CENTRAL BANK OF NIGERIA

SEMINAR ON ISSUES IN FINANCIAL INSTITUTIONS SURVEILLANCE IN NIGERIA

Publication of

Cbn Training Centre, Lagos

NO. 3

TABLE OF CONTENTS

FOREWORD

The purpose of this publication - the third in the series of Training Centre publications - is to provide the readers with basic source of information on issues in financial sector surveillance. It is packaged for the benefit of practitioners and those who have keen interest in knowing how the financial system is monitored by the regulatory authorities.

The financial system plays a very significant role in economic growth, development and social mobilization. The bank failures experienced in the early nineties and its rippling effects on other sectors of the economy brought to fore the strategic position of the sector. This has necessitated the examination of the roles of the regulatory institutions and their repositioning to meet the challenges of being the watchdog of the activities in the system.

The financial system has undergone radical changes in recent years in Nigeria in line with the international standards. The changes have been driven by changes in the banking laws, developments in communication and information technology and the adoption of hi-tech in the business of banking. These have, in turn, brought about innovations in products and ideas, keen competition, diversity of institutions and new risks.

The nature of the financial services and especially the way the players in the banking system conduct themselves and practise banking is such that risk is misaligned and depositors tend to panic whenever there is a little sign of distress in the system. Furthermore, the urge for high returns and competitive edge have kept operators on their toes thereby making some to cut corners and engage in other sharp practices. All these pose a huge challenge to the regulatory authorities as they are called upon to restore confidence in the financial system by a more proactive, efficient and effective surveillance.

There is no doubt that the Central Bank of Nigeria (CBN) plays a major role in financial institutions surveillance since it occupies the apex position in the financial system. The theme of the seminar, “Promoting Efficiency In Financial Surveillance in Nigeria” points at the current effort of the Bank to accomplish one of its cardinal missions of effective and efficient management of the financial sector.

This publication, therefore, addresses such issues as: the Nigerian Financial System and the Role of the Central Bank of Nigeria; Financial System Regulation in Nigeria; Theoretical Framework and Institutional Arrangements; An Overview of The Regulatory Reports on Banks In Nigeria; Financial Systems Surveillance: The Operators Perspective; Constraints and Prospects of Effective Financial Surveillance in Nigeria; Financial Regulations In Nigeria and the Challenges of the Second West African Monetary Union; the Peculiarities and Challenges for the Surveillance of Non-Bank Financial Institutions; and Official Safety-Nets for the Nigerian Financial System: the Role of the Nigerian Deposit Insurance Corporation.

It is my hope that the issues addressed here will stimulate the awareness of the readers in the challenges of providing efficient and effective surveillance for the financial system in Nigeria.

Deacon M. Okunfolami,
Director, Human Resources,
CBN, Abuja.

ACKNOWLEDGEMENT

In acknowledging the roles of the various contributors to this publication, I first of all want to give thanks and praises to the Almighty God for making this effort a reality.

A big thank you goes to the Governor and his Team for creating the right environment for training, learning and research at the Training Centre.

I wish to express my heart-felt gratitude to all those who contributed in one-way or the other to bring this publication to fruition. Chief among these are our erudite paper presenters including Mr. G.A. Ogunleye (MD/CEO, NDIC), Dr. Chris Itsede (D.G., WAIFEM) and Mr. Godwin Emefiele (Deputy MD, Zenith Bank Ltd.), among others.

The ceaseless efforts of the Director, Human Resources Department of the Bank in driving the Centre towards excellence are worthy of note.

I will not fail to appreciate members of the Training Centre Faculty and other support staff who worked tirelessly to ensure that this publication sees the light of the day.

In concluding this acknowledgement, I will like to appreciate the necessary finesse put into this publication by the Academic Committee of the Centre.

B. O. Ibikunle (ACS),
Deputy Director/Principal,
CBN Training Centre,
Lagos.

The Nigerian Financial System and the Role of Central Bank of Nigeria

By

Larry Uffot*

INTRODUCTION

A financial system is a composition of various institutions, markets, instruments and operators that interact within an economy to provide financial services. It can also be seen in the context of sets of rules and regulations, and heap of financial arrangements within the financial sector. Such services may include resource mobilization and allocation; financial intermediation; and foreign exchange transaction to enhance international trade, among others. The financial system thus plays important role in the process of economic growth and development in a country.

In Nigeria, the financial system has undergone remarkable changes in terms of ownership structure, the depth and breadth of instrument employed, the number of institutions established, the economic environment and the regulatory framework within which the system operates.

The Nigerian Financial System has witnessed remarkable evolution over the past two decades. Let us take a look at three major phases during this period.

The Pre-SAP Era (Between 1980 and 1986)

This witnessed the emergence of wholly owned Nigerian banks. The banking industry during this period was characterized by minimal competition and poor capitalization. Also during this period the Banking Industry was highly regulated and dominated by government. In terms of policy, it was a period of relative monetary restraint. The key factors in this regard include the economic stabilization measures of 1982–83 and the austerity measures of 1983 to 1985.

*** Larry Uffot is a Faculty Member, CBN Training Centre, Lagos.**

The SAP Era (Between 1986 and 1993)

This era witnessed an economic reform package designed to liberalize the economy with emphasis on the financial system. The reforms brought about the removal of various administrative controls and the progressive move towards a market-oriented economy. Thus the major element of this era was deregulation, which brought about the following:

- A phenomenal increase in the number of players i.e. banks, finance companies, bureau de change, primary mortgage institutions and community banks.
- Deregulation of interest rates and foreign exchange market. Removal of administrative restrictions on the various activities of banks.
- Enhancement of the regulatory and supervisory regime, which brought about the promulgation of the CBN Decree No. 24 of 1991 and BOFID No. 25 of 1991.

The Post SAP Era (The period following the termination of SAP)

This Era witnessed a brief period (1994) of renewed regulation (with interest and exchange rates fixed by fiat) and subsequently, the period of guided deregulation. The deregulatory approach to monetary management and the resultant proliferation of banking and financial institutions in the early 1990s brought about increased number of players far beyond what could be effectively managed by the CBN. As a result, the financial industry witnessed serious waves of distress that caused crisis of confidence in the industry. The Failed Banks (Recovery of Debts) and Financial Malpractice in Banks Decree was promulgated in 1994 to sanitize the banking industry. The CBN in collaboration with NDIC has since 1994 intensified efforts towards achieving a healthy operating environment for the financial services sector.

This Paper is an attempt to review the Nigerian Financial System and exposit on the roles of the Central Bank of Nigeria in the development and deepening of the Financial System. Following this introduction, section II discusses the functions and structure of the financial system. The regulatory authorities in the financial system are the subject of Section III, while an overview of the Financial Markets and Institutions that make up the system are discussed in Section IV. Section V discusses the roles of CBN in the financial system. The paper ends with conclusions in Section VI.

SECTION 2

FUNCTIONS AND STRUCTURE OF THE FINANCIAL SYSTEM

FUNCTIONS OF THE FINANCIAL SYSTEM

The financial system performs quite a number of unique functions within the Nigerian economy. Chief amongst which is ensuring adequate stock of money to service the needs of the economy as well as facilitate the transfer of money between economic units. The transfer is usually from areas of surplus to areas where there are deficits or needs. The financial system also helps to mobilize the collection and storage of savings.

STRUCTURE OF THE NIGERIAN FINANCIAL SYSTEM

The Nigerian financial system is made up of various segments including the regulatory and supervisory authorities for banks and non-bank financial institutions. Others are the Money Market and its institutions, the Capital Market and its players. The system also consists of the Development Finance Institutions and Other Financial Institutions and Funds.

SECTION THREE

THE REGULATORY AUTHORITIES:

These are institutions, which are responsible for the orderly development of the financial system. They ensure compliance with laid down rules and regulations guiding their operations.

They are made up of the following institutions and organizations:

1. Central Bank of Nigeria;
2. Nigeria Deposit Insurance Corporation;
3. Securities and Exchange Commission;
4. Federal Ministry of Finance;
5. National Insurance Commission;
6. Federal Mortgage Bank of Nigeria; and
7. National Board for Community Banks.

