations Coordinating Committee (FSRCC) – the Committee was established by the CBN Act to coordinate the supervision of financial institutions and to articulate the strategies for the promotion of safe, sound and efficient practices by financial intermediaries.

The members of the Financial Services Regulations Coordinating Committee are:

1. The Governor of CBN who chairs the Committee;
2. The Managing Director of NDIC;
3. The Director-General of Securities and Exchange Commission (SEC);
4. The Commissioner for Insurance;
5. The Registrar-General of the Corporate Affairs Commission (CAC);
6. A representative of the Federal Ministry of Finance not below the rank of a Director.

Auditors

The role of auditors (internal and external) include financial checks, operational accounting, evaluation and review of the system of internal control of the banks to ensure they are in line with applicable standards set by the CBN and other regulatory authorities.

Types/Forms of Bank

They are:

State-owned banks

The Central Bank of Nigeria (CBN) generally regulates all banks in Nigeria, and regularly issues guidelines, circulars and directives regulating each of the different types of bank.

The only State-owned banks are the Developmental or Specialised financial Institutions, which include:
- Bank of Industry
- Federal Mortgage Bank of Nigeria
- Bank of Agriculture
- The Nigeria Export Import Bank
- The Infrastructure Bank
- The National Economic Reconstruction Fund

The CBN issued the Regulatory and Supervisory Guidelines for the Development Finance Institutions in Nigeria in February, 2015 to regulate Development Finance Institutions.

Universal banks, commercial and retail banks

Under a Circular dated 4 October 2010, (on the Regulation on the Scope of Banking Activities and Ancillary Matters), the CBN repealed the Universal Banking Guidelines which had introduced a regulatory framework, whereby a licensed bank in Nigeria, could carry out all categories or types of banking activities. Pursuant to this circular, the CBN made it mandatory that the different types of banking activities needed to be done under different legal structures, thus a single legal entity could not carry out investment banking, merchant banking and commercial banking activities.

The only banks permitted to carry on business in Nigeria under the Circular are commercial banks, merchant banks and specialised banks which include non-interest banks, micro finance banks, development banks and mortgage banks.

The CBN also released the Prudential Guidelines for Deposit Money Banks in Nigeria, 2010 to regulate commercial banking activities in Nigeria.

Investment banks
The CBN Prudential Guidelines for Deposit Money Banks in Nigeria, 2010 also regulates investment and merchant banks in Nigeria. The Securities and Exchange Commission also has oversight and regulatory purview over investment banks in Nigeria, to the extent that it relates to their capital market activities.

Other banks
Other types of banks include:

- Micro-finance banks: regulated by the CBN pursuant to its Revised Regulatory and Supervisory Guidelines for Micro-finance Banks.
- Non-interest banks: regulated pursuant to the Guidelines for the Regulation and Supervision of Institutes Offering Non-Interest Financial Services in Nigeria.
- Primary mortgage banks: regulated pursuant to the Revised Guidelines for Primary Mortgage Banks in Nigeria.

The process for applying for banking license is in two phases, namely:

- Applying for the grant of approval in principle; and
- Applying for the grant of a final banking license.

Grant of approval in principle: An approval for banking license should be addressed to the Director of Banking Supervision Department at the Central Bank of Nigeria (CBN) and submitted with the following:

- Non-refundable application fee of NG₦500,000.00;
- Deposit of the applicable minimum share capital with the CBN, with evidence of deposit by each shareholder;
- Feasibility report of the proposed bank including the ownership structure of the proposed investors and percentage of their proposed shareholding, the objectives of the proposed banks, services to be rendered, the branch expansion programme and a five-year financial projection;
- List of shareholders, proposed directors and principal officers of the proposed bank and their particulars;
- Shareholders agreement (where applicable);
- Any other document/information that may be demanded by the authority.

Grant of final license: Not later than six months after the grant of approval in principle, the promoters of a proposed bank must submit application for the grant of final banking license addressed to the Director of Banking Supervision Department at the Central Bank of Nigeria (CBN) and submitted with the following:

- Non-refundable fee of NG₦5,000,000.00 in bank draft payable to CBN;
- Three copies each of:
    - Certified copy of the certificate of incorporation of the bank;
    - Certified copy of the memorandum of association;
    - Certified copy of Form CO2 (allotment of shares) and CO7 (particulars of directors)

- Evidence of location of head office of branch building (rented or owned) for the take-off of the banking business;
- Changes, if any, of the board, management and shareholding must be clearly stated for necessary appraisal;
- Evidence of strong room, loading bay, and banking hall facilities;
- Bullion lorries with necessary security equipment;
- Evidence of IT facilities/computerisation;
- Copies of offers of letters and acceptance of employment in respect of the management team.

Requirements
Minimum paid-up capital requirement, the minimum paid-up capital requirements for the different categories of banks are as follows:

- Regional commercial banking license: NG₦10 billion or other prescribed amount.
- National commercial banking license: NG₦25 billion or other prescribed amount.
- International commercial banking license: NG₦50 billion or other prescribed amount.
- Merchant banking license: NG₦15 billion or other prescribed amount.

For an applicant meeting all the requirements, the Governor of the CBN may issue the license with or without conditions, or refuse to issue a license, and does not need to give any reason for his refusal. An applicant must submit all documents for both stages of approval as prescribed above.

Foreign Applicants
A foreign applicant must incorporate a company in Nigeria, apply for a business permit, register with the Nigerian Investment Promotion Commission (NIPC) and obtain a banking license.

On December 10, 2013, the Central Bank of Nigeria (CBN) issued guidance notes for the implementation of Basel II/III in Nigeria (Guidance notes on Regulatory Capital Measurement and Management for the Nigerian Banking System {Basel Guidance Notes}).

The Basel Guidance Notes sets out basic approaches to be adopted by banks for the computation of credit risk, market risk and operational risk.

The Framework for the Regulation and Supervision of Domestic Systematically Important Banks in Nigeria was also issued in the light of the Basel Committee on Banking Supervision (BCBS) and the Financial Stability Board (FSB) developing a framework for Domestic Systematically Important Banks (D-SIBs) and Global Systematically Important Financial Institutions (G-SIFIs).

The implementation of the Basel II/III standards by the CBN in Nigeria is an ongoing process and a target date for full implementation of the Basel III standards is yet to be set.

The Central Bank of Nigeria (CBN) is responsible for prescribing the minimum liquidity ratio for banks in Nigeria from time to time in line with its monetary policy's directions. SIFIs must comply with the minimum liquidity ratio requirement for banks.

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UNIT 2 REGULATORY AGENCIES I – CENTRAL BANK OF NIGERIA

Contents

1.0 INTRODUCTION

In the last unit, efforts were made to discuss the legal framework for banking regulation; regulatory authorities for banking; procedures for issuance of bank licence; forms or types of banks available; organisation of banks and incidental corporate governance; role of liquidity and capital adequacy in financial institutions; and consolidated supervision of banks and other related matters.

In this unit, we shall examine the regulatory authorities and agencies, their roles, powers, functions and responsibilities. We shall start with the Central Bank of Nigeria (CBN) and this will be followed by the others in subsequent units.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- define Central Bank of Nigeria (CBN);
- trace the historical evolution of CBN;
- enumerate the objectives of CBN;
- list the functions of CBN;
- discuss the regulatory and supervisory framework of CBN; and
- list and explain measures adopted by CBN to control Commercial Banks.

3.0 MAIN CONTENT

3.1 Central Bank of Nigeria (CBN)

The apex regulator of the Nigerian banking system is the Central Bank of Nigeria (CBN).It was established by the Central Bank of Nigeria Act 1958 as amended.

The principal objectives of CBN Act are to (Section 2, CBN Act):

- Ensure monetary and price stability.
- Issue legal tender currency.
- Maintain external reserve to safeguard international value of the currency.
- Promote a sound financial system.
- Act as banker and provide economic advice to the Federal Government.

Under the Banks and Other Financial Institutions Act (BOFIA), the CBN is responsible for granting banking licenses to carry on the business of banking and for supervising and regulating banks and other financial institutions in Nigeria.

The CBN is also responsible for the monitoring and regulation of the Autonomous Foreign Exchange Market and has the power to issue guidelines Foreign Exchange (Monitoring and Miscellaneous Provisions) Act. The CBN regularly issues circulars and guidelines in line with its oversight responsibilities over banks and other financial institutions the foreign exchange market in Nigeria.

The CBN also has powers to intervene when as a result of its various examinations and supervisory powers it considers that a bank is failing by directing that the management and control of the bank be turned over to the Nigeria Deposit Insurance Corporation (NDIC).

3.2 Historical Evolution of CBN

In spite of the introduction of the Banking Ordinance in 1952, bank failures continued unabated in the early 1950s leading to the call for the establishment of a Central Bank. It took the sustained agitation of many nationalists/leaders to compel the colonial administration to engage the Fisher's Commission (1950) and IBRD (1953) to investigate the feasibility of a Central Bank for Nigeria. The reports of these Committees considered as premature the establishment of a central bank for the country.

However, another Commission headed by Mr. J.B. Loynes turned in its report in 1957 in support of the establishment of a Central Bank for the country. Based on the views and recommendations of the Loynes commission, a bill was sent to House of Representatives in March 1958 for consideration. The bill was passed and the CBN Act 1958 emerged. It became operational on July 1, 1959 when the CBN effectively came into operation. The CBN Act 1958 invested in the Central Bank of Nigeria the powers to regulate and supervise the Nigerian financial sector. Following the increase in the level of activities in the financial sector and subsequent drive to achieve efficiency in financial regulation, the Securities and Exchange Commission (SEC) Decree of 1979 was promulgated. The Act established the Securities and Exchange Commission to oversee the regulation of the capital market segment of the financial sector while the CBN concentrates on the money market.

The primary functions of the Central Bank of Nigeria (also referred to as the Bank) include: promotion of monetary and financial sector stability, banker and financial adviser to the Federal Government of Nigeria, promotion and development of other financial institutions, promotion of economic growth and development.

To be able to effectively discharge its primary responsibilities, the instruments of legal authority backing up the Bank's operation include the CBN Act 1958, CBN Decree No 24 of 1991 (amended in 1997, 1998, and 1999) and the Banks and Other Financial Institutions Decree No. 25 of 1991 (amended in 1997, 1998, 1999). Each of these amendments aimed at defining and redefining who controls the monetary policy and other operations of the CBN. For instance, prior to the 1991 amendments to the 1958 landmark Act, the CBN operated under the supervision of the Federal Ministry of Finance. It was erroneously perceived by many as a department in the Federal Ministry of Finance.

With the 1991 Decrees, the CBN acquired the powers to formulate monetary and banking policies for the economy but subject to the approval of the President and Commander-in-Chief of the Federal Republic of Nigeria (see sections 8(1) and (2) of the CBN Decree No. 24. However, the CBN Decree No. 24 and BOFI Decree (Banks and Other Financial Institutions Decree) No. 25 brought the supervision and regulation of the banking sector and other financial institutions under the CBN. It is important to note that hitherto other financial institutions operated outside any regulatory framework.

Decree No 41 of 1999 was a major milestone in Central Banking operations in Nigeria. The Decree granted limited autonomy to the Central Bank of Nigeria. By this Decree, the CBN was no longer to be directed by either the Presidency or the Federal Ministry of Finance on issues of monetary policy formulation and general administration of the affairs and business of the Bank. However, the provisions of sections 4(a) and (b) still required the Governor of the Central Bank of Nigeria to keep the President and Commander-in-Chief of the Federal Republic informed, from time to time, of the affairs of the bank as well as make a formal report of the affairs of the Bank available to the Provisional Ruling Council at the end of every six months.

It is heart-warming to note that the CBN Act of 2007 finally granted full autonomy to the Bank with unlimited powers to formulate monetary and credit policy for the economy. The underlying objectives of the 2007 Act were primarily to facilitate the attainment of price stability as well as support the economic policy of the government of the Federal Republic of Nigeria. The implication of the new independent status acquired by the CBN under 2007 Act is that it has the latitude to determine the monetary policy rate (MPR) that will facilitate the attainment of defined monetary policy objectives. Hence, it will no longer be directed by either the Federal Ministry of Finance or the Presidency to maintain an MPR lower than the rate of inflation so that government can borrow at the cheap rate to finance budget deficits. This is a bold step towards prudent management of financial resources as the government is forced to cut its coat according to available material (cloth) and not necessarily according to size.

3.3 Objectives of CBN

The principal objectives of CBN Act are to (Section 2, CBN Act):

- ensure monetary and price stability.
- issue legal tender currency in Nigeria.
- maintain external reserves to safeguard the international value of the legal tender currency.
- promote a sound financial system in Nigeria.
- act as banker and provide economic advice to the Federal Government of Nigeria.

3.4 Functions of CBN

The basic functions of the CBN include:

- Conduct of monetary policy through the use of appropriate instruments in order to influence the levels of monetary and credit aggregates so as to achieve moderate or low level of inflation and enhanced economic growth.
- Production, distribution and management of the legal tender currency.

- Management of foreign reserves as well as the international value of the domestic currency.
- Promotion of a sound financial system through adequate regulation and supervision.
- Banker and economic adviser to the government: The CBN not only keeps public sector deposits but also lends to the government to finance budget deficits. It also renders economic advisory functions to the government.
- Banker to other banks: Banks keep a proportion of their deposits with the CBN. They also approach the CBN for financial accommodation or bail-out when the need arises (banker of the last resort function).
- The CBN also engages in developmental activities through promotion of specialized financial institutions in order to accelerate economic growth and development.

3.5 Regulatory and Supervisory Framework of CBN

Policy formulation and implementation of regulation that target financial system stability are domiciled in financial policy and regulation department of the CBN. The department is charged with the responsibility to grant licenses and approvals for the establishment of banks and other financial institutions in Nigeria.

The financial policy and regulation department is a department in the directorate of financial system stability with a mandate to develop and implement policies and regulations aimed at ensuring financial system stability as well as licensing and granting of approvals for the establishment of banks and other financial institutions. Other financial institutions supervision department is also a department under the Directorate of the financial system stability charged with the conduct of off-site surveillance and on-site examination of Micro Finance Banks, Bureau-de-Change, Development Finance Institutions, Primary Mortgage Institutions and Finance Houses.

With respect to supervision, the Banking Supervision Division (BSD) exercises supervisory authority over the Deposit Money Banks and Discount Houses while Other Financial Institutions Department supervises the activities of other financial institutions like Micro Finance Banks, Finance companies, Bureau-de-Change, Primary Mortgage Institutions and Development Finance Institutions (DFIs).

The supervision framework of both departments involves both on-site and off-site arrangements. On-site examination involves independent on-site assessment of banks' corporate governance, internal control system, reliability of information supplied by the banks, etc. Such examinations may be carried out within six months of commencement of operation (maiden) for new banks. It may also be a routine or regular examination targeted at specific areas of operation of a bank (like credit) and accordance with section 32 of BOFIA 1991. It entails unannounced visits to banks in orderto form an independent opinion on their performance.

Off-site supervision involves the review and analysis of the financial condition of banks based on information contained in prudential reports, statutory returns and other relevant documents provided by the banks.

3.6 Measures adopted by CBN to control Commercial Banks

1. Quantitative Tools:

(i) Bank Rate: Interest rate charged by the CBN on the re-discounting of Bills of exchange.

(ii) Open Market Operation: Sale or purchase of treasury bills by the CBN to control money supply (money in circulation).

(iii) Reserve requirements: Aimed at the controlling the credit creation capacity of deposit money banks as well as enhancing safety.

(iv) Credit ceiling: Credit control policy that specifies maximum credit exposure to specific sectors.

2. Qualitative Tools:

(i) Selective credit control: Directing or influencing the flow of credit to preferred sectors.

(ii) Moral suasion: Use of persuasion to get the banks to comply with government directives.

(iii) Sanctions: Use of punishments to enforce government directives.

4.0 CONCLUSION

The lead bank regulatory is the Central Bank of Nigeria (CBN) which was established by the Central Bank of Nigeria (Establishment) Act 2007 as amended. The principal objectives of CBN Act are to (Section 2, CBN Act): Ensure monetary and price stability; Issue legal tender currency; Maintain external reserve to safeguard international value of the currency; Promote a sound financial system; and Act as banker and provide economic advice to the Federal Government.

Under the Banks and Other Financial Institutions Act (BOFIA), the CBN is responsible for granting banking licenses to carry on the business of banking and for supervising and regulating banks and other financial institutions in Nigeria.

The CBN is also responsible for the monitoring and regulation of the Autonomous Foreign Exchange Market and has the power to issue guidelines Foreign Exchange (Monitoring and Miscellaneous Provisions) Act. The CBN regularly issues circulars and guidelines in line with its oversight responsibilities over banks and other financial institutions the foreign exchange market in Nigeria.

The CBN also has powers to intervene when as a result of its various examinations and supervisory powers it considers that a bank is failing by directing that the management and control of the bank be turned over to the Nigeria Deposit Insurance Corporation (NDIC).

5.0 SUMMARY

In this unit, we have defined Central Bank of Nigeria (CBN); traced the historical evolution of CBN; enumerated the objectives of CBN; listed the functions of CBN; discussed the regulatory and supervisory framework of CBN; and listed and explained measures adopted by CBN to control Commercial Banks.

In this next unit, we shall examine the role of Nigerian Deposit Insurance Corporation (NDIC) following the same pattern as it was done in the case of CBN.

6.0 TUTOR-MARKED ASSIGNMENT (TMA)

1. How did CBN derive its powers to regulate and supervise the banks and other financial institutions in Nigeria?
2. What are the objectives of CBN?

3. List and discuss the responsibilities of CBN under the CBN and BOFI Acts.
4. What are the measures adopted by CBN to regulate the activities of commercial banks?
5. Briefly examine the regulatory activities of the regulatory agencies in the Nigerian banking sector.
6. (i) Distinguish between On-site and Off-site bank supervision. (ii) Bank failure and bank distress.

Suggested answers:
The lead bank regulatory is the Central Bank of Nigeria (CBN) which was established by the Central Bank of Nigeria (Establishment) Act 2007 as amended.

Under the Banks and Other Financial Institutions Act (BOFIA), the CBN is responsible for granting banking licenses to carry on the business of banking and for supervising and regulating banks and other financial institutions in Nigeria.

The principal objectives of CBN Act are to (Section 2, CBN Act):
- ensure monetary and price stability.
- issue legal tender currency in Nigeria.
- maintain external reserves to safeguard the international value of the legal tender currency.
- promote a sound financial system in Nigeria.
- act as banker and provide economic advice to the Federal Government of Nigeria.

The basic functions of the CBN include:

- Conduct of monetary policy through the use of appropriate instruments in order to influence the levels of monetary and credit aggregates so as to achieve moderate or low level of inflation and enhanced economic growth.
- Production, distribution and management of the legal tender currency.
- Management of foreign reserves as well as the international value of the domestic currency.
- Promotion of a sound financial system through adequate regulation and supervision.
- Banker and economic adviser to the government: The CBN not only keeps public sector deposits but also lends to the government to finance budget deficits. It also renders economic advisory functions to the government.
- Banker to other banks: Banks keep a proportion of their deposits with the CBN. They also approach the CBN for financial accommodation or bail-out when the need arises (banker of the last resort function).
- The CBN also engages in developmental activities through promotion of specialized financial institutions in order to accelerate economic growth and development.

The basic functions of the CBN under CBN and BOFI Acts include:

- Conduct of monetary policy through the use of appropriate instruments in order to influence the levels of monetary and credit aggregates so as to achieve moderate or low level of inflation and enhanced economic growth.
- Production, distribution and management of the legal tender currency.
- Management of foreign reserves as well as the international value of the domestic currency.
- Promotion of a sound financial system through adequate regulation and supervision.
- Banker and economic adviser to the government: The CBN not only keeps public sector deposits but also lends to the government to finance budget deficits. It also renders economic advisory functions to the government.

- Banker to other banks: Banks keep a proportion of their deposits with the CBN. They also approach the CBN for financial accommodation or bail-out when the need arises (banker of the last resort function).
- The CBN also engages in developmental activities through promotion of specialized financial institutions in order to accelerate economic growth and development.

Measures adopted by CBN to control Commercial Banks

1. *Quantitative Tools:*

(v) Bank Rate: Interest rate charged by the CBN on the re-discounting of Bills of exchange.

(vi) Open Market Operation: Sale or purchase of treasury bills by the CBN to control money supply (money in circulation).

(vii) Reserve requirements: Aimed at the controlling the credit creation capacity of deposit money banks as well as enhancing safety.

(viii) Credit ceiling: Credit control policy that specifies maximum credit exposure to specific sectors.

2. *Qualitative Tools:*

(i) Selective credit control: Directing or influencing the flow of credit to preferred sectors.

(ii) Moral suasion: Use of persuasion to get the banks to comply with government directives.

(iii) Sanctions: Use of punishments to enforce government directives.

The regulatory agencies in the Nigerian banking sector which is the money market segment of the nation's financial system are:

The Central Bank of Nigeria (CBN): This is the apex regulatory agency in the money market where the banking sector is a dominant player. It is charged with the responsibility of formulating, implementing, supervising and monitoring the performance of regulatory systems in the money market as well as revision of same where necessary.

The Nigeria Deposit Insurance Corporation (NDIC): The NDIC seeks to promote stability in the banking sector through provision of insurance facility for customers (depositors) of licensed deposit money banks in the country. The NDIC guarantees customer deposits up to a specified maximum.

The Financial Services Regulatory Coordination Committee (FSRCC): This agency coordinates the regulatory activities of all the regulatory agencies in the nation's financial system in order to promote synergy.

On-site examination involves independent on-site assessment of banks' corporate governance, internal control system, reliability of information supplied by the banks, etc. Such examinations may be carried out within six months of commencement of operation (maiden) for new banks. It may also be a routine or regular examination targeted at specific areas of operation of a bank (like credit) and accordance with section 32 of BOFIA 1991. It entails unannounced visits to banks in orderto form an independent opinion on their performance. Off-site supervision involves the review and analysis of the financial condition of banks based on information contained in prudential reports, statutory returns and other relevant documents provided by the banks.

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UNIT 3 REGULATORY AGENCIES II – NIGERIAN DEPOSIT INSURANCE CORPORATION (NDIC)

Contents

1.0 INTRODUCTION

In the last unit, we have defined Central Bank of Nigeria (CBN); traced the historical evolution of CBN; enumerated the objectives of CBN; listed the functions of CBN; discussed the regulatory and supervisory framework of CBN; and listed and explained measures adopted by CBN to control Commercial Banks.

In this unit, we shall examine the role of Nigerian Deposit Insurance Corporation (NDIC) following the same pattern as it was done in the case of CBN.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- define and discuss NDIC as a regulatory agency;
- describe the legal framework governing NDIC operations;
- trace the historical evolution of NDIC;
- objectives for the establishment of NDIC;
- enumerate and explain the functions of NDIC:
- discuss the ownership and management of NDIC.

3.0 MAIN CONTENT

Deposit Insurance is a system established by the Government to protect depositors against the loss of their insured deposits (NDIC, 2017). The role of the banking sector, the financial safety net, and other financial institutions that accept deposits from the public are important in the economy because of their involvement in the payments system, their role as intermediaries between depositors and borrowers, and their function as agents for the transmission of monetary policy. By their nature, banks are vulnerable to liquidity and solvency problems, among other things, because they transform short-term liquid deposits into longer-term, less-liquid loans and investments. They also lend to a wide variety of borrowers whose risk characteristics are not always readily apparent. The importance of banks in the economy, the potential for depositors to suffer losses when banks fail, and the need to mitigate contagion risks, lead countries to establish financial safety nets. Financial safety net is usually made up of three components: prudential regulation & supervision, a lender of last resort and deposit protection scheme. The distribution of powers and responsibilities between the financial safety-net participants is a matter of public-policy choice and individual country circumstances. For example, some countries incorporate all financial safety-net functions within the central bank, while others assign responsibility for certain functions to separate entities. A deposit insurance system is preferable to implicit protection if it clarifies the authorities' obligations to depositors and limits the scope for discretionary decisions that may result in arbitrary actions. To be credible, however, and to avoid distortions that may result in moral hazard, such a system needs to be properly designed, well implemented and understood by the public. A deposit insurance system also needs to be part of a well-designed financial safety net, supported by strong prudential regulation and supervision, effective laws that are enforced, and sound accounting and disclosure regimes. A large variety of conditions and factors that can have a bearing on the design of the DIS system need to be assessed. These include: the state of the economy, current monetary and fiscal policies, the state and structure of the banking system, public attitudes and expectations, the strength of prudential regulation and supervision, the legal framework, and the soundness of accounting and disclosure regimes.

3.1 Nigerian Deposit Insurance Corporation (NDIC)

The Nigerian Deposit Insurance Corporation (NDIC) is responsible for insuring all deposit liabilities for all licensed banks and other deposit taking financial institutions operating in Nigeria and assisting monetary authorities in formulating and implementing banking policy to ensure sound banking practice and fair competition among financial institutions.

Based on its role and focus in the financial system, a deposit insurance scheme has been defined as a financial guarantee to protect depositors in the event of a bank failure and also to offer a measure of safety for the banking system (Ebhodaghe 1997). In most economies where the scheme exists, it serves as one of the complementary supervisory agencies employed by the monetary authorities for effective management and orderly resolution of problems associated with both failed and failing depository institutions. In addition, the scheme also offers some form of deposit guarantee to depositors such that their confidence in the banking system is not eroded in situations where deposit-taking financial institutions fail. The scheme also provides government with a framework for intervention and sterilization of disruptive effects on the economy following the failure of deposit- taking institutions. Policymakers have many choices regarding how they can protect depositors. Some countries have implicit protection that arises when the public, including depositors and perhaps other creditors, expect some form of protection in the event of a bank failure. This expectation usually arises because of the governments' past behaviour or statements made by officials.

Implicit protection is, by definition, never formally specified. There are no statutory rules regarding the eligibility of bank liabilities, the level of protection provided or the form which reimbursement will take. By its nature, implicit protection creates uncertainty about how depositors, creditors and others will be treated when bank failures occur. Funding is discretionary and often depends on the government's ability to access public funds. Although a degree of uncertainty can lead some depositors to exert greater effort in monitoring banks, it can undermine stability when banks fail. Statutes or other legal instruments usually stipulate explicit deposit insurance systems. Typically, there are rules governing insurance coverage limits, the types of instruments covered, the methods for calculating depositor claims, funding arrangements and other related matters. A deposit insurance system is preferable to implicit protection if it clarifies the authorities' obligations to depositors and limits the scope for discretionary decisions that may result in arbitrary actions. A deposit insurance system can also provide countries with an orderly process for dealing with bank failures.

The introduction of a deposit insurance system can be more successful when a country's banking system is healthy. A deposit insurance system can contribute effectively to the stability of a country's financial system if it is part of a well-designed safety net. To be credible, a deposit insurance system needs to be properly designed, well implemented and understood by the public. It also needs to be supported by strong prudential regulation and supervision, sound accounting and disclosure regimes, and the enforcement of effective laws. A deposit insurance system can deal with a limited number of simultaneous bank failures, but cannot be expected to deal with a systemic banking crisis by itself. A well-designed financial safety net contributes to the stability of a financial system; however, if poorly designed, it may increase risks, notably moral hazard. Moral hazard refers to the incentive for excessive risk taking by banks or those receiving the benefit of protection. Such behaviour may arise, for example, in situations where depositors and other creditors are protected, or believe they are protected, from losses or when they believe that a bank will not be allowed to fail. In these cases, depositors have less incentive to access the necessary information to monitor banks. As a result, in the absence of regulatory or other restraints, weak banks can attract deposits for high-risk ventures at a lower cost than would otherwise be the case.

Moral hazard can be mitigated by creating and promoting appropriate incentives through good corporate governance and sound risk management of individual banks, effective market discipline and frameworks for strong prudential regulation, supervision and laws. These elements involve trade-offs and are most effective when they work in concert. Specific deposit insurance design features can also mitigate moral hazard. These features may include: placing limits on the amounts insured; excluding certain categories of depositors from coverage; using certain forms of coinsurance; implementing differential or risk-adjusted premium assessment systems; minimising the risk of loss through early closure of troubled banks; and demonstrating a willingness to take legal action, where warranted, against directors and others for improper acts.

Many of the methods used to mitigate moral hazard require certain conditions to be in place. For example, differential or risk-adjusted differential premium assessment systems may be difficult to design and implement in new systems and in emerging or transitional economies. Early intervention, prompt corrective action and, when warranted, bank closure require that supervisors and deposit insurers have the necessary legal authority, in-depth information on bank risk, financial resources, and incentives to take effective action. Personal-liability provisions and availability of sanctions can reinforce incentives of bank owners, directors, and managers to control excessive risk, but they depend on the existence of an effective legal system that provides the necessary basis for action against inappropriate behaviour.

3.2 Legal Framework for NDIC

The major Acts that guide the operations of the Corporation are the following:

- **Nigeria Deposit Insurance Corporation (NDIC) Act**
  An Act to establish the Nigeria Deposit Insurance Corporation (NDIC) for the purpose of insuring all deposit liabilities of licensed banks and other financial institutions operating in Nigeria, providing assistance in the interest of depositors in case of imminent or actual financial difficulties; and other financial institutions; guaranteeing payments to depositors

in case of imminent suspension of payments by insured banks and other financial institutions and assisting the authorities in the formulation and implementation of banking policy.

While on the other hand Regulation involves providing input into developing and interpreting legislation and regulations, issuing guidelines, and approving requests from regulated financial institutions. The three main types of supervision are Transaction Based, Consolidated and Risk Based Supervision.

- **Banks and Other Financial Institutions Act (BOFIA)**
  An Act which confers on the Central Bank of Nigeria (CBN) the power to regulate banks and other financial institutions and for matters connected therewith which includes but not limited to licensing, examination (on-site and off-site), supervision, take over and control of management of distressed banks, prescription of capital requirement, revocation of licences, and general control over banks and other financial institutions operating in Nigeria.

- **Failed Banks (Recovery of Debts) and Financial Malpractices in Banks Act (Failed Banks Acts)**
  An Act to provide for the speedy recovery of debts owned to failed banks arising in the course of business and which remains outstanding as at date the bank is closed or declared a failed bank and for the speedy trial of offences relating to financial malpractices in banks and other financial institutions as specified in the Act or such other offences relating to the business or operation of a bank under any enactment. Pursuant to its Statutory Powers under the NDIC Act 2006,and as part of the statutory obligations towards ensuring safe and sound banking practices, the Corporation's efforts at sanitizing the banking sector is manifested in its implementation of the failed Banks Acts

  To this end, the Corporation is involved in the criminal prosecution of Bank Directors, officials and customers suspected of committing banking malpractices as well as the recovery of debts owed to failed banks in order to pay dividends or depositors of the failed banks using the provision of the failed banks Acts.

- **Implementation of the failed Banks Act**
  The Failed Banks Decree was promulgated in November, 1994. The Tribunals that were established under the Act commenced sitting in July, 1995. The Promulgation and Implementation of the Failed Banks Act was to ensure the quick dispensation of Justice. The twin objectives of the Decree were to assist in resolving distress of failing banks through speedy recovery of their non-performing loans and to sanitize the banking sector through criminal prosecution and conviction of errant directors found guilty of banking malpractices.

  The implementation of the Failed Banks Decree by the NDIC and the Central Bank of Nigeria was indeed a major plank in the resolve to contain distress and promote the soundness of the Nigerian banking system. The success achieved by the Tribunals is widely acknowledged. Between 1994 – 1999, a period of 5 years, the 14 Tribunals tried and conclusively disposed of 45 criminal cases and 672 civil/debt recovery cases.

  However, with the return to democratic rule in 1999 the Tribunals were abolished by the Tribunal, (Consequential Repeal, etc) Act No.62 of 1999, which transferred jurisdiction to try civil and criminal cases pursuant to the Failed Banks Decree to the Federal High Court. The Decree as amended is now referred to as the Failed Bank (Recovery of Debts) and Financial Malpractices in Bank Act, Cap F2 Laws of the Federation of Nigeria, 2004. The Act seeks to ensure safe and sound practices by punishing the bank directors, staffs and customers who contributed in any manner to the collapse of any bank as well as recovery of debts owed failing/failed bank.

Some bank executives and other officers are currently facing criminal prosecution pursuant to the provisions of Failed Bank (Recovery of Debts) and Financial Malpractices in Bank Act, Cap F2 Laws of the Federation of Nigeria, 2004 and some have actually been convicted. Amongst them is the high profile trial and conviction on October 9, 2010 of Mrs. Cecilia Ibru, the former managing director of Oceanic Bank PLC, who was convicted to six months in jail and ordered to forfeit over N150 billion in assets and cash. She was convicted under Section 15(1)(b) of the Failed Bank (Recovery of Debts) and Financial Malpractices in Banks Act Cap F2 Laws of the Federation of Nigeria, 2004 and punishable under Section 16(1) (a) of the same Act.

To view the summary of criminal cases pending against Directors and Officers of Banks and debt recovery instituted against debtors on behalf of Failed Banks pursuant to the Failed banks (Recovery of Debts) and financial malpractices in Banks Act, go to Litigations and Click Legal Matters

The Deposit Insurance Scheme (DIS) being implemented by the NDIC was designed as a Risk Minimiser, with the following mandate:

(i) ***Deposit Guarantee* -**This is perhaps the most significant and distinct activity of the Corporation. As an insurer, NDIC guarantees the payment of deposits up to the maximum limit in accordance with its statue in the event of failure of an insured financial institution.

(ii) ***Banking Supervision* -** The Corporation supervises banks so as to protect depositors; foster monetary stability; promote an effective and efficient payment system; and promote competition and innovation in the banking system. Banking supervision is an essential element of the Nigeria deposit insurance scheme as it seeks to reduce the potential risk of failure and ensures the unsafe and unsound banking practices do not go unchecked.

(iii) ***Failure Resolution* -** One of the primary roles of the NDIC is to ensure that failing and failed institutions are resolved in a timely and efficient manner

(iv) ***Bank Liquidation* -** The bank liquidation option is always adopted by the corporation for banks that fail to respond to failure resolution measures. Liquidation process involves orderly and efficient closure of the failed institutions with minimum disruption to the banking system, cost-effective realisation of assets and settlement of claims to depositors, creditors and where possible, shareholders.

3.3 Historical Evolution of NDIC

Following the rising episodes of banking distress and failures in Nigeria which led to loss of customer deposits and consequent erosion of confidence in banking operations, the idea of a deposit insurance scheme was mooted to protect customers of deposit money banks (DMBs) against loss of their hard-earned savings, restore public confidence in the sector and thereby promote stability of the banking system.

The Nigeria Deposit Insurance Corporation (NDIC) was established in 1988 as an independent agency of government to ensure the stability of the banking system in particular and the economy in general through provision of financial guarantee to depositors of licensed deposit-taking financial institutions. As a key component of the financial safety-net, the NDIC sees to the protection of depositors and promotion of public confidence thereby contributing to financial system stability.

Deposit Insurance Scheme (DIS) developed out of the need to protect uninformed small depositors from the risk of loss of their deposits and also to protect the banking system from instability occasioned by runs and loss of depositors' confidence. The origin of the scheme is credited to the United States of America (USA), where it is on record that six states established deposit insurance schemes during the pre-civil war years in that country, to protect state bank notes. However, it was in 1924 that the first nation-wide deposit insurance scheme was introduced by former Czechoslovakia (now Czech and Slovak Republics). Following suit, the United States government in 1933 established the Federal Deposit Insurance Corporation (FDIC). India, the Philippines and Sri Lanka all in the Asian Continent established their schemes in 1961, 1963 and 1987 respectively. In Continental Europe, the Germans' scheme which is administered by private institutions was established in 1976. In Britain, the scheme was established in 1979 while France introduced its own scheme in 1980. In Africa, Kenya established its scheme in 1985 while the Nigerian scheme was established in 1988.

The NDIC Decree No. 22 of 1988 established NDIC to provide insured protection or cover for depositors in the event of bank failures, and it is jointly owned by the Federal Government and CBN in the ratio of 60 percent and 40 per cent respectively. Under the Decree, licensed banks are mandated to pay 15/16 of 1 per cent of their total deposit liabilities as premium to the NDIC. The Corporation in return provides cover up to a maximum of N50,000 per depositor in the event of bank failure. The cover has been increased to N500,000 per depositor in line with changing macroeconomic conditions.

The NDIC not only provides cover against deposit liabilities of conventional banks (DMBs), but also insures deposits of microfinance banks (MFBs) and primary mortgage institutions (PMIs). For MFBs and PMIs, the maximum cover is N200,000 per depositor. As a way of furthering the promotion of financial inclusion, the NDIC, in 2015, introduced Pass-Through Deposit Insurance (PTDI) for subscribers of Mobile Money Operators (MMOs) in Nigeria. Under the scheme, subscribers of MMOs are guaranteed the payment of the sum of N500,000 in the event of failure of a DMB where MMOs maintain pool account.

3.4 Objectives of NDIC

A mandate is a set of official instructions or statement of purpose. There is no single mandate or set of mandates suitable for all deposit insurers. Existing deposit insurers have mandates ranging from narrow, so-called paybox systems to those with broader powers and responsibilities, such as risk-minimisation, with a variety of combinations in between. Whatever the mandate selected, it is critical that there be consistency between the stated objectives and the powers and responsibilities given to the deposit insurer. Paybox systems largely are confined to paying the claims of depositors after a bank has been closed. Accordingly, they normally do not have prudential regulatory or supervisory responsibilities or intervention powers. Nevertheless, a paybox system requires appropriate authority, as well as access to deposit information and adequate funding, for the timely and efficient reimbursement of depositors when banks fail.

A risk-minimiser deposit insurer has a relatively broad mandate and accordingly more powers. These powers may include: the ability to control entry and exit from the deposit insurance system, the ability to assess and manage its own risks, and the ability to conduct examinations of banks or request such examinations. Such systems also may provide financial assistance to resolve failing banks in a manner that minimises losses to the deposit insurer. Some risk-minimisation systems have the power to set regulations, as well as to undertake enforcement and failure-resolution activities.

The objectives of NDIC are:
(i) Reducing the incidence of bank runs thereby contributing to financial system stability.
(ii) Boosting public confidence in the banking system through provision of a framework for the resolution and orderly exit of failing and failed insured institutions.
(iii) protection of depositors through provision of an orderly medium for reimbursement to depositors in the case of imminent or actual failure of a licensed deposit-taking financial institution.

3.5 Functions of NDIC

The functions of NDIC are:

1. Guarantee of Deposits: The NDIC guarantees depositors' funds in licensed DMBs, MFBs, and PMBs up to a certain maximum in accordance with its enabling Act and therefore stand ready to indemnify depositors up to the stated maximum in the event of failure of the insured institution. The maximum cover for depositors of DMBs is N500,000 per depositor (non-interest banks inclusive) and for MFBs and PMBs, it is N200,000. For subscribers of mobile money operators (MMO), the NDIC provides cover up to N500,000 per subscriber per DMB where MMOs maintain pool account.