THE CENTRAL BANK OF NIGERIA

The Central Bank of Nigeria was established by Act of 1958 and commenced operations on 1st July 1959. The Act, which has undergone some amendments, was re-enacted as the CBN Act No 24 of 1991. In addition, Banks and other financial Institution Act No 25 of 1991 was promulgated. The two Acts with necessary amendments up to 1999 gave CBN more flexibility in regulating and supervising the banking sector and licensing finance companies, which hitherto operated outside any regulatory framework.

The CBN today stands as the apex regulatory authority of the financial system by virtue of the functions it has to perform in the Nigerian economy. It also serves as the principal regulator and supervisor in the money market, as well as the activities of finance companies and specialized and development finance institutions.

Functions of the Central Bank of Nigeria

The CBN performs a myriad of functions, which are derivable from its objectives to:

a) Issue legal tender currency;
b) Maintain the external value of legal tender currency;
c) Promote monetary stability and sound financial system;
d) Banker and financial adviser to; the Federal Government;
e) Banker to the banks;

Using CBN's various organs, its functions can be classified into two broad categories, namely: core, and developmental functions.

Its core functions include currency issue and distribution, banker to other banks, banker to the government; promotion and maintenance of monetary stability and sound financial system, debt Management, foreign exchange management and providing facility to entertain public complaints.

The developmental functions carried out by the apex bank include the promotion of the financial markets, introduction of money market instruments, facilitating capital market institutions and instruments and sponsoring specialized institutions.

The specialized institutions sponsored by CBN over the past 4 decades include the following:

- BOI – Bank of Industry.

- NACRDB – Nigerian Agricultural Cooperative and Rural Development Bank.
- NAIC – Nigerian Agricultural Insurance Corporation;
- NDIC – Nigerian Deposit Insurance Corporation;
- NEXIM – Nigerian Export Import Bank;
- SEC – Securities and Exchange Commission; and
- Specialised schemes and funds such as:
    - ACGS;
    - Rural banking scheme (1977-1980; 1980-1985; 1985-1989);
    - NERFUND;
    - SME (Apex) Unit loan scheme and
    - SMIEIS.

NIGERIAN DEPOSIT INSURANCE CORPORATION

The growth in the banking sub-sector of the financial system at the dawn of the 1980s resulted in rapid licensing of new Banks most of which could not compete effectively given the prevailing economic environment. This growth in the number of operating banks brought a lot of pressure on the CBN in the conduct of its supervisory roles. The collapse of some of these new banks necessitated the establishment of the Nigerian Deposit Insurance Corporation. This was to complement the regulatory and supervisory role of the Central Bank of Nigeria.

The NDIC was established by Decree No. 22 of 15th June 1988 and took off in February 1989. It was set up principally to provide deposit insurance and related services for banks in order to promote confidence in the banking industry. It was empowered to examine the books and affairs of insured banks and other deposit taking financial institutions.

THE SECURITIES AND EXCHANGE COMMISSION

This regulatory organ for the capital market operation was formerly called Capital Issues Commission and was established by SEC Act of 27th September 1979 and further strengthened by SEC Decree of 1988.

It is the apex regulatory authority of the Capital Market and was established to promote an orderly and active capital market. The commission ensures adequate protection of the investing public as well as determines the prices and the time companies' securities are to be sold, the sales volume, registering all securities dealers to ensure professionalism. It is empowered to approve and regulate mergers and acquisitions and authorize the establishment of unit trusts as well as maintain surveillance over the market to enhance efficiency.

THE FEDERAL MINISTRY OF FINANCE

The Federal Ministry of Finance caters for the Federal Government's involvement in the financial system. The Ministry is primarily in charge of the fiscal policy of the Federal Government. It advises the Federal Government on its fiscal operations, which influence monetary policy. It cooperates with the CBN on monetary matters as well. The ministry had some responsibility for foreign exchange management prior to 1986 deregulation. This function is now performed solely by the CBN.

NATIONAL INSURANCE COMMISSION

At the apex of the Insurance sub-sector is the National Insurance Commission (NAICOM), which replaced the Nigerian Insurance Supervisory Board established by Decree No. 62 of 1992. NAICOM is responsible for effective administration, supervision, regulation and control of the business of Insurance in Nigeria. By law, it is expected to establish standards for the conduct of insurance business and protection of insurance policy holders. It ensures adequate capitalization and reserves, good management, high technical expertise and judicious fund placement in by the Insurance companies it supervises.

THE FEDERAL MORTGAGE BANK OF NIGERIA (FMBN)

This body is at the apex of mortgage financial institutions in the country. The FMBN was established by Decree No. 7 of 1977 and immediately took over the assets and liabilities of the Nigerian Building Society, which was performing the statutory regulatory role before then. The FMBN provides banking and advisory services and research activities pertaining to housing in Nigeria. It was empowered by the letters of the National Housing Policy in 1990 to license and regulate primary mortgage institutions in Nigeria and act as apex regulatory body for mortgage finance industry.

NATIONAL BOARD FOR COMMUNITY BANKS

The Board was established by government as apex regulatory body with the responsibility of licensing and supervising the activities of the community banks in the country. It was established in 1992 to accept and process applications from interested communities, provide guidelines for operations and ensuring compliance. The Board is expected to monitor, inspect and supervise the operations of Community Banks and applies sanctions when necessary.

It also carries out promotional activities for enlightenment purposes. Most of the above functions are now vested in the CBN and the Board is presently hamstrung to perform them due to this fact. Efforts are still being made to resolve the conflict arising from this duplication of regulatory functions.

FINANCIAL SERVICES COORDINATING COMMITTEE (FSCC)

This committee was established by the Federal Government to coordinate the supervision of activities of all the regulatory institutions in the financial system. It is chaired by the Governor of CBN, and consists of Director General of the Securities and Exchange Commission, the Commissioner for Insurance, the Registrar-General of the Corporate Affairs Commission (C.A.C), and a representative of the Federal Ministry of Finance, (FMF).

This committee is saddled with the responsibility of coordinating the supervision of financial institutions, especially conglomerates. It is expected to cause reduction of arbitrage opportunities usually created by differing regulation and supervision standards among supervisory authorities in the economy. This it does by creating a forum to discuss such conflicts without creating unnecessary tension in the system. The Committee also deliberates on problems experienced by members in their relationship with any financial institution. In so doing, it eliminates any information gap encountered by regulatory agencies in their relationship with groups of financial institutions. Finally, the committee articulates the strategies for the promotion of safe, sound and efficient practices by financial intermediaries. The roles are currently being performed satisfactorily as there are reduced conflicts between the financial system's regulatory authorities.

SECTION FOUR

THE FINANCIAL MARKETS AND INSTITUTIONS

MONEY MARKETS

The money market can be defined as a market for short-term debt instruments. The major function of this market is to facilitate the raising of short-term funds from surplus sector to the deficit sector of the economy. This is done through trading in short-term securities such as Treasury Bills, Treasury Certificates, Call Money, Certificates of Deposit, and Commercial Papers. The Central Bank of Nigeria further deepened the market with the commencement of its Open Market Operations activities.

MONEY MARKET INSTITUTIONS

The money market institutions are those institutions that participate actively in the markets. These institutions include Discount houses, Commercial and Merchant Banks as well as Community Banks.

THE CAPITAL MARKET

The Capital Market is a veritable channel for mobilizing long-term funds. The main institutions in the market include Securities and Exchange Commission, which is at the apex and serves as the regulatory authority of the market, the Nigerian Stock Exchange, the Issuing Houses and the Stock Broking Firms.

The Capital Market is classified into three. These are the Primary Market, which are markets for new issues of securities. The mode of offer for the securities traded in this market includes offer for subscription, right issues and private placements.

The Secondary Market is a market for trading in existing securities. It consists of exchanges and over-the-counter markets where securities are bought and sold after issuance in the primary market.

The Unit trust scheme is a mechanism for mobilizing the financial resources of small and big savers and managing such funds to achieve maximum returns with minimum risks through efficient portfolio diversification. It offers the advantages of low cost, liquidity and high returns.

The Nigerian Stock Exchange was established to provide facilities to the public for the purchase and sale of stocks and shares of any kind and the investment of money etc.

DEVELOPMENT FINANCE INSTITUTIONS.

These are specialized banks and development finance institutions established to contribute to the specific sectors of the economy. They include the Bank Of Industry (BOI), Nigerian Export-Import Bank (NEXIM), URBAN DEVELOPMENT BANK (UDB), Nigerian Agricultural and Rural Development Bank (NARDB) among others.

OTHER FINANCIAL INSTITUTIONS AND FUNDS

Other financial institutions and funds under the financial system include Insurance companies, Finance companies, Bureaux de Change, Primary Mortgage Institutions, The National Economic Reconstruction Fund (NERFUND), and the Nigerian Social Insurance Trust Fund (NSITF).

SECTION FIVE

CENTRAL BANK OF NIGERIA AND THE FINANCIAL SYSTEM

Central Banking refers to the role of a central monetary authority or an apex financial institution within the entire financial system. In Nigeria, the CBN performs the following roles among others:

FINANCIAL SECTOR SURVEILLANCE

CBN carries out a comprehensive surveillance of the financial system. It also develops a regulatory and supervisory framework for on-site and off-site supervision of the other financial institutions.

FOREIGN EXCHANGE MANAGEMENT

The Central Bank participates actively in buying and selling of forex. It has been very proactive in the interbank foreign exchange market.

LIQUIDITY MANAGEMENT

CBN has played very active role in this area and is expected to enhance the operations at the secondary market for government debt instruments through the introduction of a diversified portfolio of instruments.

MAINTENANCE OF MONETARY STABILITY

The role of CBN in ensuring macroeconomic stability is tied to the objective of achieving monetary stability.
This is only possible if the fiscal, income and other policies of government are supportive.

EFFICIENT PAYMENTS SYSTEM

An efficient payment system underlies the optimal utilization of resources, enhances implementation of monetary policies and maintains monetary stability.

These functions are unique and critical for national socio-economic development so much that they are usually provided for in the enabling legislation establishing the central bank.

The current legal framework within which the CBN operates is the CBN (amendment Decree No. 37 of 1998), which repealed Decree No. 3 of 1997.

SECTION SIX

CONCLUSION

Central Bank of Nigeria has remained dominant in the nation's financial system. The current and future challenges would undoubtedly require the Bank to be proactive so as to keep pace with developments in the industry.
Indeed, the world of central banking is one of variety of structures, functions and powers, which are in themselves by-products of the economic, political and other realities prevailing in the polity.

Furthermore, globalization makes it imperative for the Bank to adopt best practices to remain relevant and emerge as Best-In-Class.

REFERENCES

- G. O. Nwankwo (1980) The Nigerian Financial System.

- P.N.C. Okigbo (1981) Nigeria's Financial System.

- CBN Briefs: Research Dept. series No. 95/03, June 1995 - Monetary Policy in Nigeria.

- Odozi, V. A. - The Imperative of Economic Growth in Nigeria - The Nigerian Banker (Jan-June 2002).

- E. B. O. Akingbola - Strategies for Effective Management of Financial Institutions in the New Millennium (The Nigerian Banker - July-Dec 2001).

- Chief (Dr.) J. O. Sanusi - Nigeria Economy: Growth, Productivity and the role of Monetary Policy.

- Central Bank of Nigeria (2002) Monetary, Credit, Foreign Trade and Exchange Policy Guidelines for fiscal 2002/2003.

Financial System Regulation In Nigeria: *Theoretical Framework And Institutional Arrangements*

By

Job A. Olorunshola*

INTRODUCTION

The significance of finance and a virile financial system in the drive for economic growth and development is fairly well established and generally accepted. For instance, availability of adequate financial resources and regular acquisition in proper mix of the needed funds from alternative sources for investment purposes are part of derivable benefits from an efficient financial system.

A financial system is a conglomerate of various institutions, markets, instruments, and operators that interact within an economy to provide financial services. These services, among others, include resource mobilization and allocation; financial intermediation; and facilitation of foreign exchange transactions to boost international trade. In Nigeria, the financial system comprises the regulatory/supervisory authorities, banks and non-bank financial institutions. Over the years, the country's financial system has undergone remarkable changes in terms of ownership structure, the depth and breadth of instruments employed, the number of institutions established and the regulatory framework within which the system operates.

The financial system, the world over is heavily regulated and controlled by specialized agencies of the government to ensure that, generally, the sector is healthy, sound and supportive of the overall development of the economy. This paper therefore attempts to throw some lights on the theoretical framework and institutional arrangements for financial system regulation in Nigeria. In doing this, the paper is presented in four sections. Following this introduction, section II discusses the theoretical basis for regulating financial institutions while section III provides an overview of the institutional framework for the financial system regulation in Nigeria. Finally, the fourth

* **Mr. Olorunshola is an Assistant Director and Vice Principal (Academics), CBN Training Centre, Lagos.**

section highlights the major potential benefits and imperatives for an effective financial system regulation in Nigeria.

SOME THEORETICAL ISSUES ON REGULATION

The issue of whether or not government and its agencies should intervene in financial matter has been fairly treated in the literature. In particular, many economists, using Keynes' advocacy of direct active participation of government in the economy through "the invisible hand of the public sector" argue that regulation of the financial sector will not only strengthen the system, but will also enhance the flow of capital to the economy.

CONCEPTS AND DEFINITIONS:

Regulation is seen as a body of specific rules of agreed behavior either imposed by some government or implicit agreement within the industry that limits the activities and operations of financial institutions. The regulatory authorities may differ from one country to the other but the goal of promoting and ensuring efficient, safe and sound financial system is similar and paramount to them all.

Two main approaches to regulation of financial institutions, especially the non-bank financial institutions could be identified, namely, statutory regulation and self-regulation. Most financial systems have element of both. Statutory regulation is the type of regulation where the regulatory authorities i.e. Central Banks are responsible for the monitoring and enforcement of the operational guidelines while self-regulation is a case in which a federation of financial institutions in each category of business would be responsible for the monitoring and enforcement of compliance to operational guidelines.

WHY BANKS ARE REGULATED, SUPERVISED OR MONITORED

Nature of the Business of Banking:

Banks are perceived to be the most hazardous economic institutions known to man. They are intrinsically fragile and subject to the failure of human resolve under stress and temptation. Banks borrow from depositors with a promise to repay in full on demand, and they mostly invest those deposits in longer-term loans. If depositors all suddenly decide to withdraw their money at once, as their contract with the bank entitles them to, the bank cannot meet the demand for funds. It will fail.

Depositors might be induced to withdraw their money by fear that the bank might be in trouble. Once this fear starts, it becomes self-fulfilling, because if there is any doubt about the bank's safety, depositors have every reason to withdraw their cash: they lose nothing by doing so. If one bank is perceived to be in danger, other banks are likely to come under suspicion too. Bank runs, once they start, tend to spread.

The banking system is based on confidence and the failure of even a small bank can have significant and far-reaching effects on the economy. Bank failure could cause damage not just to depositors, but much more widely across the economy. Banks are needed, after all, not just for intermediation between lenders and borrowers but also to oil the economy. Unsound banking practices can have widespread repercussions, to the point of threatening the financial structure of the entire economy. If the banking system collapses, the infrastructure for making and receiving payments collapses too, and the rest of the economy will follow closely behind.

Governments have long understood this problem and solution has continuously being devised. To guard against runs, banks are carefully regulated, supervised and constantly monitored. For instance, banks are required to keep a certain minimum proportion of their assets in reserve; their lending policies are monitored; and restrictions are placed on the business banks can enter into.

Nature of the Main Banking Product:

The nature of the commodity of trade in the banking industry – money – is susceptible to change in response to, for instance, a rise in general wage levels, fluctuation in the business cycle, inflation and even government's monetary policy. Such factors can easily change both the volume and cost of money in circulation overnight. Unlike most other forms of business, banks are by their special nature compelled to sell their services on credit. Thus, the interplay of exogenous factors, in some cases, in the economy may adversely affect both the cost of sales (interest) and the commodity sold (principal loans), thereby rendering both partly or wholly irrecoverable.

Fiduciary Role of Banks:

As it is well known, loans and investments of licensed banks give rise to the creation of demand deposits, which make money supply. Thus, the quality of bank credit underlies the value of the Naira and this fact illustrates the need to ensure that the banking business is conducted in a safe and sound manner in order to maintain a high international value for the Naira. The increasing emphasis and responsibility that has recently devolved on licensed banks in the areas of interest and exchange rate determination, foreign exchange and external debt management also makes them subject to supervisory regulation and monitoring because of the special fiduciary role which the banks play on the economy.