2. Supervision of Licensed Banks: As a way of promoting the stability of the payment system and ensuring the safety of depositors' funds, the NDIC engages in on-site and off-site supervision of the licensed deposit-taking institutions (DMBs, MFBs, and PMBs). Through supervisory activities, the NDIC aims at minimizing the incidence and severity of bank failures. The NDIC collaborates with the CBN in the discharge of this function.

3. Resolution of Banking Distress: Resolution of distress in a failed or failing licensed deposit-taking financial institution could either take the form of financial assistance (loans, guarantees or accommodation bills) or technical assistance (assumption/take-over of management and control, change of management or in some cases merger with or acquisition by a more viable banking institution. This responsibility is also jointly performed by the NDIC and the CBN.

4. Liquidation of failed banks: A bank is said to have failed when it is unable to meet its obligations to pay its depositors and by implication must go out of business. Typically, the NDIC adopts two methods in managing banking liquidation. First it could use the pay-off method which entails paying off depositors up to the insured maximum limit using funds acquired from insurance premiums paid by insured banks. The bank is then liquidated (assets turned into cash) and the proceeds used to pay other creditors of the bank. Alternatively, the NDIC may adopt the purchase and assumption method which may entail reorganizing the

bank and then organizing a take-over or merger of the failed bank by a willing acquirer or merger partner who assumes the deposit liabilities of the failed bank thereby safe guarding customers' deposits.

3.6 Ownership and Management of NDIC

Fundamentally, the ownership of a DIS takes three forms. There is the purely public sector ownership in which the equity is held entirely by the government and/or its agency. An alternative arrangement is the purely private ownership of the scheme.

Under this arrangement, the decision to establish a DIS may be that of the government which enacts the necessary legislation to enable the privately-owned banks to establish and manage the DIS. Another alternative arrangement is where the DIS is jointly owned by the public and private sectors. Under this type, the equity shares are held in specific ratio and the board is made up of representative of both parties.

3.6.1 Membership

In general, membership should be compulsory to avoid adverse selection. There are some cases, however, where a strong commitment of banks to participate in a deposit protection system can be observed and broad participation of banks may be achieved without a legal obligation. This can occur if depositors are aware of and sensitive to the existence of deposit insurance, thus creating strong incentives for banks to be part of a system. In other cases, if depositors are less concerned about deposit insurance or are not aware that coverage is limited to certain banks, then the stronger banks may opt out. Further, in a voluntary system strong banks may opt out if the cost of failures is high and this may affect the financial solvency and the effectiveness of a deposit insurance system.

There are two circumstances that may require different approaches to granting membership to banks. First, when a deposit insurance system is established and second, when membership is granted to new banks in an existing system.

When a deposit insurance system is created, policymakers are faced with the challenge of minimising the risks to the deposit insurer, while granting extensive membership. Generally, two options are available: automatic membership or requiring banks to apply for entry.

Automatic membership for all banks may be the simplest option in the short term. However, the deposit insurer may then be faced with the difficult task of having to accept banks that create an immediate financial risk or that pose other adverse consequences for the deposit insurance system.

Alternatively, banks may be required to apply for membership. This option provides the deposit insurer with the flexibility to control the risks it assumes by establishing entry criteria. It also can serve to enhance compliance with prudential requirements and standards. In such cases, an appropriate transition plan should be in place that details the criteria, process and time frame for attaining membership. The criteria should be transparent.

Membership is compulsory as provided under the NDIC Act No 16 of 2006 for:

- Non-Interest Banks
- Merchant Banks
- Commercial Banks

- Microfinance Banks
- Primary Mortgage Banks

3.6.2 Coverage, Scope and Level

Insurable deposit should be defined clearly in law or by private contract. In doing so, the relative importance of different deposit instruments, including foreign-currency deposits and the deposits of non-residents in relation to the public- policy objectives of the system should be considered. Once the relevant deposits are selected, exclusions of specific deposits and/or depositors can be determined.

Many deposit insurance systems exclude deposits held by depositors who are deemed capable of ascertaining the financial condition of a bank and exerting market discipline. Examples include deposits held by banks, government bodies, professional investors such as mutual funds, and deposits held by bank directors and officers. In some cases, deposits held by individuals who bear responsibility for the financial well-being of a bank are excluded from reimbursement. Also, deposits with extremely high yields are sometimes excluded from coverage; or reimbursement may be limited to the principal owed, with a lower rate of interest applied.

Once the scope is determined, the level of coverage can be set. This can be done through an examination of relevant data, such as statistical information describing the size distribution of deposits held in banks. This gives policymakers an objective measure, such as the fraction of depositors covered, with which the adequacy of a certain level of coverage can be assessed. Whatever coverage level is selected, it must be credible and internally consistent with other design features, and meet the public-policy objectives of the system. The relationship between coverage levels and moral hazard should always be considered by the policymakers.

3.6.3 Deposit insurance assessments: flat-rate versus risk-adjusted differential premium systems

Countries have a choice between adopting a flat-rate premium system or a premium system that is differentiated on the basis of individual-bank risk profiles. The primary advantage of a flat-rate premium system is the relative ease with which assessments can be calculated and administered. However, in a flat-rate system, low-risk banks effectively pay for part of the deposit insurance benefit received by high-risk banks. Most newly established systems initially adopt a flat-rate system given the difficulties associated with designing and implementing a risk-adjusted differential premium system. However, because flat-rate premiums do not reflect the level of risk that a bank poses to the deposit insurance system, banks can increase the risk profile of their portfolios without incurring additional deposit insurance costs. As a result, flat-rate premiums may be perceived as encouraging excessive risk taking by some banks, unless there is a mechanism to impose financial sanctions or penalties.

Risk-adjusted differential premium systems can mitigate such criticisms and may encourage more prudent risk-management practices at member banks. When the information required to implement a risk-adjusted differential premium system is available, relating premiums to the risk a bank poses to the deposit insurer is preferable.

3.6.4 Public awareness

In order for a deposit insurance system to be effective, it is essential that the public be informed about its benefits and limitations. Experience has shown that the characteristics of a deposit insurance system need to be publicised regularly so that its credibility can be maintained and strengthened. A well-designed public-awareness program can achieve several goals, including the dissemination of information that promotes and facilitates an understanding of the deposit insurance system and its main features. Also, a public-awareness program can build or help restore confidence in the banking sector. Additionally, such a program can help to disseminate vital information when failures occur, such as guidance regarding how to file claims and receive reimbursements.

3.6.5 Banking Supervision

This seeks to reduce the potential risk of failure and ensures that unsafe and unsound banking practices do not go unchecked. Bank supervision is a supervisory function charged with the responsibility of ensuring the safety and soundness of the banking system as a whole. Books and affairs of every licensed insured institution are examined as a means of meeting its supervisory mandate. This function is performed through the off-site surveillance and on-site examination of the books and affairs of the banks, which exceptions are reported and recommendations made on how the observed lapses can be corrected, and the implementation of such recommendations is monitored through scheduled post examination visits to the affected banks.

While on the other hand Regulation involves providing input into developing and interpreting legislation and regulations, issuing guidelines, and approving requests from regulated financial institutions. The three main types of supervision are Transaction Based, Consolidated and Risk Based Supervision.

3.6.6 Types of Bank Supervision

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While on the one hand Regulation involves providing input into developing and interpreting legislation and regulations, issuing guidelines and approving requests from regulated financial institutions is the other.

The three main types of supervision are Transaction Based, Consolidated and Risk Based Supervision. This supervisory approach focuses on individual group entities. Individual entities are supervised on a solo basis according to the capital requirements of their respective regulators. The Transaction's Based Type of Supervision of individual entities is complemented by a general qualitative assessment of the group as a whole and, usually, by a quantitative group-wide assessment of the adequacy of capital.

3.6.7 Supervisory Guidelines and Standards

Supervisory Standards and Guidelines are set by supervisors with a view to ensuring effective supervision. Similarly, the committee of banking supervisory authorities develops supervisory standards and guidelines with the hope that member countries will adapt them with a view to encouraging convergence towards common approaches and standards

- The Basel Accords
- Core Principles for Effective Supervision
- Prudential Guidelines
- Statement for Accounting Standards
- Other Regulatory Directives

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3.6.8 Supervisory Activities

Bank Supervision in the NDIC is the responsibility of three departments, namely, the Bank Examination Department (BED), the Insurance and Surveillance Department (ISD) and Special Insured Institutions Department (SIID). On-site examination is carried out by BED and SIID while the ISD is charged with the responsibility of maintaining off-site surveillance over all insured banks. These functions however overlap and are complementary. Both the on-site and off-site examinations seek to protect depositors' fund and to prevent systemic failure.

- Off-Site Supervision
- On-Site Supervision
- Supervision of Other Financial Institutions

Bank Supervision in the NDIC is the responsibility of three departments, namely, Bank Examination Department (BED), Insurance & Surveillance Department (ISD) and Special Insured Institutions Department (SIID). As the names imply, on-site examination is carried out by BED and SIID while the ISD is charged with the responsibility of maintaining off-site surveillance over all insured banks. Both the On-site and Off-site supervision ensure that the insured institutions remain healthy at all times and/or where there are problems, they would be detected and addressed promptly. In addition, supervision protects the bank depositors, encourages competition among banks and assists in efficient and orderly payment system

1. **Off-site Surveillance**

   Off-site supervision involves the receipt and analysis of returns from insured banks on a periodic basis to ascertain the banks' compliance with prudential regulations. Returns, basically, are requirements of the regulatory/supervisory authorities from the banking institutions which are made on determined periodic basis to assist in ensuring that the banks conform to desired operating rules. Two categories of regulatory returns can be identified. These are statutory and non-statutory returns. Statutory returns are the returns that must be made by financial institutions as provided for in various acts governing the banking business. Non-statutory returns on the other hand are those returns which the regulatory/supervisory authorities can require from banks in their day to day operations. These non-statutory returns are usually called for by means of circulars or questionnaires.

   Returns required to be prepared and submitted by financial institutions in the system are expected to be made in specified formats in accordance with instructions and in a consistent manner. The specified returns formats can only be changed or varied by the regulatory/supervisory authorities. All items are to be completed with no item left blank. Presently, the periodicity and types of bank returns can be categorized into the following:

- mid-month;
- monthly;
- quarterly; and
- semi-Annually/Annually

Others are irregular, depending on the financial environment as well as the objective of the regulatory/supervisory authorities. Upon the receipt of the appropriate returns by the Insurance and Surveillance Department (ISD), they are first checked for completeness, accuracy and consistency before they are analysed with the aim of identifying salient problem areas in the banks' operations and to proposing appropriate remedies to the banks. The analysis which takes the form of spreadsheets and ratios are in turn further subjected to level, trend, peer and industry analysis. The analysis is concluded with a report on the condition and performance of individual banks and the industry. A recurrent feature of these reports is the rating/ranking of individual banks and recommendation for corrective action in areas where weaknesses are observed. Information from off-site surveillance serves as the basis for identifying potential financial distress in the individual banks. On confirmation of distress through on-site examination, supervisory measures are adopted to contain the situation and maintain stability. Those measures may include granting of loans, take-over of the management of the bank or directing the bank to make specific changes in its management. The adoption of any of the measures will depend on the severity of the problems identified. The Corporation also uses such returns to monitor its Insurance Risk Exposure. The Off-site Surveillance performs the following functions:

(1) ***Deposit Insurance***

The Off-site Surveillance is responsible for the orderly collection and administration of Deposit Insurance Premium. It assesses premium payable by banks using External Auditor's Certified Statement of Deposits and Call Reports. Onsite deposit verification exercise is also conducted with a view to ascertaining the actual insured deposit payable by each bank. The department developed and implemented the Differential Premium Assessment System (DPAS) where banks are charged based on their perceived level of risks. The DPAS framework incorporates both quantitative and qualitative factors. It is meant:

- To provide incentives for sound risk management in insured institutions.
- To ensure fairness in deposit insurance pricing
- To reduce the overall premium burden on insured institutions.

(2) ***Reporting on Financial Condition of Banks***

This is usually carried out through the analysis of periodic call reports. Also through the analysis of the call reports, rating and categorization of banks into various risk buckets is done for regulatory purposes. The bank rating had assisted the Corporation and the CBN in designing regulatory interventions for different categories of banks as appropriate.

(3) ***Provision of Early Warning Signals***

Through the Off-site surveillance, signals of problems in banks are detected early and addressed. Where the problems persist, On-site Examinations are conducted to assess potential problem areas earlier identified by Off-site Surveillance, with a view to resolving such problems.

(4) ***Monitoring of Banks Compliance with Prudential Standards***
The Corporation through its Off-site Surveillance monitors banks to ensure their compliance with the Prudential Standards as well as necessary guidelines such as codes of Corporate Governance and risk management framework in order to ensure their safety and soundness.

(5) ***Development and Deployment of Tool for Off-Site Surveillance***
The Bank Analysis System (BAS) jointly developed by NDIC and CBN to ensure credible results of bank analysis, had been enhanced to electronic-Financial Analysis and Surveillance System (e-FASS) that had ensured availability of required information from supervised banks on an on-line real time basis. That development had assisted in reducing the problems associated with off-site supervision such as late and inaccurate rendition of returns.

2. **Focus of Supervisory Activities**

The CBN/NDIC during bank supervision and examination focus on the main aspects of banking operations. These include capital requirement, loan concentration, liquidity ratio, provisioning, internal control and management among others.

- Capital Requirements
- Loan Concentration
- Liquidity Ratio
- Provisioning
- Internal Control
- Management
- Off-Balance Sheet Engagement

Adequate capital is very important for any business, and banking is not an exception. The importance of adequate capital in banking stems from the following functions being performed by capital, viz: capital provides a cushion for absorbing operational losses; it provides a measure of shareholders' confidence and stake in the bank; it reveals the bank's ability to finance its capital expenditure and fixed assets; and it provides protection to depositors' funds, among others. It is therefore necessary to have enough capital so that depositors' risks could be minimized.

Government, on the advice of the monetary authorities, prescribes the minimum paid-up capital for banks. Recently the CBN consolidated the banks by raising the Shareholders fund to N25 billion. A bank's capital adequacy is based on the capital ratio which involves the weighting of a bank's capital base against the portfolio of risk assets carried. A minimum of 10 percent of the total risk-weighted assets of a bank is required to be maintained as capital funds. Similarly, it is required that not less than 50 percent of a bank's capital must be Tier 1 or primary capital (that is, paid-up capital plus reserves). In addition, the ratio of adjusted capital to loan assets of the bank should be a maximum of 1:10. In other words, a Naira capital should support not more than N10 of loans.

Using banks' total risk-weighted assets ratio for example, the supervisory authorities classify banks as adequately capitalized, marginally under-capitalised, significantly under-capitalised, critically under-capitalised or technically insolvent, depending on the value of their risk-weighted asset ratios. While a bank with risk-weighted asset ratio of 10 percent and above is classified as adequately capitalized, a bank with a negative risk-weighted assets ratio is classified as technically insolvent. This classification is an attempt at establishing bench-marks for prompt supervisory intervention.

3. List of Insured Institutions

This is a list of Insured institutions which are all deposit-taking financial institutions licensed by the Central Bank of Nigeria (CBN) such as

- Universal Banks (deposit money banks);
- Micro-finance Banks – (MFBs); and
- Primary Mortgage Institutions (PMIs).

4.0 CONCLUSION

The Nigerian Deposit Insurance Corporation (NDIC) is responsible for insuring all deposit liabilities for all licensed banks and other deposit taking financial institutions operating in Nigeria and assisting monetary authorities in formulating and implementing banking policy to ensure sound banking practice and fair competition among financial institutions. Deposit Insurance Scheme (DIS) developed out of the need to protect uninformed small depositors from the risk of loss of their deposits and also to protect the banking system from instability occasioned by runs and loss of depositors' confidence.

The NDIC Decree No. 22 of 1988 established NDIC to provide insured protection or cover for depositors in the event of bank failures, and it is jointly owned by the Federal Government and CBN in the ratio of 60 percent and 40 per cent respectively. Under the Decree, licensed banks are mandated to pay 15/16 of 1 per cent of their total deposit liabilities as premium to the NDIC. The Corporation in return provides cover up to a maximum of N50,000 per depositor in the event of bank failure. The cover has been increased to N500,000 per depositor in line with changing macroeconomic conditions.

The major Acts that guide the operations of the Corporation are Nigeria Deposit Insurance Corporation (NDIC) Act, Banks and Other Financial Institutions Act (BOFIA), Failed Banks (Recovery of Debts) and Financial Malpractices in Banks Act (Failed Banks Acts) and Implementation of the failed Banks Act. The Deposit Insurance Scheme (DIS) being implemented by the NDIC was designed as a Risk Minimiser, with the mandate of deposit guarantee, banking supervision, failure resolution and bank liquidation.

The objectives of NDIC are to reduce the incidence of bank runs thereby contributing to financial system stability, boost public confidence in the banking system through provision of a framework for the resolution and orderly exit of failing and failed insured institutions, and protect depositors through provision of an orderly medium for reimbursement to depositors in the case of imminent or actual failure of a licensed deposit-taking financial institution.

The functions of NDIC are guarantee of deposits, supervision of licensed banks, resolution of banking distress and liquidation of failed banks.

The NDIC is jointly owned by the Federal Government and CBN in the ratio of 60 percent and 40 per cent respectively. Other issues in connection with ownership and management of NDIC are: membership, coverage scope and level, deposit insurance assessments, public awareness, banking supervision, types of bank supervision, supervisory guidelines and standards, and supervisory activities.

5.0 SUMMARY

In this unit, we have been able to define and discuss NDIC as a regulatory agency; describe the legal framework governing NDIC operations; trace the historical evolution of NDIC; objectives for the establishment of NDIC; enumerate and explain the functions of NDIC and discuss the ownership and management of NDIC.

In the next unit, we shall consider the Financial Services Regulation Coordinating Committee (FSRCC).

6.0 TUTOR-MARKED ASSIGNMENT (TMA)

1. Discuss the primary objectives and functions of the NDIC.
2. Briefly discuss the common methods adopted by the NDIC in resolution of banks' liquidation in Nigeria.

Suggested answers:

Objectives of the NDIC

(1) Protection of depositors through provision of an orderly medium for reimbursement to depositors in the case of imminent or actual failure of a licensed deposit-taking financial institution.

(2) Reducing the incidence of bank runs thereby contributing to financial system stability.

(3) Boosting public confidence in the banking system through provision of a framework for the resolution and orderly exit of failing and failed insured institutions.

Functions of the NDIC

(1) Guarantee of Deposits: The NDIC guarantees depositors' funds in licensed DMBs, MFBs, and PMBs up to a certain maximum in accordance with its enabling Act and therefore stand ready to indemnify depositors up to the stated maximum in the event of failure of the insured institution. The maximum cover for depositors of DMBs is N500,000 per depositor (non-interest banks inclusive) and for MFBs and PMBs, it is N200,000. For subscribers of mobile money operators (MMO), the NDIC provides cover up to N500,000 per subscriber per DMB where MMOs maintain pool account.

(2) Supervision of Licensed Banks: As a way of promoting the stability of the payment system and ensuring the safety of depositors' funds, the NDIC engages in on-site and off-site supervision of the licensed deposit-taking institutions (DMBs, MFBs, and PMBs). Through supervisory activities, the NDIC aims at minimizing the incidence and severity of bank failures. The NDIC collaborates with the CBN in the discharge of this function.

(3) Resolution of Banking Distress: Resolution of distress in a failed or failing licensed deposit-taking financial institution could either take the form of financial assistance (loans, guarantees or accommodation bills) or technical assistance (assumption/take-over of management and control, change of management or in some cases merger with or acquisition by a more viable banking institution. This responsibility is also jointly performed by the NDIC and the CBN.

(4) Liquidation of failed banks: A bank is said to have failed when it is unable to meet its obligations to pay its depositors and by implication must go out of business. Typically, the NDIC adopts two methods in managing banking liquidation. First it could use the pay-off method which entails paying off depositors up to the insured maximum limit using funds acquired from insurance premiums paid by insured banks. The bank is then liquidated (assets turned into cash) and the proceeds used to pay other creditors of the

bank. Alternatively, the NDIC may adopt the purchase and assumption method which may entail reorganizing the bank and then organizing a take-over or merger of the failed bank by a willing acquirer or merger partner who assumes the deposit liabilities of the failed bank thereby safe guarding customers' deposits.

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UNIT 4 REGULATORY AUTHORITY 3 - THE FINANCIAL SERVICES REGULATION COORDINATING COMMITTEE (FSRCC)

Contents

1.0 INTRODUCTION

In the last unit, we defined and discussed NDIC as a regulatory agency; described the legal framework governing NDIC operations; traced the historical evolution of NDIC; objectives for the establishment of NDIC; enumerate and explained the functions of NDIC and discussed the ownership and management of NDIC.

In this unit, we shall consider the Financial Services Regulation Coordinating Committee (FSRCC). The discussion will lead to defining FSRCC, tracing its historical evolution and enumerating the objectives and functions of this agency.

2.0 OBJECTIVE

At the end of this unit, you should be able to:

- define FSRCC,
- trace its historical evolution and
- enumerate the objectives and functions of this agency.

3.0 MAIN CONTENT

3.1 The Financial Services Regulation Coordinating Committee (FSRCC)

The Financial Services Regulation Coordinating Committee (FSRCC) is an inter-agency body set-up to deal with matters of common interest and concern to the various regulatory and supervisory authorities in the financial services industry.

The Committee was established by the CBN Act to coordinate the supervision of financial institutions and to articulate the strategies for the promotion of safe, sound and efficient practices by financial intermediaries.

The members of the Financial Services Regulations Coordinating Committee are:

- The Governor of CBN who chairs the Committee;
- The Managing Director of NDIC;
- The Director-General of Securities and Exchange Commission (SEC);
- The Commissioner for Insurance;
- The Registrar-General of the Corporate Affairs Commission (CAC);
- A representative of the Federal Ministry of Finance not below the rank of a Director.

3.2 Historical Evolution of the FSRCC

This body was established in April 1994 as the Financial Services Coordinating Committee (FSCC) as a framework for the coordination of regulatory and supervisory activities in the Nigerian financial sector (made up of money and capital market institutions) to address more effectively, through consultation and regular inter-agency meetings, issues of common concern to regulatory and supervisory bodies.

However, the Committee had its name changed to FSRCC on May 27, 1994. The Committee was expected to harmonize the activities of the various regulatory organizations in Nigeria.The Committee which was formally inaugurated in May 1999 was accorded legal status through an amendment to section 38 of the CBN Act 1998. The FSRCC is a statutory Committee comprising of regulators in the Nigerian financial services sector (the banking sector, the capital market, the insurance sector, the pension sector).

3.3 Objectives of the FSRCC

The underlying objectives or motivations for the establishment of the FSRCC are:

(i) Institutionalize a code of ethics for regulators that would guide their dealings with operators and other stakeholders
(ii) Promote efficient, competitive and sound financial system, which would lead to proper allocation of resources and thereby promote economic growth.
(iii) To promote the integrity and transparency of the financial markets so as to ensure the proper functioning of the financial system and protect depositors, investors and other stakeholders.
(iv) To engender co-operation and coordination of supervision of the financial sector and information sharing among the regulatory authorities.
(v) To provide guidance for the implementation of consolidated supervision in Nigeria.

3.4 Functions of the FSRCC

The functions of the Financial Services Regulation Coordinating Committee as specified in section 44 of the CBN Act 2007 include:

- co-ordinate the supervision of financial institutions especially conglomerates;
- cause reduction of arbitrage opportunities usually created by differing regulation and supervision standards amongst supervisory authorities in the economy;
- deliberate on problems experienced by any member in its relationship with any group of financial institutions;
- eliminate any information gap encountered by any regulatory agency in its relationship with any group of financial intermediaries;
- deliberate on such other issues as may be specified from time to time; and

- articulate the strategies for the promotion of safe, sound and efficient practices by financial intermediaries.

4.0 CONCLUSION

The Financial Services Regulation Coordinating Committee (FSRCC) is an inter-agency body set-up to deal with matters of common interest and concern to the various regulatory and supervisory authorities in the financial services industry.

The FSRCC is a statutory Committee comprising of regulators in the Nigerian financial services sector (the banking sector, the capital market, the insurance sector, the pension sector).

This body was established in April 1994 as the Financial Services Coordinating Committee (FSCC) as a framework for the coordination of regulatory and supervisory activities in the Nigerian financial sector (made up of money and capital market institutions) to address more effectively, through consultation and regular inter-agency meetings, issues of common concern to regulatory and supervisory bodies.

The underlying objectives or motivations for the establishment of the FSRCC are to institutionalize a code of ethics for regulators that would guide their dealings with operators and other stakeholders; promote efficient, competitive and sound financial system, which would lead to proper allocation of resources and thereby promote economic growth; promote the integrity and transparency of the financial markets so as to ensure the proper functioning of the financial system and protect depositors, investors and other stakeholders; engender co-operation and coordination of supervision of the financial sector and information sharing among the regulatory authorities and provide guidance for the implementation of consolidated supervision in Nigeria.

The functions of the Financial Services Regulation Coordinating Committee as specified in section 44 of the CBN Act 2007 include: co-ordinate the supervision of financial institutions especially conglomerates; cause reduction of arbitrage opportunities usually created by differing regulation and supervision standards amongst supervisory authorities in the economy; deliberate on problems experienced by any member in its relationship with any group of financial institutions; eliminate any information gap encountered by any regulatory agency in its relationship with any group of financial intermediaries; deliberate on such other issues as may be specified from time to time; and articulate the strategies for the promotion of safe, sound and efficient practices by financial intermediaries.

5.0 SUMMARY

In this unit, we have defined FSRCC, traced its historical evolution and enumerate the objectives and functions of this agency.

To this end, we have come to the end of the second module of this course.

6.0 TUTOR-MARKED ASSIGNMENT (TMA)

1. What are the basic motivations or objectives of the Financial Services Regulatory and Coordinating Committee?
2. Briefly describe the functions of FSRCC.

Suggested answers:

The underlying objectives or motivations for the establishment of the FSRCC are:

- Institutionalize a code of ethics for regulators that would guide their dealings with operators and other stakeholder;
- Promote efficient, competitive and sound financial system, which would lead to proper allocation of resources and thereby promote economic growth.
- To promote the integrity and transparency of the financial markets so as to ensure the proper functioning of the financial system and protect depositors, investors and other stakeholders.
- To engender co-operation and coordination of supervision of the financial sector and information sharing among the regulatory authorities.
- To provide guidance for the implementation of consolidated supervision in Nigeria.

The functions of the Financial Services Regulation Coordinating Committee as specified in section 44 of the CBN Act 2007 include:

- co-ordinate the supervision of financial institutions especially conglomerates;
- cause reduction of arbitrage opportunities usually created by differing regulation and supervision standards amongst supervisory authorities in the economy;
- deliberate on problems experienced by any member in its relationship with any group of financial institutions;
- eliminate any information gap encountered by any regulatory agency in its relationship with any group of financial intermediaries;
- deliberate on such other issues as may be specified from time to time; and
- articulate the strategies for the promotion of safe, sound and efficient practices by financial intermediaries.

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MODULE THREE ETHICS AND BEST PRACTICES IN BANKING REGULATION

Welcome to the third module of this course.

This module starts with a basic explanation of the concept of ethics, its objectives and guiding principles as well as its importance to banking business. It also presents a discussion on ethical values and sources of ethical behaviour. Common examples of unethical conducts are also highlighted.

The module also discussed some ethical issues like corporate governance and insider abuse; both are major irritants of banking distress in the domestic and global economy. The module concludes with a discussion on bank fraud with particular emphasis on the common types of fraud and the basic motivations for fraud.

UNIT 1 CODE OF ETHICS IN BANKING

Contents

1.0 INTRODUCTION

In this unit, we will define the concept ‘ethics’; explain the general objectives of banking code of ethics; discuss the basic principles of professional code of ethics for bank staff and list the importance of code of ethics in banking.

We will also enumerate the advantages of ethics, state some ethical values, list sources of ethical behaviours and some common unethical conducts found in the banking industry.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- define the concept 'ethics';
- explain the general objectives of banking code of ethics;
- discuss the basic principles of professional code of ethics for bank staff;
- list the importance of code of ethics in banking;
- enumerate the advantages of ethics;
- state some ethical values;
- list sources of ethical behaviours; and
- enumerate some common unethical conducts found in the banking industry.

3.0 MAIN CONTENT

3.1 Definition of Ethics

Ethics refer to a moral system or set of principles particular to a certain group, profession, and community or individual. Ethics relate to the study or the science of morals. It deals with rules or principles of behaviour, specifying what is right and what is wrong.

Code of ethics is a set of principles designed to guide behaviour. It prescribes rules of behaviour and moral conduct. In very simple terms, code of ethics specifies the "Dos" and "Do Nots" within a particular group, profession, community or even among individuals. As a normative science, ethics prescribe acceptable standards of conduct for individuals, groups, etc.

With regard to banking business, code of ethics specifies how a bank should behave towards its various stakeholders in the conduct of its operations. The basic objective is to ensure strict adherence to best banking practices and strong commitment to ethical and professional standards of behaviour in the operation of banking business.

3.2 General Objectives of Banking Code of Ethics

The banking code of ethics is a regulatory framework designed to guide the behaviour or conduct of members of the banking industry. Article 2 (d) of the Bankers Code of Conduct (Professional Code of Ethics and Business Conduct) of 2014 defines members of the banking industry to include individual and corporate members of the Chartered Institute of Bankers (CIBN) and other employees engaged in the banking industry. The general objectives of the bankers' code of ethics as approved by the Bankers Committee in Nigeria include:

(i) To guide every member, individual and corporate, in meeting their obligation to customers and other stakeholders by maintaining and improving standard of service, performance, and quality of banking products.
(ii) To ensure that all bank employees conduct their duties fairly and honestly.
(iii) To maintain best banking practice and strong commitment to sound ethical and professional standards in the banking industry.
(iv) To guide stakeholders within the banking industry in complying with applicable laws and regulations.
(v) To reaffirm and clarify individual and corporate members rights and obligations.

(vi) To enable members provide a policy to develop and maintain constructive dialogue with, seek assistance and advice from colleagues when confronted with difficulties in matters of judgement.
(vii) To enable members provide a policy to avoid acceptance of gifts on services arising from the performance of their official duties which might influence member's capacity to make independent judgement.
(viii) To enable members provide a policy to adhere to generally acceptable principles of honesty, integrity and fairness so as to uphold the mutual trust and public confidence reposed in them.
(ix) To enable members provide a policy to be fair-minded in their day-to-day dealings both in office and during their social interactions. All bank employees are expected to be committed to high standards of conduct in daily social life in order to uphold the dignity, reputation, and good standing of the banking profession.
(x) To promote (individually and collectively) the efficiency of bank services as an instrument of economic growth.

3.3 Basic Principles of Professional Code of Ethics for Bank Staff

Section 1 of the Bankers Code of Conduct (Professional Code of Ethics and Business Conduct) of 2014 outlines the core principles guiding the professional conduct of individual members of the banking industry. Section 1(1) of the said code specifically provides that a member shall:

(i) Conduct himself in relation with customers and third parties on principles of honesty, integrity, diligence, credibility, transparency, fairness, and trust.
(ii) In the performance of his professional duties as a banker, attain appropriate levels of professional education/certification, training, competence, skill and expertise.
(iii) Advice his customers, where necessary, without deliberately misleading them.
(iv) Abstain from discrimination but treat all customers and co-employees equally regardless of age, sex, religion, ethnicity, status, colour, language, disability, etc.
(v) Exercise care and caution while discharging his duties.
(vi) Abstain from physical and verbal assaults of customers, co-employees and other stakeholders.

Section 1(2) of the Code provides for Confidentiality/Dissemination of Information. The provisions specify that a member shall:

(i) Not in the course of discharging his professional duties, knowingly or recklessly disseminate false or misleading information to his customers or any other party.

(ii) Not disclose or permit the disclosure to any third party, any confidential information concerning his employer's or his customers' business during or after employment except as required or permitted/enjoined by law, thus:

   (a) Where a bank is compelled by a court of competent jurisdiction or regulatory provision to do so;
   (b) Where there is duty to the public to disclose;
   (c) Where the interest of the bank requires disclosure;
   (d) Where disclosure is made at the request or with the consent (express or implied) of the customer.

(iii) Sign a declaration of secrecy to bind himself to confidentiality of information.

Another important ethical issue is conflict of interest. This is aptly provided for in the Bankers Code of Ethics. Section 1(3) provides that:

> *A member shall, at the earliest opportunity bring to the notice of his employer, customer, or any third party, in all cases, where conflicts arise in the discharge of his duties to such employer, customers or third party.*

Note that conflict of interest arises in the banking system when banks or their employees have an incentive to serve their own interests rather than those of their customers through misuse of information, provision of false information, or concealment of material information. As service providers, banks offer an array of financial services to their customers. Banks develop broader and longer term relationships with their clients. In the process, they gather, produce and disseminate information. The same set of information can be used for many different services, leading to conflict of interest. Conflicts of interest are more apparent when a bank provides multiple services to a single client or to many clients. Bringing financial institutions like banks that offer multiple services under one roof (either as universal banks or a conglomerate) is a major source of conflict of interest and leads to unethical behaviour. In an effort to provide these services, employees or departments of banking institutions may conceal information, or disseminate misleading information to financial markets.

Conflicts of interest can adversely affect the quality of information delivered to financial markets thereby increasing the challenge of unbalanced or one-sided (asymmetric) information.

Prevalence of asymmetric information promotes inefficiency in the economic system because it prevents financial resources from being channeled to their most productive uses. When there is a conflict of interest, banks or their employees resort to concealment of vital information from clients thereby jeopardizing the same interests they are supposed to protect.

3.4 Importance of Code of Ethics in Banking

The importance of code of ethics in banking is that it:

(i) specifies principles guiding conduct and practice of banking business;
(ii) provides guidance for the resolution of conflict of interest;
(iii) removes the use of discretion and promotes professional practice consistent with acceptable standards;
(iv) keeps employees in check thereby upholding the principles of honesty, integrity, transparency and accountability;
(v) secures the trust and confidence of the public in the banking system; and
(vi) helps in moulding the character of the individual employees which thereby impacts positively on the larger society.

3.5 Advantages of Ethics

The advantages of ethics are as follows:

i. Banks with a known history of good ethical conduct are held in high esteem as they are regarded as ones that play by the rules. They enjoy the goodwill and support of regulators, employees and investors. The reputation of a brand is likely to attract ethically conscious clients.
ii. It defines the boundaries within which all the parties (the employer, the employee, regulators and other stakeholders like auditors, consultants, etc.) should operate.
iii. Sound ethical practice promotes confidence, mutual trust and productivity. Banks occupy a position of trust and banking business is sustained by trust.

iv. Banking Code of Ethics does not only promote the corporate image of banking institution but also promotes the perception of the employees by the society. In other words, it also adds value to the individual employees. Bank employees enjoy some measure of respect from the public because they are perceived to have integrity.

v. Ethics compel banks to be conscious of how their actions affect their customers and other stakeholders or how their actions are perceived by these groups.

vi. Ethical codes provide a standard on which the banking industry can be rated.

vii. Ethics help to promote stability in the banking sector. When each party is guided by the code of conduct, industrial peace is assured and labour turnover is at a minimum.

viii. Maintenance of sound ethical standards is critical to long-term success of the banking industry.

ix. Ethics help to ensure that banks and their employees conduct themselves in a fair and ethical manner, bearing in mind the interest of customers.

x. Code of ethics helps to develop the commitment of the banking industry towards its customers thereby enhancing banker-customer relationship.

3.6 Ethical Values

(i) *Commitment or Responsibility*: Banks should be firmly committed to every component of service delivery necessary to promote customer satisfaction. To this end, they should constantly monitor the quality of service offered to customers in order to ensure that it meets their requirements and expectations. This is essential for customer loyalty and retention. To ensure delivery of quality-oriented service to customers, a proper integration of technology and qualified and dedicated staff is a necessity. Employees should be properly trained and must possess relevant skills and knowledge, must be competent and must assume responsibility to deliver high quality service to customers.

The bank should be quick to respond to customer complaints in an orderly manner, while ensuring that every complaint is investigated and relevant measures put in place to avoid a reoccurrence. Every complaint must be treated fairly and where it is the result of employees' wrong practices, such employees should be appropriately instructed and guided.

(ii) *Honesty and Integrity*: Banking business should be conducted with a high level of honesty and integrity. It should demonstrate a very high level of moral and ethical standards so that customers can have confidence and trust in the industry. Customers should be treated with honesty and sincerity. With respect to employees, they should be assured of a respectable and dignified treatment. Employees should however avoid a clash of interest in the discharge of their duties to their employers or customers. Every potential area of conflict between personal interest and official interest (employer's or customer's interest) should be promptly disclosed. Employees should also promptly report suspicious, dubious or unlawful transactions to designated authorities and shall not help a dishonest or fraudulent employee to escape sanction.

(iii) *Confidentiality of Customer Information*: One guiding principle of banker-customer relationship is secrecy or confidentiality of customer information. Banks should treat information on customer's accounts as confidential and should not disclose them to third parties unless with written consent of the customer or in compliance with an order of the court.

(iv) *Fairness in the treatment of customers*: There should be fairness, equity and impartiality in the treatment of customers. Customers should also be treated courteously.

(v) *Transparency*: Banks should be as transparent as possible in dealing with their customers. All relevant information relating to bank products and services, including associated risks, should be fully disclosed. In like manner, all charges, fees and other obligations should be made available to customers. No material information should be withheld from customers.

(vi) *Acceptance of Gifts*: Acceptance of gifts by bank staff for services rendered or to be rendered should be discouraged because it is capable of compromising the judgement of the staff in the course of his official duties. Where it is unavoidable, extreme care should be taken to ensure that bank staff are not unduly influenced in their decision making activity. The guiding principle, however, should be "Do not receive gifts from customers".

(vii) *Corporate Governance*: Governance is an indispensable component of organizational performance. Sound corporate governance practices promote accountability, integrity, transparency and profitability. Banks should therefore adhere strictly to the codes of corporate governance, particularly those of 2006 (CBN Code of Corporate Governance) and 2010 (CBN Prudential Guidelines for Licensed Banks), to promote governance in the Nigeria banking industry.

3.7 Sources of Ethical Behaviour

Sources of ethical behaviour include:

- *The Family*: Early training and character development take place at home. The parents, siblings, relations and even neighbours are the first instructors a child encounters in life and they have an impact (positive or negative) on his development. Children are taught basic life lessons at home.
- *The School*: Educational institutions are also major determinants of ethical behaviour. Basic lessons necessary for character building are also taught at school.
- *Peer Group Influence*: Peer groups also exert a strong influence on the development of the individual. The society has the good, the bad, and the ugly. The character of the individual depends on the group he identifies with.
- *The Church*: Moral lessons learnt in the churches and other religious organizations also contribute to the formation of human character.
- *Professional Associations*: Different professional bodies have their code of ethics and compliance of members to these codes affect their behaviour even beyond the group.
- *The Legal System*: The provisions of the law specify rules of conduct or behaviour and clearly states sanctions for non-compliance.
- *Workplace*: Every organization has internal codes of conduct which employees are expected to comply with.