Primary Regulatory Objectives:

The broad objectives of banking regulation and supervision are, therefore to:

1. prevent undue concentration of economic power and promote healthy competition in the financial system;

2. ensure a safe and sound financial system to safeguard the public against the worst consequences of instability;

3. encourage and promote a high level of operating efficiency and innovation in the financial system;
4. meet the needs of the public for conveniently available credit facilities and financial services;

5. enforce the implementation of government's monetary and credit policy guidelines; and

6. promote an equitable distribution of costs and benefits among the management, stakeholders, creditors, and customers of banks and other financial institutions.

NIGERIAN INSTITUTIONAL FRAMEWORK FOR FINANCIAL SYSTEM REGULATION

HISTORICAL ANTECEDENTS

Earlier, especially between 1960 and 1965, the supervision of banks was a shared responsibility between the CBN and the Federal Ministry of Finance (FMF). While the Bank handled off-site supervision, the Federal Ministry was in charge of on-site supervision. From 1966, however, the CBN took over the overall responsibility of banking supervision. Also, prior to the promulgation of the BOFI Decree (No. 25) in 1991, the Ministry was the approving authority of bank licences on the recommendation of the CBN. The entire responsibility of bank licensing was, however, reverted to the Bank from 1991.

TYPOLOGY OF INSTITUTIONS AND THEIR ROLES

Central Bank of Nigeria (CBN)

The BOFID brought the activities of a myriad of financial institutions under the CBN. For instance, the Decree empowers the Bank to issue guidelines to any person and any institution that engages in the provision of financial services as well as having the last say in formulating operating rules and codes of conduct. Also, the Bank is empowered under BOFID to undertake special investigations of these institutions if the Governor of CBN considers it necessary. These provisions of the BOFID and the CBN Decrees, therefore, give the Bank clear and substantial powers to regulate the activities of all financial institutions operating in the country.

Nigeria Deposit Insurance Corporation (NDIC)

Decree No. 22 of 1988 of deposit insurance and related services to banks in order to promote confidence in the banking industry established NDIC. To this end, the NDIC is empowered to examine the books and affairs of insured banks and other deposit-taking financial institutions.

Securities and Exchange Commission (SEC)

SEC was set up in 1979 by an Act as the apex regulatory organ of the country's capital market. The Companies and Allied Matters Decree of 1990 further empowers SEC to approve and regulate mergers and acquisitions and authorize the establishment of unit trust.

National Insurance Commission (NAICOM)

The National Insurance Commission (NAICOM), established in 1997, is the regulatory authority in the insurance industry. It replaced the National Insurance Supervisory Board (NISB), which was established by the Insurance Special Supervision Fund (Amendment) Decree No. 62 of 1992 to take over the regulation and supervision of insurance business from the FMF.

Federal Mortgage Bank of Nigeria (FMBN)

Federal Mortgage Bank of Nigeria was set up by Decree 7 of 1977.The adoption of National Housing Policy in 1990 and subsequently promulgation of Decree No 7 of 1991 empowered the bank to licence and regulate Primary mortgage institutions in Nigeria.

Financial Services Regulation Coordination Committee (FSRCC)

FSRCC was inaugurated in 1994 due to the emergence of many regulatory bodies in the nation's financial sector. The objective of FSRCC is to coordinate and standardize the regulatory policies of all financial institutions in the system under the chairmanship of the Governor of the CBN, with a view to evolving some cooperation among regulatory agencies.

SOME POTENTIAL BENEFITS OF FINANCIAL SYSTEM REGULATION

Some Potential Benefits of Efficient Regulation:

Among the many potential benefits of an efficient financial regulatory framework are to:

- Protect the depositors/investors;
- Promote monetary stability;
- Integrate the activities of the informal sector of the economy to harness their boundless economic potentials;
- Ensure a stable, efficient and coordinated payments system;
- Promote healthy competition among financial institutions;
- Ensure disclosure of adequate and correct financial information to users
- Reduce such undue financial intermediation risks as liquidity, credit, investment, interest rate and fraud risks;
- Ensure the safety and soundness of individual institutions and, by extension of the financial system; and
- Reduce unprofessional practices among practitioners and thereby promoting professionalism.

Some Critical Success Factors:

Evidence from the literature and advanced economies reveal that there are certain critical factors that propel an efficient financial regulatory framework from which Nigeria can take a cue. These include:

1. **Adequate Professionals**
   Adequate and well-trained professional regulators/examiners will ensure that there are no hideouts for operators as non-compliance and/or defaults will be detected early and remedial measures meted

promptly. Also, highly motivated examiners will be difficult to influence, thereby guaranteeing credible reports.

2. **Macroeconomic Stability**

Economic instability generates distortions which impede productive activities. For instance, foreign exchange rate misalignment boosts rent-seeking and black-marketeering activities of banks which put regulators on their toes. However, when major macroeconomic variables are consistently in desirable direction, productive activities are enhanced to boost investment and financial intermediation, with multiplier effects. Self-regulation is therefore engendered and the propensity to cut corners is reduced to the barest minimum.

3. Effective Coordination

No economy has ever been over-banked and Nigeria is no exception. In particular, the evolvement of other financial arrangements to take care of sector-specific peculiarities is largely in response to the need to fill gaps created by the rapid growth of economic activities and which the conventional banks could not by their nature cope with. The emerging and supplementary specialized banking and non-banking financial institutions are usually answerable to different regulators within the system which calls for high-level coordination for effect.

4. **Total Quality Management**

The adoption of total quality management principles, including customer-focusing and provision of zero-defect services by both regulated and the regulators will undoubtedly ease regulatory processes and promote efficient financial system.

5. **Supportive Infrastructures**

Financial regulation by nature is facilitated by availability of supportive infrastructural facilities, especially functional power supply and telecommunication networks. These facilities ease off-site examinations and by and large reduce cost of regulation.

CONCLUSION

To stem financial system failure and its debilitating effects on the economy, the sector is generally regulated in most economies. Besides, efficient regulatory framework generates some widespread beneficial effects. Consequently, all critical factors on which the success of the nation's financial regulatory efficiency hinge must be addressed decisively and on a continuous basis so as to boost overall development of the sector.

SELECTED REFERENCES

- Agene, C. E. (1995): “The Principles of Modern Banking”. Gene Publications, Abuja and Lagos.
- CBN Briefs (Various Issues).
- The Economist, October 18, 2003.
- Ojo, M. O. (2000): “Principles and Practice of Monetary Management in Nigeria”. Benjasprint Ltd.

Operational Requirements For Banking Supervision and Examination in Nigeria

By

Mr. Nwoha*

INTRODUCTION

The supervision and examination of banks are premised on the legal authority given by the provision of Sections 30-32 of BOFID 1991 as amended whereby the CBN Governor is given power to appoint a Director of Banking Supervision (DBS) with power to carry out supervisory duties in respect of banks and other financial institutions in the country. In carrying out this duty, the DBS shall among other things, under conditions of confidence, examine periodically the books and affairs of each bank, have a right of access at all times to the books, accounts and vouchers of banks, etc. In the exercise of the above power by the CBN Governor and in order to carry out the associated responsibility, the Banking Supervision Department was created in the CBN and charged with the responsibility. The operational requirements of the Department would then cover/include those things that would make it possible for the department to discharge its responsibilities.

BACKGROUND OF BANKING SUPERVISION AND BANK EXAMINATION DEPARTMENTS

Banking Supervision Department, until 1977, was known as the Bank Examination Department. The Department was established in 1959 as a Division of the Federal Ministry of Finance. It was transferred to the Central Bank of Nigeria, in January, 1966 and operated that year as a Division of the General Manager's Department.

The Department which was responsible for the supervision and examination of banks became autonomous from 1st January, 1967, incorporating the Scrutiny section which had existed in the Central Bank of Nigeria.

* **Mr. Nwoha is of the Banking Supervision Department, Central Bank of Nigeria**

Thus, from 1967 to 1976, Bank Examination Department consisted of two divisions – Bank Examination and Scrutiny. Following the recommendations of a firm of Management Consultants, Mckinsey International of USA, the Department was renamed Banking Supervision Department and restructured in 1977 into three divisions:

- Central Supervision
- Field Examination
- Financial Sector Development

Each of the Divisions was headed by a Deputy Director, while a Director was the Head of the Department.

The need for a thorough examination of banks' foreign exchange transactions necessitated the creation of the Foreign Exchange Inspectorate Division from the Field Examination Division in 1984. The Structural Adjustment Programme (SAP) introduced in 1986, amongst other things, focused on self-reliance. In consonance with the objectives of the SAP, the conditions for licensing of banks were liberalized. This liberal policy increased the number of banks significantly from 41 in 1986 to 120 in 1991. This sudden rise in number of Banks put a lot of pressure on the staff of the Department.

The Department was therefore split into two in April 1992 to enhance the effective supervision of banks. One Department retained the name Banking Supervision, while the other was named Bank Examination Department.

In 1993, the Other Financial Institutions Department (OFID) which started as a division in BSD was also approved to be a Department to regulate the increasing number of other financial institutions which came into the financial system in Nigeria following the embargo on banking licensing in 1991. Other financial institutions include finance companies, mortgage institutions, community banks, bureaux de change, etc. However, the Department did not take off until May 2001.

ORGANISATIONAL STRUCTURE OF BANKING SUPERVISION AND BANK EXAMINATION DEPARTMENTS

a) Banking Supervision Department

The Department had four Divisions, consisting of Prudential Analysis, Central Regulation, Surveillance and Other Financial Institutions. Each of these divisions was further subdivided into offices. The detailed structure of the offices and the various responsibilities being carried out are illustrated on the attached Appendix I.

b) Bank Examination Department

The Bank Examination Department (BED) undertakes the on-site examination of licensed banks and thereby complementing the work of the Banking Supervision Department which focuses on off-site analysis of the returns from these institutions.

Essentially therefore, the BED is charged with the responsibility of carrying out the physical examination of books, records and affairs of licensed banks and other financial institutions. Its functions are to ascertain the current condition of each bank in respect of the quality of its management structure, and quality of its assets, adequacy of capital in relation to the volume and characteristics of business, earnings, liquidity, level of the internal control system and record keeping, compliance with banking regulations and practices and also its viability as a going concern.

In order to enhance its effectiveness and operational efficiency, the organization structure of the department consisted of 4 divisions each headed by a Deputy Director, assisted by Assistant Directors. These included Commercial Banking, Merchant Banking, Foreign Exchange Inspectorate and Monitoring, Enforcement and Administration. The Department is headed by a Director.

However, following the World Bank/IMF recommendations and subsequently the recent restructuring of the Bank's activities through Project EAGLES, both Banking Supervision and Bank Examination Departments have adopted the team-based structure since year 2001.

Consequently, the Banking Supervision Department is currently made up of:

- 3 Groups, headed by Deputy Directors
- 9 Teams in addition to Administration and Training Office as well as the Bankers Committee and the Liaison Office in Lagos.

The Bank Examination Department, on the other hand, is made up of:

- 9 Groups
- 21 Teams in addition to the Liaison Office in Abuja

Basically, the functions of both departments had remained the same as in the former divisional and office arrangements – off-site and on-site surveillance of the banking system in Nigeria.

OPERATIONAL REQUIREMENTS

(i) Operational requirements can be seen from the activities the departments undertake and the type of regulatory reports required by the CBN to regulate the activities of banks as well as monitors the performance of banks based on the provisions of BOFID and the Monetary Policy Circulars.

The primary regulatory reports statutorily required by the BOFI include:

- Monthly, Quarterly and Semi-annual Reports
- Audited Annual Financial Statements, including audit reports
- Others Reports – e.g. insider related credits

Other Regulatory Requirements:

- Application for banking/discount house licences
- Application for branch expansion/closure and relocation
- Application for increases in paid-up capital
- Application for investments
- Contingency plan reports of banks, etc.
- Universal Banking Practice Guidelines
- Money Laundering/Terrorist Financing
- Know Your Customer (KYC) Principles

PURPOSE AND USE

It must be said that it is largely through the use of these documents that the Central Bank carries out one of its principal objects which is "to promote monetary stability and a sound financial structure" in Nigeria. Therefore, these reports serve to enable the CBN:

- through the Banking Supervision and Research Department receive meaningful information on a timely basis or promptly from the banks, the Stock Exchange and Other Financial Institutions so as to facilitate early detection of problems.

- to monitor compliance of these Institutions with the BOFID and the Monetary Policy Circulars.

- to perform its supervisory function of scrutinizing, analyzing and processing information on each institution;

- to control the structure and system of banking;

- to identify trends and developments in the banking industry;

The use of the regulatory reports and documents imposes certain responsibilities on the Banking Supervision and Bank Examination Departments. These include:-

- ascertaining the accuracy and timely delivery of the reports;

- ascertaining the compliance with legal and policy requirements by the banks;

- determining the adequacy of internal controls;

- relate, compile and submit reports;

- effect corrective actions where deficiencies are found;

- that reports are effectively coordinated and work papers properly kept to support compilation of information and to facilitate verification;

- raw data are verified by a person other than the one who initially compiled them or by a superior officer who did not take part in the compilation and verification.

SPECIFIC REPORTS – FORM MBR 300, ETC.

The authority of CBN, to demand these returns from the licensed banks and other financial institutions, derives from Sections 25(1)-(3) of the BOFID. MBR 300 is a format showing specified items of assets and liabilities which a licensed bank is required to submit monthly to CBN. MBR 500 & 600 are formats showing items on which a bank must report on its loans and advances also on monthly basis.

The returns must be submitted to the CBN not later than 10 days after the last day of each month – failing which a monetary penalty would be imposed.

EXAMINATION FUNCTION

It is the responsibility of the Banking Supervision Department to process the returning schedules. In this respect, the Department carries out the following duties:

- Preparation of summaries, tables and graphic representation of data obtained from statutory returns;
- Preparation of monthly liquidity and capital adequacy ratios and rating of banks;
- Maintenance of a "Black Book" for recording names of blacklisted members of the Board and Management of banks;
- Preparation of monthly reports on banks;
- Correspondence on the activities and queries arising from the operation of banks and financial institutions;
- Writing of quarterly/semi-annual/annual reports on the developments in the financial system;
- Maintenance and reconciliation of miscellaneous accounts, e.g. penalties.

APPLICATION FOR BANKING LICENCE AND LICENCE FOR NON-BANK FINANCIAL INSTITUTIONS

The procedure for applying for a banking licence is found in Section 3 and 57 respectively of the BOFIA. Any such application must be addressed to the Governor of the CBN for approval.

The application is processed by the Banking Supervision Department, CBN, and appropriate recommendation is made to the Governor.

Information called for in support of an application for a banking licence are:

a) feasibility report of the proposal;

b) the management structure and specified requirements for appointment to the Board and Management positions;

c) draft Memorandum and Articles of Association of the proposed bank;

d) the latest audited balance sheet (where the company was previously in existence and engaged in other businesses); and

e) evidence of payment of N2 billion minimum paid-up capital into CBN escrow account.

The documents are scrutinized with a view to determining:

(i) the stability of the funds for initial paid-up capital
(ii) the experience of the promoters in the proposed field;
(iii) the viability of the proposal;
(iv) the suitability of the appointments to the Board and management positions;
(v) satisfactory security clearance report from the State Security Services on the fit and proper test on major shareholders, Board and Top Management of banks;
(vi) the conformity of the provisions in the Memorandum and Articles of Association with the statutory requirements and banking conventions;
(vii) the financial ability of the applicant as determined from its balance sheet or other information about the proprietors to conduct a successful banking business.

Upon receipt of the recommendation from the Director, Banking Supervision Department, the Governor in consultation with the Committee of Governors would take a decision on the application.

APPLICATION TO OPEN A BRANCH OFFICE

The authority for this exercise derives from Section 6 of the BOFIA which stipulates that any licensed bank wishing to open (or close) a branch office must obtain the prior consent of the CBN in writing.

Any such application duly supported by detailed feasibility report received by CBN is processed by the BSD and appraised against the following main criteria:

- unsatisfied demand for banking services in the proposed area, as evidenced by the absence or inadequacy of banking facilities in the area;
- the non-representation of the bank in the proposed area;

- the capacity of the bank to cope with further expansion considering its free funds, capital adequacy, management effectiveness and availability of suitable staff.