- *Culture and Belief System*: Every society has its cultures, traditions, and belief systems and these have a way of influencing the behaviour of individuals.

3.8 Common Unethical Conducts in The Banking Industry

Some common unethical conducts found in the banking industry include:
1. Kiting of cheques and suppression of cheques.
2. Material Alteration or Falsification of Figures.
3. Colluding with outsiders to commit fraud.
4. Breach of duty of secrecy or confidentiality of customer information.
5. Sexual harassment.
6. Lending without due authorization, e.g to family members, friends, etc.
7. Misuse of internal expense accounts.
8. Use of abusive or vulgar words.
9. Fraudulent conversion of bank property to private use.
10. Non-disclosure of other interests which are at variance with the interest of the employer or customers.
11. Borrowings by staff from customers
12. Demand for and/or receipt of gratification for services rendered or yet to be rendered.
13. Theft.

4.0 CONCLUSION

Ethics relate to the study or the science of morals. It deals with rules or principles of behaviour, specifying what is right and what is wrong. Code of ethics is a set of principles designed to guide behaviour. In relation to banking business, code of ethics specifies how a bank should behave towards its various stakeholders in the conduct of its operations to ensure strict adherence to best banking practices.

Article 2 (d) of the Bankers Code of Conduct (Professional Code of Ethics and Business Conduct) of 2014 defines members of the banking industry to include individual and corporate members of the Chartered Institute of Bankers (CIBN) and other employees engaged in the banking industry. It also specifies the objectives of the professional code and business conduct.

Section 1 of the Bankers Code of Conduct (Professional Code of Ethics and Business Conduct) of 2014 outlines the core principles guiding the professional conduct of individual members of the banking industry. Section 1(2) of the Code provides for Confidentiality/Dissemination of Information. Section 1(3) provides that:*A member shall, at the earliest opportunity bring to the notice of his employer, customer, or any third party, in all cases, where conflicts arise in the discharge of his duties to such employer, customers or third party.*

The importance of code of ethics in banking is as stated in the body of the section of this unit.
The advantages of ethics are also specified in the section.

Ethical values include traits such as commitment or responsibility; honesty and integrity; confidentiality of customers information; fairness in the treatment of customers; transparency; acceptance of gifts and corporate governance.

Sources that can influence ethical behaviours have been enumerated in the section while some common unethical behaviours found in the banking industry were also listed in the appropriate section.

5.0 SUMMARY

In this unit, we have defined ethics; explained the general objectives of banking code of ethics; discussed the basic principles of professional code of ethics for bank staff and listed the importance of code of ethics in banking. We also enumerated the advantages of ethics, stated some ethical values, listed sources of ethical behaviours and some common unethical conducts found in the banking industry.

In this next unit, we shall examine the concept 'corporate governance' and discuss the concept in detail as it relates to the banking.

6.0 TUTOR-MARKED ASSIGNMENT (TMA)

1(a) Under what conditions can the duty of secrecy of customer information be waived?
1(b) Mention some common examples of unethical behaviours among bank employees.

2. What is conflict of interest and how can it affect the performance of banking financial institutions?

3. What is ethics? Why should it be considered an important issue in the banking profession?

4. Discuss the relevant ethical values that support optimal performance of the banking system.

5. What are the basic factors that determine ethical conduct in the society?

Suggested answers:
Under normal circumstances, a banker is expected to treat all information in respect of customer accounts with utmost confidentiality. However, this duty is waived in situations such as:

i. Where a bank is compelled by a court of competent jurisdiction or regulatory provision to do so.
ii. Where there is duty to the public to disclose
iii. Where the interest of the bank requires disclosure
iv. Where disclosure is made at the request or with the consent (express or implied) of the customer.

Some Common Unethical Conducts in The Banking Industry include:.

- Kiting of cheques and suppression of cheques.
- Material Alteration or Falsification of Figures.
- Colluding with outsiders to commit fraud.
- Breach of duty of secrecy or confidentiality of customer information.
- Sexual harassment.
- Lending without due authorization, e.g to family members, friends, etc.
- Misuse of internal expense accounts.
- Use of abusive or vulgar words.
- Fraudulent conversion of bank property to private use.
- Non-disclosure of other interests which are at variance with the interest of the employer or customers.
- Borrowings by staff from customer.
- Demand for and/or receipt of gratification for services rendered or yet to be rendered.

- Theft.

Conflict of interest refers to a situation where banks or their employees have an incentive to serve their own interests rather than those of their customers through misuse of information, provision of false information, or concealment of material information. As service providers, banks offer an array of financial services to their customers and thereby develop broader and longer term relationships with their clients. In the process, they gather, produce and disseminate information. The same set of information can be used for many different services, leading to conflict of interest.

Conflicts of interest are more apparent when a bank provides multiple services to a single client or to many clients. Bringing financial institutions like banks that offer multiple services under one roof (either as universal banks or a conglomerate) is a major source of conflict of interest and leads to unethical behaviour. In an effort to provide these services, employees or departments of banking institutions may conceal information, or disseminate misleading information to financial markets. Conflicts of interest can therefore adversely affect the quality of information delivered to financial markets thereby increasing the challenge of unbalanced or one-sided (asymmetric) information.

Prevalence of asymmetric information promotes inefficiency in the economic system because it prevents financial resources from being channeled to their most productive uses. When there is a conflict of interest, banks or their employees resort to concealment of vital information from clients thereby jeopardizing the same interests they are supposed to protect.

Ethics refer to a moral system or set of principles particular to a certain group, profession, community or individual. Ethics relate to the study or the science of morals. It deals with rules or principles of behaviour, specifying what is right and what is wrong.

Importance of Code of Ethics in Banking:

i. It specifies principles guiding conduct and practice of banking business.
ii. It provides guidance for the resolution of conflict of interest.
iii. It removes the use of discretion and promotes professional practice consistent with acceptable standards.
iv. It keeps employees in check thereby upholding the principles of honesty, integrity, transparency and accountability.
v. It secures the trust and confidence of the public in the banking system.
vi. It helps in moulding the character of the individual employees which thereby impacts positively on the larger society.

(i) Commitment or Responsibility: Banks should be firmly committed to every component of service delivery necessary to promote customer satisfaction. To this end, they should constantly monitor the quality of service offered to customers in order to ensure that it meets their requirements and expectations. This is essential for customer loyalty and retention. To ensure delivery of quality-oriented service to customers, a proper integration of technology and qualified and dedicated staff is a necessity. Employees should be properly trained and must possess relevant skills and knowledge, must be competent and must assume responsibility to deliver high quality service to customers.

    The bank should be quick to respond to customer complaints in an orderly manner, while ensuring that every complaint is investigated and relevant measures put in place to avoid a reoccurrence. Every complaint must be treated fairly and where it is the result of employees' wrong practices, such employees should be appropriately instructed and guided.

(ii) Honesty and Integrity: Banking business should be conducted with a high level of honesty and integrity. It should demonstrate a very high level of moral and ethical standards so that customers can have confidence and trust in the industry. Customers should be treated with honesty and sincerity. With respect to employees, they should be assured of a respectable and dignified treatment. Employees should however avoid a clash of interest in the discharge of their duties to their employers or customers. Every potential area of conflict between personal interest and official interest (employer's or customer's interest) should be promptly disclosed. Employees should also promptly report suspicious, dubious or unlawful transactions to designated authorities and shall not help a dishonest or fraudulent employee to escape sanction.

(iii) Confidentiality of Customer Information: One guiding principle of banker-customer relationship is secrecy or confidentiality of customer information. Banks should treat information on customer's accounts as confidential and should not disclose them to third parties unless with written consent of the customer or in compliance with an order of the court.

(iv) Fairness in the treatment of customers: There should be fairness, equity and impartiality in the treatment of customers. Customers should also be treated courteously.

(v) Transparency: Banks should be as transparent as possible in dealing with their customers. All relevant information relating to bank products and services, including associated risks, should be fully disclosed. In like manner, all charges, fees and other obligations should be made available to customers. No material information should be withheld from customers.

(vi) Acceptance of Gifts: Acceptance of gifts by bank staff for services rendered or to be rendered should be discouraged because it is capable of compromising the judgement of the staff in the course of his official duties. Where it is unavoidable, extreme care should be taken to ensure that bank staff are not unduly influenced in their decision making activity. The guiding principle, however, should be "Do not receive gifts from customers".

(vii) Corporate Governance: Governance is an indispensable component of organizational performance. Sound corporate governance practices promote accountability, integrity, transparency and profitability. Banks should therefore adhere strictly to the codes of corporate governance, particularly those of 2006 (CBN Code of Corporate Governance) and 2010 (CBN Prudential Guidelines for Licensed Banks), to promote governance in the Nigeria banking industry.

Determinants of ethical behaviour or conduct

- The Family: Early training and character development take place at home. The parents, siblings, relations and even neighbours are the first instructors a child encounters in life and they have an impact (positive or negative) on his development. Children are taught basic life lessons at home.
- The School: Educational institutions are also major determinants of ethical behaviour. Basic lessons necessary for character building are also taught at school.

- Peer Group Influence: Peer groups also exert a strong influence on the development of the individual. The society has the good, the bad, and the ugly. The character of the individual depends on the group he identifies with.
- The Church: Moral lessons learnt in the churches and other religious organizations also contribute to the formation of human character.
- Professional Associations: Different professional bodies have their code of ethics and compliance of members to these codes affect their behaviour even beyond the group.
- The Legal System: The provisions of the law specify rules of conduct or behaviour and clearly states sanctions for non-compliance.
- Work place: Every organization has internal codes of conduct which employees are expected to comply with.
- Culture and Belief System: Every society has its cultures, traditions, and belief systems and these have a way of influencing the behaviour of individuals.

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UNIT 2 CORPORATE GOVERNANCE IN BANKING

Contents

1.0 INTRODUCTION

In the last unit, we defined ethics; explained the general objectives of banking code of ethics; discussed the basic principles of professional code of ethics for bank staff and listed the importance of code of ethics in banking. We also enumerated the advantages of ethics, stated some ethical values, listed sources of ethical behaviours and some common unethical conducts found in the banking industry.

In this unit, we shall examine the concept 'corporate governance' and discuss the concept in detail as it relates to the banking.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- define and discuss the concept 'corporate governance';
- discuss CBN code of corporate governance for Banks, 2006;
- explain what we mean by insider abuse;
- state and explain the concept bank fraud;
- list the types of bank fraud; and
- discuss the basic motivation for bank fraud.

3.0 MAIN CONTENT

3.1 Definition of Corporate Governance

Corporate governance connotes the processes involved in the discharge of the mandate of governance in corporate entities. It refers to the process through which an organization is governed and controlled. Good corporate governance is of particular importance to the banking industry because the integrity of bank management defines the quality banking services delivery and in the process enhances the overall performance of the banking sector. Corporate governance promotes accountability, integrity, transparency and profitability of corporate entities, including banks. Absence of or inadequacy of corporate governance structures is often blamed for the woeful performance of business entities.

The imperative for good corporate governance in the financial services sector, especially banks, is underscored by the wave of corporate failures particularly in the financial services sector early in this millennium. The CBN, citing a study by the Security and Exchange Commission (SEC) blames failure of corporate governance for virtually all known cases of banking distress in Nigeria. To avert the rising wave of corporate failures in the Nigerian banking sector, three specific guidelines aimed at regulating the practice of corporate governance in the sector have been issued namely, SEC Corporate Governance Code 2003, CBN Code of corporate Governance for Banks 2006 and CBN Prudential Guidelines 2010. Also the Institute of Directors was established in 1983 in Nigeria as a professional association dedicated to the promotion of corporate governance through training of would-be-directors.

3.2 CBN Code of Corporate Governance for Bank, 2006

Observed weaknesses in governance practices by banks as well as emerging cases of infractions of standard corporate governance practices among banks which played out in the post banking consolidation exercise in Nigeria informed the need for a distinct code of corporate governance for banks. The code not only specified the core elements of corporate governance practices for banks but also addressed issues like attributes of sound corporate governance practices, risk management, and the role of internal and external auditors.

A highlight of the guidelines on the core elements of the corporate governance is presented below:

(i) Equity Ownership: The code provides that:

- (a) Governments' equity holding (direct and indirect) in banks shall be limited to 10% by the end of 2007.
- (b) The approval of the CBN is required for an individual to hold more than 10% of a bank's share capital.

(ii) Organizational Structure:

- (a) The office of the Chairman of the Board of Directors shall be separated from that of the Managing Director/Chief Executive. There shall be different responsibilities for both offices.
- (b) The responsibilities of the Board Chairman and the Managing Director shall not be discharged by one person. In other words, no one person shall occupy both offices.
- (c) The office of Executive Vice Chairman shall no longer exist.
- (d) The persons of the Chairman and Managing Director shall not belong to the same or extended family.

(iii) Quality of Board Membership: The code specifies as follows:

- (a) Members shall be persons of proven integrity who are knowledgeable in business and financial matters and shall be conversant with oversight functions of the Board.
- (b) Institutionalized programme and continuing education of Board members shall be budgeted for and implemented regularly.
- (c) For any bank, the number of non-executive directors shall exceed that of executive directors subject to a maximum of 20 directors.

(d) The remuneration of executive directors shall be determined by a committee of non-executive directors.
(e) The remuneration of non-executive directors shall be limited to sitting allowances, director's fee and reimbursable travel and hotel expenses.
(f) Tenure of office for non-executive directors shall be limited to 12years, i.e, not more than 3 terms of 4 years each.
(g) The board shall have at least 3 board committees: risk management, audit, and credit committees.
(h) No board Chairman shall simultaneously serve as chairman or member of another board committee.

(iv) Board Performance Appraisal: The 2006 CBN code of corporate governance also specifies that there shall be yearly review/appraisal covering all aspects of the board's structure, functioning and performance, preferably to be undertaken by an outside consultant and the report presented to the Annual General Meeting (AGM) and copied to the Central Bank of Nigeria.

(v) Quality of Management:

(a) Merit rather than other considerations shall be the basis for appointments to top management positions.
(b) Track record of the appointee, in terms of integrity and performance, shall also be considered to ensure that only fit and proper persons are appointed to management positions.

(vi) Reporting Relationship: It is also specified that:

(a) The structure of a bank shall clearly reflect the hierarchy as well as the clearly defined and acceptable lines of responsibility.
(b) There shall be for each bank a Chief Compliance Officer who shall monitor the implementation of the whistle blowing procedures that encourages and all stakeholders to report any unethical activity or breach of corporate governance code.
(c) The Chief Compliance Officer shall render monthly returns to the CBN on all whistle blowing reports and any breaches of the corporate governance code.

3.3 Insider Abuse

This refers to the practice whereby insiders, notably senior bank officials, directors, Board Chairmen, abused their privileged position to obtain loans without due process and requisite collateral back-up. Such loans dubiously and illegally procured are usually irrecoverable due, largely, to the amount involved and the waivers attached to them. These senior officers often approve such loans for themselves and on their own terms.

Insider abuse is a major source of bank fraud. It is an aspect of white collar crime. This type of abuse spins around identity fraud and abuse of authorization. It is aggravated in recent times by the increasing wave of automation in banking payment processes, particularly in banks with weak authentication procedures.

Perpetrators of this unwholesome behaviour often attempt to rationalize their actions by blaming it on harsh economic conditions. To combat this menace, the authorities should first try to understand how, why and when it occurs. Adequate system of internal control should therefore be put in place.

3.4 Bank Fraud

Fraud is a deliberate act of deception in order to gain some kind of benefits. It is unethical, illegal and criminal. It can be used to describe an activity, conduct or a person. Globally, fraud is a punishable offence and it attracts varying degrees of punishment depending, among others, on the severity. Though a lot of reasons may be advanced for the rising incidence of fraudulent behaviour, the most common reason underlying every case of fraud is greed.

Bank fraud refers to the criminal act of illegally obtaining or attempting to obtain money or other assets from a bank or other financial institution. Fraud is so endemic that there is hardly any case of bank failure that does emanate from it. It is so disturbing that involvement in fraudulent activities cuts across all categories of staff in the banking industry.

3.5 Types of Bank Fraud

The types of bank fraud are but not limited to:

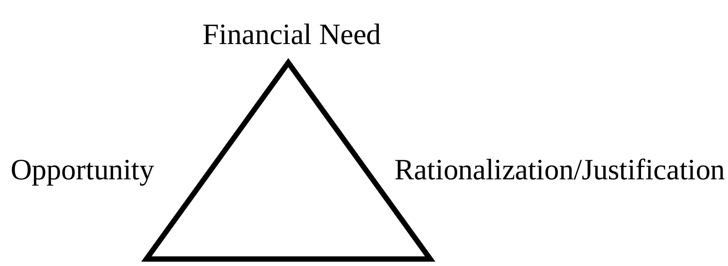
(a) ATM/ Card related fraud
(b) Web-Based or Internet Banking fraud.
(c) Fraudulent Transfer/ Withdrawal of Deposit.
(d) Suppression of Deposits or Cheques
(e) Presentation of Forged or Stolen Cheques.
(f) Stealing of Cash in Local or Foreign Currencies (either by staff or outsiders)
(g) Unauthorized Credits.
(h) Diversion of Bank Charges (Commissions and Fees).
(i) Fraudulent Conversion of Cheques.

3.6 Basic Motivation for Bank Fraud

The basic motivations for bank fraud can be traced to:

(a) Unmet financial needs.
(b) An opportunity to commit fraud.
(c) Economic justification or rationalization for fraudulent behaviour.

These factors can be presented in a triangular form as follows:



Ability to identify these components and when they occur is key to detection and prevention of fraudulent practices in banks. Having identified the timing of their occurrence, the next step is to establish an effective system of internal controls.

It may not be easy to prevent employees from having financial needs but emphasis should be to control them through value re-orientation. Opportunities for fraudulent practices should be prevented or minimized while a corporate culture strongly centered on ethical behaviour should be encouraged to reduce rationalization for corrupt practices.

4.0 CONCLUSION

Corporate governance connotes the processes involved in the discharge of the mandate of governance in corporate entities. Corporate governance promotes accountability, integrity, transparency and profitability of corporate entities, including banks. Absence of or inadequacy of corporate governance structures is often blamed for the woeful performance of business entities.

A highlight of the guidelines on the core elements of the corporate governance dealt with equity ownership, organisational structure, quality of board membership, board performance appraisal, quality management and reporting relationship.

Insider abuse refers to the practice whereby insiders, notably senior bank officials, directors, Board Chairmen, abused their privileged position to obtain loans without due process and requisite collateral back-up. Such loans dubiously and illegally procured are usually irrecoverable due, largely, to the amount involved and the waivers attached to them. These senior officers often approve such loans for themselves and on their own terms.

Bank fraud refers to the criminal act of illegally obtaining or attempting to obtain money or other assets from a bank or other financial institution. The types of bank fraud are listed in a section in this unit.

Basic motivation for bank fraud was also discussed with graphic representation of what leads to this act.

5.0 SUMMARY

In this unit, we defined and discussed the concept ‘corporate governance’; discussed CBN code of corporate governance for Banks, 2006; explained what we mean by insider abuse; stated and explained the concept bank fraud; listed the types of bank fraud; and discussed the basic motivation for bank fraud.

In the next unit, we shall consider another important unit i.e. Sources of Instability in the Banking Sector.