The outcome of the appraisal will determine the authorization of such branch expansion.

Other Regulatory Requirements

a) Contingency Planning for Systemic Distress

In view of historic experience of financial distress in Nigeria, e.g. in the 1930s and 1990s when about 21 and 31 bank failures respectively were recorded, the CBN has put in place a framework for contingency planning for banking system crisis. This consists of a set of identified policies, actions and processes necessary for the prevention, management and containment of banking systemic crisis. Its implementation will induce sharpening of the supervisory process, inducing self-regulation among the banks and lowering the cost of crisis resolution and provide requisite advance consideration and agreements by all stakeholders.

The framework involved mainly:

- determining the financial condition of the banks; and
- determining the threshold for supervisory intervention in the following areas:
  - capital adequacy
  - liquidity
  - asset quality earnings
  - internal control

On the basis of the above, the CBN issued Guidelines for banks in developing their own contingency plans which must be submitted and approved by the CBN. The banks were expected to make specific plans for addressing deterioration in the underlisted parameters:

- Capital - Capital impairment
- Liquidity - Illiquidity
- Asset quality - Poor asset quality
- Earnings - Declining earnings
- Continuity of top management and board
- Management
- Information technology

b) Universal Banking Practice

The adoption of Universal Banking Practice in Nigeria in 2001 expanded the definition of banking business and ushered in a level-playing field for operators in the Nigerian banking system. Operators or banks are given the liberty to choose which area(s) of the financial services industry they wish to operate, depending on their core competence and available resources.

- Retail banking
- Capital market activities
- Insurance marketing services

Banks are, however, required to meet the regulatory requirements of the subsectoral regulators as follows:

-	Retail banking:	CBN
-	Capital market activities:	Securities & Exchange Commission
-	Insurance marketing services:	National Insurance Commission

c) Money Laundering/Terrorist Financing

In view of the adverse effects of the activities of money launderers on both national and global economies, Nigeria, like several other nations, put in place anti-money laundering laws to check the effects of the scourge. The Money Laundering Decree 3 was passed in 1995 and amended in 2002. The promulgation of this law has effects for the supervisory activities of the CBN over banks. In order to comply with the provision of the law, the CBN requires banks and other financial institutions to, among other things:

- Report cash transactions of N1 million and N5 million and above for individuals and corporate bodies respectively to the CBN as well as to report suspicious transactions of their customers.

- Appoint money laundering compliance officers in their head office, branches, cash centres and regional offices to monitor money laundering activities in their banks.

- Appoint chief money laundering compliance officer who should not be below the grade of a General Manager who will be responsible for enforcing the provisions of the Money Laundering Decree of 1995, as amended.

In the same way, terrorism has been identified to constitute a serious threat to financial sector growth and development. To stem the adverse effect of this scourge, the CBN has issued several circulars to the banks requiring them to confirm whether they operated bank accounts for identified terrorist individuals/groups.

d) Know Your Customer (KYC) Principle

In view of the incidence of reported criminal transactions in banks and other financial institutions emanating from both within and outside the country and consequently the need for the banks to avoid being used by criminal elements, the CBN had issued circulars to all banks emphasizing the need to have proper knowledge of their customers before establishing business relationships with them. The latest Know Your Customer Manual (KYC) which was issued to banks and other financial institutions required banks to:

(i) obtain sufficient identification evidence and verifying them before establishing business relationship;

(ii) take reasonable steps to update information on their customers from meetings/discussion and communication with customers and make same available to the Money Laundering Compliance Officer or even the regulatory authority; and

(iii) view identification evidence obtained at the outset against inherent risk in the business or service desired.

Obtaining sufficient information and making use of them enables a bank to:

- avoid being used to launder the proceeds of crime
- minimize the risk of being used for illicit activities.
- be protected against fraud, as well as reputation and financial risks.
- recognize suspicious activities.

Although those other regulatory requirements appear advisory, the Banking Supervision and Examination Departments monitor compliance with their provisions and may impose sanctions where necessary.

CONCLUSION

In conclusion, it must be emphasized that it is mainly the Banking Supervision and Bank Examination Departments that play the statutory role of the overall surveillance of the banking system in Nigeria. In carrying out the supervisory role, their operational requirements had usually been based on the provisions of the relevant laws, principal among which are CBN Act and BOFIA (as amended) and the monetary policy circulars which are issued by the Bank. However, the CBN also has the power to vary these requirements from time to time according to the dictates of the changing economic environment. Whatever the changes may be, at any time, the CBN Management always ensures that they are consistent with the Bank's fundamental objects of developing a stable and progressive banking/financial system through the effective supervision and control of the licensed banks and other financial institutions in Nigeria.

An Overview of the Regulatory Reports on Banks in Nigeria

By

Longe, A. A. (Mrs.)*

INTRODUCTION

1. There has been no consensus on the definition of the word 'bank'. Some writers traced its origin to the French word 'Banqui' and the Italian word 'Banca'.

   Chambers Universal Advanced Learners' Dictionary defines it as a place where money is lent or exchanged or put for safety and/or to acquire interest. Economists have also adduced various functional definitions to the word. In Crowther (1958) "the banker's business is to take the debits of other people and offer his own in exchange, and thus create money". Similarly, Kent (1961), defined 'bank' as an organisation which principal operations are concerned with the accumulation of the temporary idle money of the general public for the purpose of advancing it to others for expenditure. Sayers (1967) defined it thus: 'ordinary banking business consists of changing cash for bank deposits, and bank deposits for cash; transferring bank deposits from one person or corporation to another; giving bank deposits in exchange for bills of exchange, government bonds, the secured or unsecured promises of businessmen'.

2. The main aim of a bank is to make profit like any other business organisation. Profitability would guarantee long-term survival, enhance the value of the business and serve as a reward to the shareholders. The profit earning capacity of a bank, however, depends on the prudent combination of its assets and liabilities to meet the liquidity and solvency requirements imposed upon it by its environment, including the monetary and banking policies.

3. It is generally believed that the banking industry is unique because of its fundamental role of intermediation of funds between the surplus and deficit units in an economy. The provision of finance can retard

---

* **Longe, A. A. (Mrs.) is the Deputy Director, Bank Examination Dept., CBN – Lagos.**

economic development if it is repressed, or stimulate it, if it is liberalised.

Central banks depend upon the industry for the successful implementation of its monetary policy in keeping with the requirements of a developing economy. Banks are, however, vulnerable to financial crisis, hence, the industry is driven or heavily dependent on the sustained confidence of the public. In addition to the existence of prudential regulations to which the industry is subjected, every bank should employ adequate strategy to minimise both the risks and costs of failure.

4. Banking activities started in Nigeria in 1892 with the establishment of the African Banking Corporation which was absorbed in 1894 by Bank of British West Africa (now known as First Bank of Nigeria Plc). Apart from Colonial Bank, (now known as Union Bank of Nigeria Plc), several other banks, especially indigenous banks that were established during the mushrooming period (1925 to 1929) closed down almost as soon as they were established. Similarly, between 1923 and 1945 as well as during the banking boom period of 1950 and 1951, several banks were either voluntarily wound-up or closed down by the police due to insufficient capital, poor management, poor record-keeping, rapid expansion of offices, illiquidity, fraudulent directors, reckless and imprudent lending, and absence of banking regulations to specify their code of conduct. Bank failures are undesirable, as they weaken public confidence in the banking system, create problems for the economy, including sudden contraction of money supply, disruption of the payment system through breaking of already established credit lines, severance of client relationship, individual losses and contagion effect. It was on the basis of the recommendations of Panton Commission of 1946 that the first banking legislation in Nigeria, viz the Banking Ordinance, 1952 was promulgated. The Ordinance set out the rules and regulations to guide banking activities in Nigeria. It provided for minimum paid-up capital, maintenance of adequate liquidity and statutory reserve funds, imposition of credit ceilings, and the examination and supervision of banks.

Outline of the Paper

5. This paper is focused on the regulatory reports from the perspective of the Bank Examination Department. Thus, the rest of the paper is

organized as follows: Part one deals with the historical background of Bank Examination Department; part two discusses the definition, objectives and types of examination; part three deals with bank examination procedure while part four contains the concluding remarks.