6.0 TUTOR-MARKED ASSIGNMENT (TMA)

1. Briefly explain the concept of corporate governance. Highlight its importance to the performance of the banking sector.

2. Insider abuse has often been blamed for incessant case of bank distress in Nigeria. You have just received an invitation from the Chartered Institute of Bankers of Nigeria to speak on this topical issue as part of a training programme for newly recruited bank employees. Briefly

explain what is meant by insider abuse, highlighting its implications for the industry and basic motivations for its continued occurrence as well as ways to contain the ugly trend..

Suggested answers:
Corporate governance connotes the processes involved in the discharge of the mandate of governance in corporate entities. It refers to the process through which an organization is governed and controlled. Good corporate governance is of particular importance to the banking industry because the integrity of bank management defines the quality banking services delivery and in the process enhances the overall performance of the banking sector. Corporate governance promotes accountability, integrity, transparency and profitability of corporate entities, including banks. Absence of or inadequacy of corporate governance structures is often blamed for the woeful performance of business entities.

The imperative for good corporate governance in the financial services sector, especially banks, is underscored by the wave of corporate failures particularly in the financial services sector early in this millennium. Also, the failure of corporate governance has been identified in virtually all known cases of banking distress in Nigeria. This is an indication that efficient corporate governance structures in banks is necessary for optimum performance.

Insider abuse refers to the practice whereby bank insiders, notably senior bank officials, directors, Board Chairmen, abuse their privileged positions to obtain loans without due process and requisite collateral back-up. Such loans dubiously and illegally procured are usually irrecoverable due, largely, to the amount involved and the waivers attached to them. These senior officers often approve such loans for themselves and on their own terms. It may also extend to wrong or fraudulent use of information obtained by reason of membership of the banking profession for personal gain.

Insider abuse is a major source of bank fraud. It is an aspect of white collar crime. This type of abuse spins around identity fraud and abuse of authorization. It is aggravated in recent times by the increasing wave of automation in banking payment processes, particularly in banks with weak authentication procedures.

Perpetrators of this unwholesome behaviour often attempt to rationalize their actions by blaming it on harsh economic conditions. It is also the result of weak or inadequate internal control system. To combat this menace, the authorities should first try to understand how, why and when it occurs. Adequate system of internal control should therefore be put in place.

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UNIT 3 SOURCES OF INSTABILITY IN THE BANKING SECTOR

CONTENTS

1.0 INTRODUCTION

In the last unit, we defined and discussed the concept 'corporate governance'; discussed CBN code of corporate governance for Banks, 2006; explained what we mean by insider abuse; stated and explained the concept bank fraud; listed the types of bank fraud; and discussed the basic motivation for bank fraud.

In this unit, we shall consider another important unit i.e. Sources of Instability in the Banking Sector.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- explain the concept macroeconomic environment;
- discuss asymmetric information;
- explain how weak management affects banking instability;
- discuss inappropriate corporate governance structures; and
- state what is meant by inadequate or poor regulatory and supervisory capacity.

3.0 MAIN CONTENT

There are a number of factors, both exogenous and endogenous, that can precipitate instability in the banking system. The exogenous factors, which include macroeconomic shocks emanate from negative effects of financial liberalization, globalization and rapid technological changes. The internal factors include inappropriate corporate governance and inadequate regulatory and supervisory capacity among others. Some of these factors are examined in details below.

3.1 Macroeconomic Environment

The macroeconomic environment represents a combination of factors that impact on the banking system which could be either favourable or adverse to the system. When the impact is adverse, banks tend to embark on protective strategies, which may not augur well for both the banking system and the economy. For instance an economy experiencing sluggish growth or in recession poses formidable challenges to all economic agents, causing business opportunities to shrink. Under such circumstances, it is critical that bankers take actions which will not affect the health of the banking system adversely or further destabilize the economy.

Generally, it is easier to achieve sound banking system under a stable macroeconomic environment than an unstable one. On the other hand, an unsound banking system could trigger off macroeconomic instability, hence the symbiotic relationship between the banking system and macroeconomic environment.

3.2 Asymmetric Information

It is a fact that information asymmetry results in mismatching of financial contracts, precipitating runs on banks. As we all know, depositors have little information about the soundness of banks and the safety of their deposits. Thus any misinformation, as was experienced in the country recently, can cause panic withdrawals, creating runs on the banks with potentials of contagion and loss of credit confidence. Similarly, poor loan selection due to information asymmetry leading to funding of unviable projects could lead to having very high volume of non-performing loans.

3.3 Weak Management

One of the major internal factors that have contributed to the observed weakness in some financial institutions is poor management. This is often reflected in poor asset quality, insider abuse, inadequate internal controls, and fraud, including unethical and unprofessional conduct, squabbles and high staff turnover rate.

Weak risk-control systems have been a major factor in the emergence of a number of crises, leading to a variety of balance sheet differences including large and undetected mismatches on the balance sheet or poor asset quality, leading to large unrealizable losses.

3.4 Inappropriate Corporate Governance Structures

Corporate governance refers to the extent to which companies are run in an open and honest manner. Thus, effective corporate governance practice incorporates transparency, openness, accurate reporting and compliance with statutory regulations, among others. Historical antecedents indicate that financial crisis is a direct consequence of lack of good corporate governance in banks. In particular, the need to implement good corporate governance in the banking sector became more apparent after the Asian financial crisis.

3.5 Inadequate or Poor Regulatory and Supervisory Capacity

Inadequate or poor regulatory and supervisory capacity can contribute to instability in the financial system. Consequently, regulatory and supervisory capacity must be adequate for effective monitoring of the system. Regulatory Supervisors must exhibit a high level of integrity, competence and be equipped with modern facilities, in order to meet the challenges of contemporary banking practices.

4.0 CONCLUSION

There are exogenous and endogenous that can precipitate instability in the banking system. These include macroeconomic shocks emanating from the negative effects of financial liberalization, globalization and rapid technological changes (exogenous factors) and the endogenous factors that include inappropriate corporate governance and inadequate regulatory and supervisory capacity among others.

5.0 SUMMARY

We have in this unit explained what macroeconomic environment represented, discussed asymmetric information. We have also discussed corporate governance structures, while effort had been made to educate students on how weak management affects banking instability as well as what inadequate or poor regulatory/supervisory capacity means.

In this next unit, we shall examine the role of regulatory authorities aimed at stabilizing the financial system.

6.0 TUTOR-MARKED ASSIGNMENT

Write short notes on the following:

- Macroeconomic Environment
- Asymmetric Information
- Weak Management
- Inappropriate Corporate Governance Structures
- Inadequate or Poor Regulatory and Supervisory Capacity

Suggested answers

1. The macroeconomic environment represents a combination of factors that impact on the banking system which could be either favourable or adverse to the system. When the impact is adverse, banks tend to embark on protective strategies, which may not augur well for both the banking system and the economy.

2. Information asymmetry results in mismatching of financial contracts, precipitating runs on banks. As we all know, depositors have little information about the soundness of banks and the safety of their deposits. Thus any misinformation, as was experienced in the country recently, can cause panic withdrawals, creating runs on the banks with potentials of contagion and loss of credit confidence. Similarly, poor loan selection due to information asymmetry leading to funding of unviable projects could lead to having very high volume of non-performing loans.

3. One of the major internal factors that have contributed to the observed weakness in some financial institutions is poor management. This is often reflected in poor asset quality, insider abuse, inadequate internal controls, and fraud, including unethical and unprofessional conduct, squabbles and high staff turnover rate.

   Weak risk-control systems have been a major factor in the emergence of a number of crises, leading to a variety of balance sheet differences including large and undetected mismatches on the balance sheet or poor asset quality, leading to large unrealizable losses.

4. Corporate governance refers to the extent to which companies are run in an open and honest manner. Thus, effective corporate governance practice incorporates transparency, openness, accurate reporting and compliance with statutory regulations, among others. Historical antecedents indicate that financial crisis is a direct consequence of lack of good corporate

governance in banks. In particular, the need to implement good corporate governance in the banking sector became more apparent after the Asian financial crisis.

5. Inadequate or poor regulatory and supervisory capacity can contribute to instability in the financial system. Consequently, regulatory and supervisory capacity must be adequate for effective monitoring of the system. Regulatory Supervisors must exhibit a high level of integrity, competence and be equipped with modern facilities, in order to meet the challenges of contemporary banking practices.

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UNIT 4 REGULATORY AUTHORITIES EFFORTS AT STABILIZING THE FINANCIAL SYSTEM

CONTENT

1.0 INTRODUCTION

In the last unit, we examined the sources of instability in the financial sector. In this unit, we shall discuss the efforts made by the regulatory authorities aimed at stabilizing the system.

In recent times, various actions have been taken by the regulatory authorities to address the adverse development experienced in the "Nigerian financial services sector".

2.0 OBJECTIVES

At the end of this unit, you should be able to discuss:

- Regulation
- Supervision
- Emphasis on Good Corporate Governance

3.0 MAIN CONTENT

3.1 Regulation

The focus of regulation has been to reduce the risk of bank insolvency and the potential cost of bank failure to depositors. This is the hallmark of the 1988 capital accord of the Basel committee on banking supervision. The major elements of the 1988 capital accord included the explicit linkage of capital requirements to a bank's quantum, degree of risks, and the establishment of internationally comparable minimum capital requirement.

The need for more flexibility and risk sensitivity as well as provision of coverage for effective bank-level management, supervision and market discipline gave the fillip for the new capital accord which took effect from 2007. The bank also strengthened its regulatory framework, with emphasis on creating an environment for competitiveness, efficiency, financial soundness and sustainable growth.

3.2 Supervision

In the discharge of its statutory responsibility, the CBN has continued to undertake both off-site and on-site supervisory activities. Emerging issues from these supervisory efforts include poor/weak management structure, weak internal control systems, under-capitalization, inadequate collateralization of facilities granted and exceeding the single obligor limits are quite revealing, and are of great concern to the monetary authorities.

In addressing these weaknesses, the CBN introduced prudent guidelines encompassing capital adequate ratio, mandatory uniform accounting standards and strict enforcement of licenses which are issued to only those who are fit and proper to operate a bank.

The ability of the supervisory authorities to prevent, contain, manage and resolve the distress syndrome was severely handicapped by the absence of a comprehensive regulatory framework for distress/crisis management. Against this background the CBN and the NDIC put in place in July 2002 the framework on contingency planning for banking that would ensure the systemic management of crisis in Nigerian banks. The regulators have since then, been ensuring that banks adopt realistic accounting policies and standards, in generating financial statements that would facilitate the valuation of the assets and liabilities and classification in accordance with a uniform bank rating system. This apart, the bankers committee recently adopted the code of corporate governance for directors of banks, which is designed to inculcate good corporate governance in the banking industry in line with international regulations on best practices.

More so, the committee of ethics and professionalism was set up in 2001 and it has since issued the "code of ethics" which every banker in the country should not only possess but observe. The objective is to enforce the tenets of good ethics and professionalism in Nigerian banking system. The committee, which has so far performed satisfactorily, has entertained and adjudicated on complaints against banks from their customers and banks ag6inst other banks.

3.3 Emphasis on Good Corporate Governance

It will be recalled that the major causes of distress in the Nigerian banking sector in the 1990s were identified to include weak management, poor capital base, inadequate credit policy and fraudulent and corrupt practices. All these were reflections of unsound and inadequate corporate governance structures in the sector. The CBN has, in recent times, placed emphasis on the enthronement of good corporate governance in the financial sector. For instance, the issue of multiple directorships in the banking system has been given regulatory attention by the CBN.

The restriction was designed to reduce or possibly eliminate conflict of interest, reduce sharp practices, reduce undue influence of one director on the others and guard against abridge practice by the banks with common directorship. Also, the banks have strengthened the requirement for appointment into board and top management positions, both in terms of minimum educational qualifications and requisite years of experience.

4.0 CONCLUSION

The focus of regulation has been to reduce the risk of bank insolvency and the potential cost of bank failure to depositors.

In the discharge of its statutory responsibility, the CBN has continued to undertake both off-site and on-site supervisory activities. Emerging issues from these supervisory efforts include

poor/weak management structure, weak internal control systems, under-capitalization, inadequate collateralization of facilities granted and exceeding the single obligor limits are quite revealing, and are of great concern to the monetary authorities.

Since the major causes of distress in the Nigerian banking sector in the 1990s were identified to include weak management, poor capital base, inadequate credit policy and fraudulent and corrupt practices. All these were reflections of unsound and inadequate corporate governance structures in the sector. CBN has put in place regulatory framework to ensure sound corporate governance system in the financial system.

5.0 SUMMARY

In this unit, we made effort to discuss the efforts made by the regulatory authorities aimed at stabilizing the financial system.

In the next unit, we shall consider another important unit viz: critical and emerging aspects of banking practices that requires control and regulation.

6.0 TUTOR-MARKED ASSIGNMENT

What efforts are made by regulatory authorities to address instability in the financial system?

Suggested answers

5.0 One of the efforts made by regulatory authorities to address instability in the financial system is sound regulation. The focus of regulation has been to reduce the risk of bank insolvency and the potential cost of bank failure to depositors. This is the hallmark of the 1988 capital accord of the Basel committee on banking supervision. The major elements of the 1988 capital accord included the explicit linkage of capital requirements to a bank's quantum, degree of risks, and the establishment of internationally comparable minimum capital requirement.

6.0 In the discharge of its statutory responsibility, the CBN has continued to undertake both off-site and on-site supervisory activities. Emerging issues from these supervisory efforts include poor/weak management structure, weak internal control systems, under-capitalization, inadequate collateralization of facilities granted and exceeding the single obligor limits are quite revealing, and are of great concern to the monetary authorities. In addressing these weaknesses, the CBN introduced prudent guidelines encompassing capital adequate ratio, mandatory uniform accounting standards and strict enforcement of licenses which are issued to only those who are fit and proper to operate a bank.

The ability of the supervisory authorities to prevent, contain, manage and resolve the distress syndrome was severely handicapped by the absence of a comprehensive regulatory framework for distress/crisis management. Against this background the CBN and the NDIC put in place in July 2002 the framework on contingency planning for banking that would ensure the systemic management of crisis in Nigerian banks.

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The restriction was designed to reduce or possibly eliminate conflict of interest, reduce sharp practices, reduce undue influence of one director on the others and guard against abridge practice by the banks with common directorship. Also, the banks have strengthened the requirement for appointment into board and top management positions, both in terms of minimum educational qualifications and requisite years of experience.

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UNIT 5 CRITICAL AND EMERGING ASPECTS OF BANKING PRACTICES SUBJECT TO CONTROL AND REGULATION

CONTENTS

1.0 INTRODUCTION

In the last unit, we made effort to discuss the efforts made by the regulatory authorities aimed at stabilizing the financial system.

In this unit, we shall consider another important unit viz: critical and emerging aspects of banking practices that requires control and regulation.

2.0 OBJECTIVES

At the end of this unit, you should be able to discuss:

- Globalization and Financial Openness
- Transparency Information Disclosure
- Emphasis on Good Corporate Governance
- Competitiveness
- Superior Service Quality
- Market Orientation
- Product Innovation
- Adequate Capitalization
- Investment in Technology
- Capacity Building
- Social Demand on Financial Institutions
- Imposition of Sanctions

- Legal Tussle between CBN and Other Banks

3.0 MAIN CONTENT

We are all aware that the Nigerian financial system (i.e. banking system) has over the years witnessed some improvements in terms of stability. However, some outstanding problems as earlier highlighted, pose serious challenges to the soundness and stability of the sector. These could be complicated by the challenges imposed by globalization and technological innovations, especially, in terms of competition and efficient service delivery. Another challenge is the increasing sophistication of the consumers of financial services and the requirements for upgrading of financial services which would put a lot of pressure on the resources available to the operators. Some other challenges are underlisted below:

3.1 Globalization and Financial Openness

While increasing openness of the banking system to foreign influence to allow for transfer of technology that may benefit the sector, financial openness provided an easy way for systemic contagion, as was the case with the Asian financial crisis. With the Nigerian banking system responding to transactions with correspondent banks, the system is becoming more vulnerable to international systemic risks. There is also the challenge of insuring transparency in foreign financial transactions in order to discourage money laundering and other malpractices within the banking system. In this regard, the CBN has embarked on strengthening its regulatory and supervisory capacity and framework in order to avoid the contagious effect of adverse development similar to those that were inflicted on the East Asian financial markets.

3.2 Transparency Information Disclosure

Effective monitoring of the banking system under the New Capital Accord would rely on efficient, timely and accurate data. As indicated earlier, the supervisory role of the regulatory authorities suffers setbacks since some banks do not seem to be transparent in the rendition of the financial returns to the CBN. This lack of transparency undermines the ethics of good corporate governance and the prospect for effective contingency plan for managing systemic distress. It is expected that the introduction of the automated Bank Analysis System (BAS) will partly help to address this short-coming and enhance the efficiency of off-site supervision. In order to stem the persistent incidence of misreporting and violations of regulatory requirements, the CBN will, from now on, regard offending directors and chief executive officers as unfit to operate a bank and may be removed from the banking system.

3.3 Combating Money Laundering and Advance Free Fraud (419)

The CBN is concerned that despite the efforts being made and the strategies put in place to combat the problem of money laundering and the menace of Dynamics of Credit Economic System in Africa,advanced free fraud (otherwise known as 419) in the economy, the banking system is being used as a conduit pipe for perpetrating this monumental crime. The CBN has conducted various investigations into reported cases of advanced fee fraud, which involved the use of banks and other financial institutions under its supervisory purview. Consequently, the CBN has put in place measures and safeguards to ensure that the financial system is not used as a channel for laundering money or perpetrating other financial frauds. In this regards, the CBN has enhanced its internal structures as well as equipped staff in the sensitive operational areas with the relevant tools for identifying and tracking the activities of money launderers.Besides, the CBN has beefed up its surveillance capacity to ensure that banks and other financial institutions observe the rules of the

Financial Action Task Force (FATF). Deposit money banks are also required to appoint high-ranking officers as Chief Compliance Officers (CCOs) in each of their branches to complement such efforts, while reported cases of advance fee fraud are properly invested.

It is noteworthy that, following its oversight activities, the CBN has been able to track fake web sites used by fraudsters and with the collaboration of the police, contacted internet service providers hosting such web site and proceeded to shut down such service providers. In addition to this, the Economic and Financial Crime Commission (EFCC) and the Independent Corrupt Practices Commission (ICPC) are now tracking down those money launderers and other fraudulent people.

The Problem of De-Marketing and False Rumours of Distress - It has been observed that some banks have often capitalized on the problem of asymmetric information in the system to de-market other banks. This is a worrisome trend as it could engender loss of public confidence in the banking system and consequently precipitate instability in the financial sector.

It is very important that the banking industry should observe high ethical standards and professionalism in the provision of financial services to the nation. The industry must be insulated from abuses and criminal tendencies.

3.4 Competitiveness

The level of competition among financial institutions has been on the increase in recent times and following the post - distress shakeout, the need to reposition or to consolidate by surviving financial institutions has in some way become the driving force. The problem is that if the emerging pattern is anything to go by, then, a sound competitive strategy that would ensure the survival of the financial institution and guide the managers of these financial institutions is something paramount in the new millennium.

3.5 Superior Service Quality

In a service-based industry such as banking, the product can hardly be separated from the supplier, and since most bank products revolve around money, which is a commodity, there is little room for differentiation. The attitude that goes with the service, such as timeliness, courtesy, accuracy, etc. is therefore important.

3.6 Market Orientation

Market forces have become the great disciplinarians that whip any erring business into line. The market will be playing even more decisive roles in the new millennium, which has liberalization as one of its chief slogan. Any business manager that ignores the market cannot compete favourably and as such, can hardly survive for long. We must therefore, be permanently tuned to the market for vital information on customers' needs, market competitiveness and product pricing. The effective manager in the coming dispensation will be one that can provide high quality service efficiently and at the least price.

3.7 Product Innovation

The current age in which we live has been described not only as the information age but also the age of knowledge. It is an age that thrives on creativity and skill; therefore business managers who demonstrate these attributes shall continue to hold on to their customers. Effective financial institutions should be able to design appropriate products that comply with the emerging new ways of life in order to ensure customers' satisfaction and convenience.

3.8 Adequate Capitalization

The current age in which we live has been described not only as the information age but also the age of knowledge. It is an age that thrives on creativity and skill; therefore, business managers who demonstrate these attributes shall continue to hold on to their customers. Effective financial institutions should be able to design appropriate products that comply with the emerging new ways of life in order to ensure customers' satisfaction and convenience.

3.9 Investment in Technology

The banking industry is heavily dependent on the processing, storing and retrieving of information in the form of banking transactions. The efficiency and effectiveness of a financial institution can therefore be greatly enhanced through automation. More than a processing tool, however, the frontier advancement in information technology offers a vast scope of application to the financial industry that is too potent to ignore.

3.10 Capacity Building

The relevance of universal banking brings to the fore the need for capacity building in the financial industry. Many banks that are already well established into one or more areas of businesses are making efforts at developing their personnel. However, the efforts of these, banks are obviously not enough, which explains why the incidences of staff poaching and the use of inexperienced staff in highly sensitive jobs have remained unabated. This anomaly is expected to be minimized with the bank consolidation exercise going on right now. Experienced persons will now be employed to synergize and move the industry forward to a greater height.

3.11 Social Demand on Financial Institutions

We have witnessed clear signals from the society that financial institutions should play roles which were thought to be for the government. Some have called it social responsibility, while others say it is a measure of the sensitivity of financial institutions to their environment. Beside the presidential call on banks to fund and build hostel accommodations on university campuses, demands are also being made for the construction or rehabilitation of roads. There is also the issue of funding and supporting security outfits like the police.

3.12 Imposition of Sanctions

An element of most regulations is the provision of sanctions against banks that breach CBN stipulations.

Following investigations on alleged foreign exchange (forex) malpractices, the CBN suspended for one year, the dealership licenses of 21 banks. This action jolted the financial markets and the vibrations caused are yet to get settled. Our experience with these sanctions has revealed the need for greater consultation and confidentiality between the operators and regulators of the banking system. Incidents of poor information management in the sanctioning process must be minimized and this is supported by the awareness that the core objective of sanction is to reform conduct with a view to restoring system integrity and stability.

3.13 Legal Tussle between CBN and other Banks

Until recently, it was unheard of for an operator to square up issues with the CBN at the law courts. But the environment has changed and is still changing. We have witnessed some operators dragging the CBN to the law court for various reasons aimed at avoiding actions taken by the regulator. What this means is that both regulators and operators should be prepared to account for their actions.

3.14 Control measures and possible remedial actions

It is in the light of the above developments that new initiatives and control measures have been put forward at various levels with a view to make the banking sector secure. Some of these suggestions are highlighted here under:

1. Good corporate governance.
2. Leadership by good example.
3. Transparent compliance with regulations and guidelines as well as - financial sector standards.
4. Emplacement of corporate contingency plan and framework for risk management (including effective internal control systems).
5. Self-regulations by operators.
6. Due customer diligence.
7. Manpower training and development (Human capacity building).
8. Co-operation and where necessary dialogue with regulatory authorities.
9. Collaborative competition.
10. Policy stability with only needful fine-tuning.
11. Ethics and professionalism.
12. Respect for law, order and rights of others.
13. Consumer care and sensitivity.
14. Proactive supervisory and surveillance activities.
15. Research and development.
16. Use of modern technology.
17. Good corporate citizenship.
18. E-banking regulation.
19. A new sanction execution regime.

4.0 CONCLUSION

It is my view that if a greater proportion of the above are sincerely adopted and implemented, all stakeholders as well as the entire system model would be better for it. To weather the storm and make the financial sector not only resilient but also growth and development oriented, there must be true understanding, co-operation and collaboration between participants in the market.

Finally, the old adage that the customer is "king" may have become an Old Testament phraseology. But the new age is a derivative of the old and without the old, there probably would be nothing new. It should therefore be the vision of regulators and operators to serve, not themselves, but customers and consumers of financial services.

Proper recognition and situation of this fact should elicit a new approach to the management and handling of affairs in financial institutions to ensure that the customers, consumers and indeed, all stakeholders in the system are protected against bank distress and failure whether or not financial institutions are regulated

5.0 SUMMARY

In this unit, we had considered an important unit viz: critical and emerging aspects of banking practices that requires control and regulation.

In the next and final unit, we shall consider the forms and methods by which regulatory authorities carryout their supervisory roles and responsibilities.

6.0 TUTOR-MARKED ASSIGNMENT

1. Why is the banking industry considered unique with regard to regulation?

2. It can be argued that since banks are made up of different departments or units, subjecting all the departments to control can have adverse implications for profit performance. To enhance the profitability of banking operations, it may be advisable to control the activities of some departments but not all. How would you contribute to this argument?

3. Identify the critical areas of banking operations subject to strict regulatory control.

Suggested answers:

The banking industry is unique in terms of regulation because experience has shown that failure of one bank has external consequences. Failure of an individual bank could lead to widespread panic and runs which may be transmitted to other banks leading to instability in the banking system and by extension the entire economy. This phenomenon is known as contagion effect and it is so strong that no matter the size of a bank, its failure may have far-reaching implications for the economy.

Every department of a bank is important to the success of its operations and must be given due attention. However, like in other modern organizations, the systems approach is adopted in the regulation of banking institutions. This approach treats every aspect of banking business as important because its failure threatens the stability of the entire institution. However some segments, departments or units are more sensitive and are therefore regulated more than the others. Therefore each department should be subjected to regulatory controls according to its sensitivity to risk.

Critical aspects of banking practices subject to control include:

- Credit Operations: Loans and advances are the most important as well as the most profitable assets of banks. They are also the riskiest of all banks assets. Being the most profitable, banks are often tempted to give out as much of deposits mobilized as possible in loans because idle cash earns zero returns but this is at the expense of liquidity. The regulatory authorities seek to ensure stability of the banking system through directives requiring banks to maintain different reserve accounts (e.g cash reserve ratio, liquidity ratio) as well as specify the limit of credit exposure to certain sectors, individual borrowers (single obligor), etc. Major instruments of control of magnitude and direction of credit flow include the Banking Decrees/Acts, Monetary Policy Guidelines, Prudential Guidelines, etc.

  Apart from the regulatory guidelines on the conduct of the lending function, individual banks formulate in-house policies on lending to ensure that loans are kept liquid, thereby minimizing the incidence of bad debts. A well articulated credit policy should aim at effective administration and control of credits. Specified lending limits should be delegated to Officers and Committees involved in lending and adequate sanctions clearly stated for violation of delegated lending limits. To ensure compliance to delegated lending authority, lending operations should be closely monitored and supervised.

- Bank Capital: It is widely acknowledged that capital adequacy is a key factor in bank performance measurement and evaluation because bank capital, especially first-tier capital or shareholders' funds, serves as the last line of defence against depositor's claims on a bank. It is also a major determinant of a bank's credit delivery capacity. Emphasis on the control of bank capital by the regulators is underscored by the fact bank regulators in Nigeria have relied heavily on bank capital review in attacking banking sector problems. Bank capital review has featured in virtually every banking sector reform in Nigeria since the 1952 Banking Ordinance.

  Bank capital is the first of the first of the five bank performance evaluation criteria, acronymic CAMEL, (capital, assets, management, earnings, and liquidity) recognized and adopted by the Bank of International Settlements (Basel System) for bank performance assessment.

1. Internal Control Systems: The increasing wave of frauds and forgeries in the Nigerian banking industry is of special concern to the regulatory authorities because these unwholesome activities undermine the safety, soundness and stability of industry. The high rate of frauds and forgeries indicate evidence of weak or inadequate internal control systems and if not properly regulated could lead to bank failures with attendant negative implications for banking stability and hence economic growth and development.

2. Cash: Statutorily, banks are required to maintain a proportion of their total deposit liabilities in cash with the Central Bank of Nigeria partly as an instrument of monetary control and partly as a first line of defence against shortfalls in liquidity position. It is therefore a liquidity management tool. The requirement for cash reserve ratio (CRR) was introduced as part of the regulatory tools in the Nigerian banking system in 1976 to control the high level of liquidity in the system. It is the percentage level of cash that banks are mandated to deposit with the Central Bank of Nigeria relative to their total deposit liabilities.

   Banks also maintain their own policy on the control and management of cash. Cash is the most vulnerable asset of a bank and must therefore be guarded jealously. It can easily be stolen and its origin can be easily be distorted. Some control measures put in place by banks include the mechanism whereby the vault cannot be opened by only person, putting a cap on the maximum level of cash that can be kept in the vault at a point in time, etc.

3. Corporate Governance: Corporate governance connotes the processes involved in the discharge of the mandate of governance in corporate entities. It is the process through which an organization is governed and controlled. The primary objective of corporate governance is to achieve defined corporate objectives thereby maximizing shareholders' value while satisfying the legitimate expectations of the various stakeholders. This is achieved through effective management.

   Management is a critical component of banking practice subject to control. There is substantial evidence of a positive link between corrupt and inept management and distress in banks. If the management team is corrupt, the bank is doomed to fail because major payment approvals are done at their level. They could approve facilities for themselves and if their activities are not regulated, they have the capacity to liquidate the bank. Also, if the management lacks the technical and administrative competence to conduct the affairs of the bank, sub-optimal decisions could lead to underperformance. Bank regulation in this regard seeks to ensure that only fit and proper persons occupy management positions in banks. Since the objectives of corporate governance can only be achieved through effective management, emphasis on quality of persons to be entrusted with the management of banking institution is not misplaced. In view of the potential threat of corrupt, poor quality and inept bank management to the stability of the banking system, the regulatory authorities have put in place various codes to ensure sound corporate governance in these institutions.

4. Liquidity: Liquidity refers to the ability to meet short-term maturing obligations. Liquidity is a very vital aspect of banking operations which must be closely monitored because of its importance not only for the stability of the banking system but also that of the entire economy. Inability of bank to meet customer withdrawals, for instance, may prompt customers to invade the bank to ask for their money (bank run) and if not controlled could destabilize the banking system as other banks' customers may massively approach their banks for withdrawals thereby creating a systemic problem (contagion effect) that may likely upset the stability of the economy.

   To ensure that banks maintain a level of liquidity necessary to support their operations, the CBN Act 1958 and its subsequent amendments specify that a minimum certain level of customers' be set aside as liquid assets. This specified minimum is called the liquidity ratio, calculated as the ratio of specified liquid assets to its total deposit liabilities. Liquid assets have minimal (for instance, treasury bills) or no cost (for instance, cash) of realization and are therefore considered a primary line of defence for banks against expected and unexpected customer withdrawals. Beyond the specified minimum, individual banks determine what proportion of assets to be kept in liquid form based on experience acquired over time in the management of customers' accounts.

   The basic motivation for the strict regulatory control over liquidity of the banking system is the desire to achieve a balance between the need to maintain adequate liquidity to meet depositors' withdrawal demands and the risk of losing earnings capacity by maintaining a sub-optimal level of in idle balance. Like cash ratios, liquidity ratios are measures of short-term solvency of banking financial institutions.

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UNIT 6FORMS AND METHODS BY WHICH REGULATORY AUTHORITIES CARRY OUT SUPERVISORY FUNCTIONS IN BANKS

Contents

1.0 INTRODUCTION

In the last unit, we had considered an important unit viz: critical and emerging aspects of banking practices that requires control and regulation.

In this final unit, we shall consider the forms and methods by which regulatory authorities carryout their supervisory roles and responsibilities.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- define the term supervision;
- list out and briefly describe the different forms of supervision;
- enumerate and discuss the conditions for effective banking supervision;
- explain the role of global supervision, foreign bank branches and cooperation with foreign supervisors;
- state the roles and responsibilities of stakeholders in ensuring good ethical conduct in the banking industry.

3.0 MAIN CONTENT

3.1 Definition of the concept 'Supervision'

In recent years, there has been great concern on the management of banks' assets and liabilities because of large scale financial distress(Chude and Chude, 2014). The experience of many countries indicates that regulation and supervision are essential for stable and healthy financial system and that the need becomes greater as the number and variety of financial institutions increase. The banking sector has been singled out for the special protection because of the vital role banks play in preventing bank failures and ensuring that they carry out their activities in accordance with wider economic and social objectives of the country.

Bank supervision entails not only theenforcement of rules and regulations, but also judgments concerning the soundness of bank assets, its capital adequacy and management (Volcker, 1992). Regulation and effective supervision leads to healthy banking industry. To maintain confidence in the banking system, the monetary authorities have to ensure banks play by the rule. The deposit insurance scheme and prudential guidelines were adopted to improve the assets quality of banks, reduce bad and doubtful debt, ensure capital adequacy and stability of the system, and protect depositors' funds (Oladipo, 1993, Oguleye, 2005).

Whereas regulations refer to a set of guide, rules and regulations governing actions, supervision is the surveillance and enforcement to ensure that those set of guide, rules and regulations are implemented or followed.

3.2 Forms of Supervision

Supervisory authorities carry out their functions through bank examinations. Bank examination may be defined as the examination of the books and records of a bank for the purpose of ascertaining that the affairs of the bank are being conducted in a safe and sound manner with respect to: adequacy of capital, asset quality, board and management, earnings, liquidity, adequacy of internal controls, adequacy of accounting system and record keeping as well as compliance with both the individual banks' internal policies and prudential regulations. To accomplish the task of examining banks, bank examiners use both off-site and on-site supervision to carry out their supervisory functions.

3.2.1 On-site supervision

On-site supervision of banks entails physical presence of regulators (CBN and NDIC) in the financial institutions to evaluate their internal controls, compliance with the laws and regulations governing their operations with a view to determining their overall risk exposure. Emphasis is placed on their capital, asset quality of management, the strength of earnings and the adequacy of liquidity. On-site supervision is carried out by the Bank Examination Department of the regulatory bodies.

3.2.2 Off-site supervision

The off-site supervision of banks is carried out by the Banking Supervision Department of the CBN/NDIC and involves essentially the appraisal of banks returns. Essentially, it serves as an early warning device to detect a bank's emerging financial problem. This is accompanied by analyzing key bank financial ratios and other financial data that are generated from periodic bank financial reports that are submitted to the supervisor.

An off-site surveillance system can also contribute to a more efficient use of examiners' resources by giving priority to the examination of banks that are experiencing problems or which appear to be significantly increasing their risk exposure. The availability of off-site surveillance reports and analyses can help examiners to prepare for on-site bank examination by focusing attention on specific banks' operational areas that may require close supervision attention.

At the aggregate level, off-site surveillance system can be employed by bank supervision to monitor the financial condition and performance of the entire banking system. Off-site surveillance system typically focuses on a variety of key bank financial ratios covering such areas as earnings, asset quality, capital and reserves and liquidity.

1. **Maiden examination -** This is usually carried out after six months of operations by a new bank to determine if the conditions and premises for granting of banking license by the CBN and the business objective of a bank are being pursued.

2. **Routine examination -** This is the normal examination, currently carried out on a yearly basis to review the prudential operations, information-processing systems, foreign exchange operations and the anti-money laundering control of banks to determine the continued conduct of banking business in a safe and sound manner.

3. **Target/Special examination -** This is usually carried out when serious issues of regulatory concern arise in bank, e.g. persistent illiquidity, lingering boardroom squabbles, deteriorating assets quality etc. In such a situation, the examination effort is concentrated primarily on the identified areas of regulatory concern.

4. **Investigation/Spot checks -** These arise from the discovery of abnormal banking practices, complaints and petitions by the banking public and other stakeholders of issues bordering on unprofessional and unethicalconduct by a bank.

3.3 Conditions for Effective Banking Supervision

The conditions necessary for effective banking supervision are as follows:

1. Sound and sustainable macroeconomic policyhas been identified as a critical success factor in the application of the core principles for effective banking supervision, which set out the best practices in supervision worldwide. This is particularly so in Nigeria where inadequate coordination of monetary and fiscal policies tend to render them impotent. Also, the unwieldy public expenditure size, largely financed by deficits (which are seldom channelled into the productive sector) has negative impact on employment and general price level.

2. Effective market discipline as a precondition requires that there exist a culture of financial transparency and the presence of good corporate governance. It is thus expected that bank lending decisions are carried out in strict commercial sense and without political pressure from the government. Banks are expected to operate credit risk thresholds that are driven strictly by the long term growth outlook and the safety and soundness of their institutions as the focus. In the case of Nigeria for example, loans to government, if performing, attract 50% provision and where such loans display any trait of delinquency, 100% provision is enforced. That proactive measure has to a large extent infused some discipline into the banking system in Nigeria.

3. Procedure for the efficient resolution of problems in banks. The core principles note the need for supervisory authorities to be vested with the power and authority required for effective distress resolution. Such distress resolution thresholds are expected to be flexible and robust in order to prevent contagion. That would require framework for early warning signals (EWS) and a holistic engagement of their thrusts. Onno (2002) was of the view that strictness requires the setting of high standard of prudential guidelines to reduce the risks of individual banks or the entire banking system in a country from becoming illiquid or insolvent. The CBN and NDIC (2002) had developed and issued the framework for contingency planning

for banking system crisis. It was billed to become effective from 1st July 2002. The document which has been circulated to all banks has comprehensive thresholds for regulatory /supervisory intervention aimed at ensuring consistency and systematic approach to distress identification and resolution. The banks are required by the CBN and NDIC to fully disclose these thresholds to all stakeholders for the purpose of transparency. In addition, each bank is required to prepare and submit to CBN its contingency plan for managing its crisis. Such a plan should be discussed and approved by the board of each bank.

4. Mechanism for providing an appropriate level of systemic protection for financial safety net. The key aspects of financial safety net include prudential regulation and supervision, a lender of last resort facility and deposit insurance according to financial stability form (FSF) in 2001. An effective mechanism in all the three areas has been emphasized. A country with a well developed mechanism in only one or two of these three areas is likely to face insurmountable obstacles in finding effective solutions for preventing or resolving serious difficulties in its banking system. The FSF (2001) stated that a deposit insurance system "needs to be supported by strong prudential regulation and supervision, sound accounting and disclosure regimes, and the enforcement of effective laws". The FSF has posited that it is vital to establish a financial safety net as in its absence, the risks of destabilization of the banking system will grow. I think we can boast that we have an effective safety net in Nigeria.

5. A well developed public infrastructure. This is another profound aspect of the preconditions for effective banking supervision. The requirement here includes the existence of a proper credit culture that would foster the honouring and enforcement of financial contracts. Added to this is the need to enthrone the best practice and ethical standards in financial dealings. Even though the laws appeared to be in place to deal with those issues, poor or inadequate enforcement powers and the lack of the will power to sanction erring banks by the supervisory authorities need to be addressed, for effective banking supervision. Also, the judiciary system has not fared well to facilitate foreclosure of collaterals for loans. The process at present is tortuous, costly and frustrating. More so, "justice delayed is justice denied". This has led to the request for a special court in Nigeria that can ensure speedy adjudication of justice relating to the recovery of bad loans.