PART 1: HISTORICAL BACKGROUND

6. Prior to the establishment of the CBN in 1959, the banking supervision function was performed exclusively by the Federal Ministry of Finance (FMF). The Scrutiny Section of the Ministry was responsible for off-site examination of banks and other financial institutions while its Banking Examination Department was charged with the responsibility for on-site examination of those institutions.

7. The Scrutiny Section was transferred to the CBN when it commenced operations in July, 1959, while the Banking Examination Department continued to reside in the FMF. The Department was also later transferred to the CBN. Within the structure of the CBN the Scrutiny Section and the Banking Examination Department were merged and placed under the General Manager's Department. The two units (i.e. the Scrutiny Section and the Banking Examination Dept.) later metamorphosed into an autonomous Bank Examination Department within the CBN in January, 1967.

8 The Bank Examination Department of the CBN was later renamed Banking Supervision Department and restructured into three divisions viz:

- Supervision
- Field Examination and
- Financial Sector Development.

9. In 1984, in its resolve to stem the foreign exchange malpractices amongst Authorized Dealers, the Management of the CBN established a fourth Division in the Department called Foreign Exchange Inspectorate Division.

10. Following, the adoption of the Structural Adjustment Program (SAP) in 1986, a liberalised bank licensing policy was adopted and this led to a rapid increase in the number of licensed banks. Moreover, the promulgation of the Banks and Other Financial Institutions (BOFI)

Act No. 25 of 1991 as amended brought the supervision/regulation of other financial institutions under the purview of the CBN. These developments led to a phenomenal increase in the enormity and complexity of supervisory/regulatory challenges facing the CBN, in general and the Banking Supervision Department in particular.

11. In 1992, the Banking Supervision Department was split into two autonomous departments namely; Banking Supervision Department and Bank Examination Department.

12. In recent times, the supervisory function of the CBN was further re-structured into three Departments namely;
    - Bank Supervision Department.
    - Bank Examination Department
    - Other Financial Institutions Department

13. On-site examination relates to the physical examination of the books, records and affairs of a bank so as to generate information that would reveal the ability of the bank to meet the demands of its depositors and creditors. Such an examination would also appraise the competence of its management and compliance with the laws, rules and regulations as well as its viability as a going concern.

THE NEED FOR THE BANK EXAMINATION FUNCTION

14. The banking sector is by far the most regulated sector of the Nigerian economy. Over the years, many have questioned the rationale for subjecting the affairs of banks to the exclusion of those of other forms of business organisations to such in-dept scrutiny. The answers lie in the following factors:

    - Banking business differs from other forms of business in that banks intermediate between the surplus and the deficit units of the economy. In performing this function, they are entrusted with public funds and those of other corporate entities and are responsible for the management and safety of such funds.

    - Banks influence the volume of money in circulation through the process of granting credit facilities.

    - Banks are the principal sources of finance for the industrial and commercial sectors of the economy. The ability/inability to perform this function, to a large extent has a profound effect on the development of the economy.

- The fortune or otherwise of one bank has far reaching implications for the entire banking system.

I will now attempt to give you an overview of our examination reports.

PART II: DEFINITION, OBJECTIVES AND TYPES OF EXAMINATION

15. Bank Examination may be defined as the examination of the books, records and affairs of a bank with a view to ascertaining its condition as at a particular date.

OBJECTIVES OF BANK EXAMINATION

16. Some of the objectives of on-site examination are as follows:
    - to adequately assess the consistency of the policies formulated by the Board of the bank and executed by its Management with the bank's stated objectives.
    - to examine the sources and uses of funds
    - to appraise the income and expenditure
    - to assess the adequacy, effectiveness and efficiency of the internal control system with a view to preventing frauds and forgeries.

    The overall objective of bank examination is to foster and maintain a sound financial system. Therefore, the Examiner appraises the quality of its policies, practices and procedures with a view to initiating/recommending corrective measures to prevent any adverse situations on the individual bank in particular and the banking system as a whole.

TYPES OF EXAMINATION

17. The Bank Examination Department, in performing its functions conducts four types of examinations viz:

- Maiden Examination
- Routine Examination
- Target Examination
- Special Examination

18. A Maiden Examination is conducted within the first six months of the commencement of operations. The main objective of a maiden examination is to ascertain that the bank's operations are conducted in a manner that is consistent with the conditions stipulated in its operating licence and that the bank is guided on the right path from its inception. A maiden examination also seeks to ascertain the safety of a bank's assets and soundness of its policies and practices.

19. A routine examination of a bank is conducted once in a year.

20. Special examinations are conducted when:
    - it is in the public interest to do so;
    - the bank has been carrying on its business in a manner detrimental to the interest of its depositors and creditors, or
    - the bank has insufficient assets to cover its liabilities to the public, or
    - the bank has been contravening the provisions of the BOFIA., or
    - an application is made by:
        (i) a director or shareholder of the bank, or
        (ii) a depositor or creditor of the bank.

21. As its name suggests, a Target Examination is targeted at evaluating the risk assets of a bank with a view to determining the adequacy or otherwise of its capital. Its main objective is to guide the Banking Supervision Department in appraising a bank's annual accounts. It also seeks to trigger a warning where problems are being anticipated.

PART III: BANK EXAMINATION PROCEDURE

PRE-EXAMINATION PREPARATIONS

22. Prior to the commencement of the examination of a bank, approval of the Governor of the CBN is obtained for the exercise to be conducted as at a specified date. The Bank Examination Department (BED)

constitutes a team of Examiners headed by a sufficiently experienced and knowledgeable officer. For large banks, two or more supporting teams could be formed to complement the efforts of the lead team. A team, on the average, comprises 8 - 10 Bank Examiners.

23. After the Governor's approval, the Team Leader proceeds to BSD, TED and FOD of the CBN to read the bank's file, obtain their IFEM winnings, interest repatriation records and copies of relevant circulars. The team leader then prepares a schedule of duty. Thereafter, team members carry out a thorough review of previous examination reports, correspondence, statistics and periodic returns sent to the CBN by the bank and compile the points for discussion with the bank's Management Team.

FIELD WORK

24. The fieldwork commences with a pre-examination discussion with the bank's top management team usually led by the MD/CEO and the CBN Examiners led by a representative of the Director, Bank Examination Department. The discussion covers, among others, criticisms and recommendations in the previous Examination Reports, which had not yet been rectified/implemented.

25. In recent times, a Routine Examination involves the examination of all the facets of the bank's operations. The steps highlighted below are normally carried out simultaneously by the members of the team.

OWNERSHIP STRUCTURE

26. In appraising the ownership structure of a bank, the Examiner verifies the Form CO2 (particulars of shareholders) and matches it with the share register. Variances are noted for rectification.

BOARD/MANAGEMENT/STAFF

BOARD OF DIRECTORS

27. The Board of Directors is responsible for:
- the formulation of the objectives and policies of the bank.
- the effective supervision of its affairs, including the appointment and removal of top Management.

28. For the purpose of assessing the role of the Board, the Examiner is guided by the materials available in the Minutes Book and also the papers and reports presented to the Board during meetings, the laid down policies and the decisions taken. The Minutes Book is perused thoroughly to determine:

(i) Changes if any, in the membership of the Board of Directors since the previous examination and the reasons thereof and whether CBN's approval was duly obtained;

(ii) Whether the Board is dominated by any one person or group;

(iii) Whether the policies made by the Directors are in the best interest of the bank;

(iv) Whether meetings are held regularly and well attended;

(v) Whether the Board unduly interferes in the day-to-day running of the bank as opposed to policy formulation, planning, budgeting and review of performance and whether in that process, important items are unnecessarily deferred.

(vi) Whether the credit proposals or other important matters required to be placed before the Board are circulated well in advance to the Directors.

MANAGEMENT

29. The success or failure of any business organisation, particularly a banking institution, depends to a very large extent, on the quality of its management. In this case, the management hierarchy consists of Board of Directors, the Chief Executive and his management Team. The Board Committees are similarly appraised against their terms of reference.