3.4 Global Supervision, Foreign Bank Branches and Cooperation with Foreign Supervisors

Very few Nigerian banks operate offshore. The few offshore operations have always been subject to supervision by the authorities with the cooperation of the host supervisors. For example, the Financial Services Authority [FSA] of the U.K. has always contacted the CBN for information on the management and internal control practices of the three Nigerian banks that have branches in the U.K. The World Bank Mission concluded that issues related to cross-border supervision were not relevant to Nigerian banks as their activities were domestic to a very large extent.

(a) **Country and Market Risks -** Hitherto, banks and supervisors in Nigeria had not been focusing on these issues. However, with the adoption of risk-based approach to supervision, the framework would be put in place to address the issues which are yet to be given due attention. The assessment was "not applicable" as the risk exposures were almost nil.

(b) **Supervisory Powers -** Both the CBN and the NDIC have sufficient and comprehensive legal powers to take adequate and timely actions on banks in distress. This was demonstrated in the liquidation of 26 terminally distressed banks in 1998 and by the revocation of the licences of three (3) banks in December 2000. The World Bank Mission expressed fear about political pressure, which might hinder the supervisory authorities in exercising their powers and rated this principle as largely fulfilled. Other principles adjudged to be largely fulfilled included those dealing with loan classification, money laundering, off-site and on-site supervision, powers to address compliance with laws, transfer of ownership, power to review acquisitions and investments, management process to control material risks and accounting policies and disclosures.

(c) **Internal Control -** It is expected that with the risk-based approach to on-site supervision, greater and more focused attention would be given to internal control. The appraisal of banks is focused on analysis of financial ratios and compliance with regulations. Although the CBN has enough power under the existing banking law to bring erring bank directors into line or to out rightly remove them, the critical role of the board in safeguarding the assets of the bank is not emphasized in the laws. This principle was consequently adjudged largely unfulfilled.

(d) **Operational Independence -** The 1999 amendment to the CBN Act granted autonomy to the CBN in the execution of its functions. The World Bank Mission was, however, of the view that the CBN may not perform its duties independently from political forces since the government, from a legal standpoint, could influence most actions taken or intended to be taken by the regulatory authorities. Efforts are being focused on addressing the inadequacies in the Banking Act through appropriate amendment. The mission found the supervisors seriously lacking in the provision and upgrading of Information Technology [IT] systems. This principle was assessed to be largely unfulfilled but efforts to achieve fulfillment were underway especially as the CBN has initiated actions to upgrade its IT systems.

(e) **Management Information -** The Mission was of the view that Management Information Systems [MIS], which would enable supervisors to identify concentration and related issues, were lacking. The Mission concluded that the principle on management information was not fulfilled and efforts to achieve fulfilment were not underway. It however noted the efforts of the CBN to collect information on loans of N1 million and above through the Credit Risk Management System (CRMS) or Credit Bureau and advised that it should be incorporated into the supervisory data process.

(f) **Connected Lending -**The mission was also of the view that the core principle on connected lending was largely unfulfilled and efforts to achieve fulfillment were not underway. The reason was that regulatory safeguards were not sufficient to discourage unsound lending practices, nor were penalties stiff enough to avert such unsound practices. The issue of insider abuse had been a source of concern to regulators in Nigeria. Serious steps had been taken to address the problem including the implementation of the Failed Banks (Recovery of Debts) and Financial Malpractices in Banks Act 1994 with the cases hitherto handled by Special Tribunals now moved to dedicated divisions of the Federal High Courts.

(g) **Legal Framework -** The core principle on legal framework and the provisions relating to the authorization of banking establishments and on-going supervision was assessed to be unfulfilled and efforts to achieve fulfilment underway, without actually stating what action had not been addressed. The Mission confirmed the granting of larger autonomy to CBN, which the regulatory authorities believed had eliminated obstacles to achieving fulfilment.

(h) **Prudential Reporting -** The Core Principle on Prudential Reporting involving the processing of returns from banks was assessed "unfulfilled and efforts to achieve fulfilment not underway". This assessment was based on the fact that the level of the IT systems of the regulators and the banks does not allow for the best use of information. The mission believed that the Bank Analysis System (BAS) might partially remedy the situation. The authorities totally agreed with the mission's assessment but hoped that the present policy thrust of the CBN towards the development of IT would, to a large extent, remedy the situation.

(i) **Legal protection to supervisors and corrective action -** There were other principles which, in the opinion of the mission, required legal provisions, otherwise they would remain "unfulfilled and effort to achieve fulfillment not underway". These included, among others, legal protection for supervisors, and corrective action by CBN and NDIC on distressed/failing banks without government interference. It is therefore the responsibility of the supervisors to make a comprehensive proposal to the National Assembly on the relevant provisions that need to be amended / included in the CBN and Banks and Other Financial Institutions Acts.

3.5 Roles and Responsibilities of Stakeholders in ensuring Good Ethical Conduct in the Banking Industry

The institutionalization and management of ethics is an important task for today's organizations if they are to effectively counteract the increasingly frequent occurrences of blatantly unethical and often illegal behavior within large and often highly respected organizations. This section discusses the important roles and responsibilities of stakeholders in the effective management of organizational ethics.

Management of organizational ethics may sound ponderous, but its meaning is straightforward. It means getting ethics formally and explicitly into daily business life. It means getting ethics into company policy formation at the board and top management levels and through a formal code, getting ethics into all daily decision making and work practices down the line, at all levels of employment. It means grafting a new branch on the corporate decision tree a branch that reads right/wrong (Purcell and Weber, 1979).

3.5.1 What is Ethics?

Ethics is the basic, moral ground rules by which we live our lives. Good ethics is learning what is right and wrong and then doing the right thing. But Organizational ethics is understanding what is right or wrong in the workplace and then doing what is right.

3.5.2 Who Are the Stakeholders?

Stakeholders are those who effect change and those who are affected by it. The aim of inclusiveness makes the identification of Stakeholders important, excluding an important Stakeholder can undermine the process and successful implementation of the policies and programs of the organization. If we consider fully what a modern ethical organization is, we must inevitably take a far wider view in defining modern Stakeholders. A modern definition of 'Stakeholder' is broader than the conventional ideas about shareholders, investors and partners, etc.

A modern definition of a Stakeholder is any group which has an interest in, involvement with, dependence on, contribution to, or is affected by, the organization. Individuals are important Stakeholders too, but for practical reasons most organizations will necessarily view stakeholders as groups, and for the purposes of this explanation the term 'stakeholder' here also means a stakeholder group. A Stakeholder is any individual or group of people who could lose or gain something because of the actions of the organization. This is especially relevant in the context of ethics, corporate responsibility, sustainability, etc.

3.5.3 Some Stakeholders in the Operations of the Central Bank of Nigeria

In defining important Stakeholders in the operations of the Central Bank of Nigeria, the following groups readily comes to mind:

- Board of Directors
- Top Management
- Staff
- the Nigerian Public/the Parliament
- Contractors, Consultants, Suppliers
- Retirees
- Family members of Board, Management and Staff
- Financial Services Sector Operators
- Government Agencies, Ministries and Departments
- Customers
- Civil Society
- The Mass Media
- The International Business Community
- Foreign Governments
- Local and international businesses
- Operators in the informal sector of the economy

3.5.4 The Stakeholders' Roles and Ethical Responsibilities

a. Following the Rule of Law

In every organization seeking to integrate good ethical management into its activities the expected roles and responsibilities of the Stakeholder must be properly defined and every Stakeholder would be expected to be guided in all action by the Rule of Law. The following rules must be clear to each Stakeholder:

1. You are responsible for obeying the laws and the spirit in which they were intended.
2. Satisfying the letter of the law is not enough. Your standards should be higher.
3. You should recognize and follow industry standards and practices, both written and non-written.
4. You are responsible for doing your homework. Ignorance of the laws is not an excuse.
5. You are responsible for behaving in an ethical manner as you work and conduct official business.
6. You should read and understand organizational guidelines, rules, codes, and procedures.
7. You should not knowingly help another person act unethically in the conduct of official business.
8. You are ethically responsible to yourself, your company, co-workers, supervisor, constituents, and your community.

b. Working for the Common Good

In all actions and decisions at all times the common good and progress of the organization must be the overriding motivation of the Stakeholder. The following rules can serve as useful guide.

1. Does it Suit a Common Purpose?

2. Does it make you Accountable/Responsible to anyone?\
3. Is there Probity in your Actions?
4. A tolerance for scrutiny
5. Appropriate disclosure
6. Are the results of your decisions and actions expected and welcome events to others?

c. **Faithful application of the Ten Personal Values for Organisational Ethics Success**
The careful and consistent deployment of personal values in decision making and actions is central to the success of organizational ethics.These values are captured below:
1. **Respect:**Respect laws, people, and property.
2. **Teamwork:** Work openly and supportively with others, aiming toward common goals.
3. **Leadership:**Show leadership in areas where you are strong.
4. **Citizenship:**Build a workplace that protects health and welfare of employees, your community, and your environment.
5. **Stakeholder Value:**Build an effective andefficient organization that will have stability and sustainable stakeholder returns.
6. **Honesty:**Believe that honesty **IS**the best policy and to live it.
7. **Integrity**: Always take the high road.
8. **Responsibility:**Take responsibility for your actions.
9. **Quality:** Strive for quality in every aspect of your work.
10. **Trust:** Build the trust of employees, superiors, your constituency, and the community at large.

d. Faithfully applying the Five Way Ethical Test
Additionally it is important that stakeholders put their decisions and actions through the five way Ethical Test at all times.
1. Is the action honest and truthful? .

   - Does the action break generally accepted moral principles of telling the truth?
   - Do you have to resort to rationalization to justify the action?

2. Is the action legal?

   - Does the action comply with organizational policies, approved practices, and organizational values?
   - If legal, is it also the "right thing to do"?

3. Can you do the action in good conscience?

   - Do you feel uncomfortable about doing this?
   - What is your "gut feeling"?
   - Can you do the action without looking back?

4. What are the consequences of my planned action?

   - How will it affect other stakeholders? Who, what, &where?
   - What are the real costs? Consider physical and emotional costs to both people and the organization.
   - What is the liability to you, the company, and to others?
   - Could there be any unintended consequences?

5. Would you do it if everyone knew about your actions?
    - Would you be proud of your actions if your spouse, children, pastor, or other respected individual knew about it?
    - Can you defend your action before your team leader, superior, peers, constituency, or community?
    - What will your manager, supervisor, or co-workers think about what you plan to do?

e. Avoid Irrational Rationalisations

Stakeholders must at all times avoid unethical rationalizations for unfair decisions and actions such as:

- Everyone is doing it.
- If it is legal it is OK.
- I really need it.
- I've got it coming.
- Nobody will be hurt.
- It is my Payback time.
- I'm not getting anything out of it.

3.6 Ethical Principles for Using Organisational Assets

a. Kinds of Assets

"Assets" are not necessarily limited to money. Assets referred to here would usually include:

- Physical Property
- Funds
- Intellectual Property (Official Information, or other Intangible Property)
- Official Records

b. Ethical Use of Organisational Assets

In the deployment and use of Organizational Assets, the following principals must always be considered:

- Everyone has a stake in the proper treatment of organizational assets.
- It is a moral and ethical imperative to take the best care of organizational property as much as possible.
- You should control and care for other's property better than you care for your own.
- Protecting assets is an important trust issue between you and your company.
- Follow the money **-** whoever pays for it owns it and controls it.

c. Way to Show Responsibility for Physical Property

- You should separate personal property from organizational property.
- You do not use organizational property or services for personal benefit. (If you do, youpay for it).
- You should seek approval in advance to use organizational property and equipment.
- Understand that organizational property should not be sold, loaned, given away regardless of condition or value without proper authorization.
- If you use it you care for it, maintain it, and clean it.
- If you are transferred or terminated, you do not remove any equipment or records.

d. Showing Responsibility for Funds

It must always be remembered that company money is given to you as a trust and must therefore be used in accordance with relevant rules and regulations.

- You should be just as careful with the organization funds as you are with you own.
- You should show good judgment regarding travel and entertainment expenses.
- You should not use the organization's cash checks, or money orders for personal use.
- Recognize that the misuse of organizational funds can have very serious consequences including termination and criminal charges or even the collapse of the organisation.

3.7 Intellectual Property

Intellectual property includes the ideas discoveries, and inventions of the people who work for the organization. These original ideas and creations have value in the marketplace. Just like physical property, they have an owner/creator and are given rights of protection.

You are responsible for protecting the organization's intellectual property! If you are granted access to sensitive information, you are obligated to protect and maintain its confidentiality and should never disclose it unless otherwise authorized.

3.7.1 Examples of Sensitive Information/Trade Secrets

These include:

- Technical data
- Bids/Pricing
- Personnel information
- Investment/Financial data
- Confidential information
- Scientific data
- Designs
- Production processes or procedures
- Formulas
- Future plans
- Market studies

3.7.2 Protecting Intellectual Property

With regard to the organizations intellectual property, it is your duty and responsibility to:

- Protect the organization's intellectual property, and act responsibly with the sensitive information of others.
- Be careful not to transfer outside the organization confidential email messages or any message intended for internal use only.
- Respect your co-workers' personal privacy.
- Protect private personnel information from those inside or outside the organization.

3.7.3 Using Company Time and Resources

You should avoid using the organization's time or other employees' services for outside activities. Examples include:

- Making phone calls
- Seeing your customers and clients while on company time.
- Using your organization's office equipment or photocopy machines, using email and the Internet

3.7.4 Selling in the Workplace

You should not promote products or services from your business to employees at your regular job during working hours. Some products include:

- Cosmetics
- Vitamins
- Insurance
- Personal care products
- Plastic containers
- Food items
- Multilevel marketing

You should not use company mail, bulletin boards, or computers to promote your services to employees.

Occasional sale of products for charity may be permitted but you should ask for permission from management first. Purchasing should be voluntary. No one should ever feel pressured to purchase a product. You might be able to do certain volunteer work on the organization's time provided you get permission first.

3.8 Conflicts of Interest

This is a very big, serious and sensitive issue in organizational ethics and ethics in management. A conflict of interest happens when your personal interests influence (or appear to influence) your ability to act in the best interest of your organization. Organizational information and resources should not be used for personal gain. You should never use your contacts or position with the organization to advance your own private business or financial interests. Conflicts of interest would also include, having a financial interest or employment with another organization (apart from Agric) at the same time as being a civil servant; divulging or using-organizational confidential information for personal purposes; doing business with family members; using organizational time or equipment for personal gain or profit; promoting or selling outside products or services at work; serving on outside boards, committees, or elected office that might pose a conflict.

3.8.1 Areas of Conflict

The areas of conflict are:

- Employment: You should not be employed by, act as a consultant to, or have an independent business relationship with contractors, other governments, or citizen groups.
- Investment: You should not invest in any customer, supplier, or competitor.
- Competition: You should not have outside employment or business interests that provide goods or services similar to those of the organization.

As a general rule, neither you nor your immediate family should have a financial interest or ownership in your organization's contractors, beneficiary groups, or competing interests with whom you deal in your job.

A conflict of interest is created when a family member works for a supplier, a beneficiary group, or competing interest; a family member has a "significant financial interest" in a contractor, beneficiary group, or competing interest; a family member receives gifts or benefits offered by a contractor, beneficiary, or competing interest. As an employee you are expected to give your full-time, best efforts to the organization.

Furthermore, as an employee you are expected to give your full-time, best efforts to the organization. You should not engage in outside business that diverts your time or attention away from your duties. If necessary, you should seek written clearance that your outside job or activity is within the bounds of your job performance and no conflict of interest exists.

You should not engage in outside business that diverts your time or attention away from your duties. If necessary, you should seek written clearance that your outside job or activity is within the bounds of your job performance and no conflict of interest exists. Always disclose a potential conflict situation to your superior and organizational legal department if you suspect a conflict of interest.

3.8.2 Family and Friends

For clarity your "family members" would include your:

- Spouse
- Parents
- Siblings
- Children
- In-laws

You should avoid engaging in any organizational business transactions with a relative by blood or marriage or with a firm where a relative is a principal, officer, or representative.

3.8.3 When to Disclose

When should you disclose your interest formally to your organization? You can determine this by asking the following questions:

- Does this business or investment opportunity have anything to do with my job responsibilities?
- Would the size or nature of this business or investment opportunity be of concern to my organization?
- If the answer to either of these is "yes," you should disclose it before taking action.

4.0 CONCLUSION

Whereas regulations refer to a set of guide, rules and regulations governing actions, supervision is the surveillance and enforcement to ensure that those set of guide, rules and regulations are implemented or followed.

Supervisory authorities carry out their functions through bank examinations. Such examination is done using both off-site and on-site supervision to carry out their supervisory functions.

The conditions necessary for effective banking supervision are sound and sustainable macroeconomic policy; effective market discipline;procedure for the efficient resolution of problems in banks; mechanism for providing an appropriate level of systemic protection for financial safety net and a well developed public infrastructure.

The institutionalization and management of ethics is an important task for today's organizations if they are to effectively counteract the increasingly frequent occurrences of blatantly unethical and often illegal behavior within large and often highly respected organizations. To that extent, the section discusses the important roles and responsibilities of stakeholders in the effective management of organizational ethics.

The ethical principles for the use of an organisation's asset are also prescribed in the section.

Intellectual property includes the ideas discoveries, and inventions of the people who work for the organization. Employees or agents are responsible for protecting the organization's intellectual property and ensure strict confidentiality.

Finally, there should be no conflict of interest between an employee's and those of the organisation he serves. A conflict of interest happens when your personal interests influence (or appear to influence) your ability to act in the best interest of your organization. Organizational information and resources should not be used for personal gain. You should never use your contacts or position with the organization to advance your own private business or financial interests.

5.0 SUMMARY

In this final unit, we shall consider the forms and methods by which regulatory authorities carryout their supervisory roles and responsibilities. In doing this, we defined the term supervision; listed out and briefly describe the different forms of supervision; enumerated and discuss the conditions for effective banking supervision; explained the role of global supervision, foreign bank branches and cooperation with foreign supervisors; stated the roles and responsibilities of stakeholders in ensuring good ethical conduct in the banking industry.

By this development, we have come to the end of the course.

6.0 TUTOR-MARKED ASSIGNMENT (TMA)

1. Define the concept 'supervision'. What is the difference between this term and regulation?
2. State the differences between on-site and off-site supervisory activities.
3. List and briefly describe some of the conditions necessary an effective banking supervision.
4. What are the roles and responsibilities of stakeholders in ensuring organisation's ethics?

Suggested answers:
Regulations refer to a set of guide, rules and regulations governing actions, while supervision is the surveillance and enforcement to ensure that those set of guide; rules and regulations are implemented or followed.

Supervisory authorities carry out their functions through bank examinations. Such examination is done using both off-site and on-site supervision to carry out their supervisory functions.

On-site supervision of banks entails physical presence of regulators (CBN and NDIC) in the financial institutions to evaluate their internal controls, compliance with the laws and regulations governing their operations with a view to determining their overall risk exposure. It is carried out by the Bank Examination Department of the regulatory bodies.The off-site supervision of banks is carried out by the Banking Supervision Department of the CBN/NDIC and involves essentially the appraisal of banks returns. Essentially, it serves as an early warning device to detect a bank's emerging financial problem.

The conditions necessary for effective banking supervision are sound and sustainable macroeconomic policy; effective market discipline;procedure for the efficient resolution of problems in banks; mechanism for providing an appropriate level of systemic protection for financial safety net and a well developed public infrastructure.

The institutionalization and management of ethics is an important task for today's organizations if they are to effectively counteract the increasingly frequent occurrences of blatantly unethical and often illegal behavior within large and often highly respected organizations. To that extent, the section discusses the important roles and responsibilities of stakeholders in the effective management of organizational ethics.

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