THE CHIEF EXECUTIVE

30. Since the success of a bank depends largely on the initiative, efficiency and effectiveness of its Chief Executive in developing its business, the Examiner ensures that:

(a) the powers vested in the Chief Executive are reasonable and are being properly exercised.

(b) there is no interference from the Board of Directors and that he does not take advantage of the Board's indifference to appropriate to himself power in excess of those allotted him.

(c) He also ascertains the degree of control the Chief Executive exercises over his staff.

PERSONNEL

31. The Examiner

- appraises the recruitment policy of the bank as it affects the calibre of staff engaged;
- determines whether the staff possess requisite qualifications for the effective performance of their functions;
- determines whether or not necessary references on prospective staff were obtained before engagement;
- appraises the functions and efficiency of Management Committees, and
- evaluates the training programme of the bank and determines their adequacy or otherwise.

ORGANISATIONAL STRUCTURE

32. The Examiner obtains the organisational structure of the bank and critically appraises the following:

- The distribution of responsibilities, line of communication and job description and notes any overlapping of functions that can generate conflicts.
- The relationship between the Inspection Department and the Chief Executive to ensure that the inspection department has a direct reporting relationship with the CEO.
- The relationship between the Executive Management and the Board.
- The Examiner also ensures that the Board receives and reviews Inspection reports at regular intervals.
- The relationship between the executive management and the board with a view to determining:
    - ♦ The effectiveness of management in carrying out the Board decisions;
    - ♦ The arrangement for management succession; and

- ♦ Any adverse effects of the chief executive's absence on the bank's operation.

INSPECTION/INTERNAL CONTROL

33. The Inspectorate Department of a bank represents a vital weapon of the management in monitoring the proper implementation of its policies at all levels.

34. In appraising the inspection/Internal control, the Bank Examiner ascertains:
    - (i) The staff strength of the Inspectorate Department
    - (ii) Caliber of staff-experience, academic/professional qualifications.
    - (iii) The scope of the inspection reports to determine its adequacy in content and coverage.
    - (iv) The frequency of inspection of each function.
    - (v) The comprehensiveness of inspection reports and adequacy of follow-up actions with regard to the irregularities noted in the reports:
    - (vi) The independence of the Chief Inspector; and
    - (vii) Management support or otherwise (in its reactions) for Inspector's reports by examining memoranda in the correspondence file between the inspectorate Unit and the Management.

35. Below are some important internal control arrangements which banks should be encouraged to adopt:
    - Separation of duties
    - Dual Control
    - Rotation of Employees
    - Compulsory Vacation

FRAUD AND FORGERIES

36. The Examiner should demand for the fraud file and assess the frequency, style, extent of staff involvement and find out whether frauds are being reported to the Central Bank on monthly basis. From the available records, the amount of potential losses arising there-from and for which provision should be made, should be determined.

ACCOUNTING SYSTEM AND RECORDS

37. The Examiner:

a) determines the accuracy and reliability of the bank's accounting system and record keeping;

b) requests for a copy of the monthly statement of assets and liabilities, Form MBR 300;

c) checks every item in the statement into the general ledger which could be in form of computer print-out;

d) checks every item in the monthly statement of profit and loss into the general ledger;

e) satisfies himself that no irregularities exist and where they exist, notes them in his working papers for eventual reporting;

f) checks the balancing of the current account ledgers;

g) checks the balancing of savings account ledgers;

h) takes note of long outstanding items in inter-branch accounts and obtains explanations about steps the bank intends to take to eliminate the long outstanding items;

i) obtains explanations for impersonal ledger account with long outstanding items;

j) obtains explanations for outstanding cases of fraud and forgery and takes note of weaknesses in the system that made frauds and forgeries possible;

k) test-checks the commission on turn-over, interest paid on savings accounts and other charges as stipulated in the Bankers Tariff;

l) analyses the deposit trend and structure;

m) checks if both local and foreign bank reconciliation statements are being prepared regularly.

RECONCILIATION OF BALANCE SHEET TO THE MBR 300

38. The Examiner reconciles the Balance Sheet to the monthly bank return to ensure that the two documents agree or note any differences.

REMITTANCE OF VALUE ADDED TAX AND DUTY COLLECTIONS

39. The Examiner identifies:
    a) Cases of non-remittance of VAT and customs duty within the stipulated 7 days, and if not, whether the amount was included in the bank's deposit base for the purpose of computing its cash reserve requirement (CRR).
    b) He determines the interest, which the defaulting bank would pay.

INFORMATION TECHNOLOGY SYSTEM

40. The Examiner should briefly comment on the application software and operating system; describe the exceptions noted in the management, operations, programming and data integrity of the system.

CREDIT ADMINISTRATION/RISK ASSETS QUALITY

41. The Examiner reviews the following areas:
    (i) the bank's credit policy, its adequacy or otherwise;
    (ii) exercise of credit judgment by the bank;
    (iii) failure to establish or enforce repayment programme;
    (iv) management's failure to evaluate credit information of financial statement;
    (v) any observed overemphasis on income;
    (vi) cases of technical incompetence on the part of bank's staff;
    (vii) incidence of concentration of credits; and
    (viii) ensure that weak facilities are classified in line with the provisions of the Prudential Guidelines as either:
        a) substandard;
        b) doubtful; or
        c) lost

        while general provision is made on performing facilities.

OTHER ASSETS

42. An age analysis of these accounts is performed and the fictitious assets amongst them are classified substandard, doubtful or lost and appropriate provisions applied.

OFF-BALANCE SHEET ENGAGEMENTS: (Contingent Liabilities)

43. The Examiner highlights:
    - The breakdown of off-Balance Sheet items;
    - The level of Off Balance Sheet items to total assets;
    - The level of accounting records; and
    - Determine the extent of loss a bank may likely sustain by considering:
        - the Date the Liability was incurred;
        - the Expiry Date;
        - the Security Pledged;
        - the Performance of other facilities (if any) being enjoyed by the customer e.g. Loans and Advances; and
        - the Perceived Risk.

DEPOSITS/LIQUIDITY

44. The Examiner should check:
    - changes in total deposits;
    - changes by each category of deposits
    - prospects – considering current level;
    - check match or mismatch of deposits.

KNOW YOUR CUSTOMER (KYC) PRINCIPLE

45. In the interest of transparency in financial transactions, banks should determine the true identity of all the customers requiring their services in accordance with CBN circular Ref BSD/DO/CIR/V.1/01/24 of 28/11/2001. Regulatory reports comments will, among others, highlight cases where:
    - accounts are kept in anonymous or obviously fictitious names;
    - proof of incorporation of corporate bodies are not verified with the Companies Affairs Commission (CAC);
    - the identity and authority of any person purporting to act on behalf of any customer is not verified;

- information on the true identity of the persons on whose behalf an account is opened or transaction is conducted is not obtained;
- records are not maintained for a minimum period of 10 years after cessation of any relationship with any customer;
- the sources of funds of any politically exposed person are not investigated before the person is accepted as a customer;
- special attention is not paid to complex and unusually large transactions through recording in writing and examination;
- there are weaknesses in the application of effective customer identification procedures and on-going monitoring standards for telephone and electronic banking customers;
- the bank fails to undertake regular reviews of existing records of customers especially when there is a material change in the conduct of the account.

SMALL AND MEDIUM INDUSTRIES EQUITY INVESTMENT SCHEME (SMIEIS)

46. Regulatory reports would highlight, among other issues:
    - whether a bank has set aside 10% of its pre-tax profit;
    - whether a wholesome procedure was adopted in identifying, guiding and nurturing enterprises to be financed under the scheme
    - whether pretax profit was invested in the equity of relevant industry under the scheme;
    - whether the bank renders returns to the CBN.

INCOME AND EXPENDITURE

47. The Examiner checks:
    - changes in income and expenditure in total, and component of each item;
    - income and expenditure trend and level of provision;
    - effects of Net Income/Loss on overall operation of the bank;
    - dividend payment – trends.

CAPITAL

48. In appraising the capital of any bank, the Examiner:

- ensures that the bank's paid-up capital is in line with the prescribed minimum of N1 billion for existing banks and N2 billion for new banks;
- notes any changes and causes of the change(s);
- appraises the adequacy of the capital for the bank's volume of operations and ensures that it accords with regulatory limits.

FOREIGN EXCHANGE OPERATIONS

49. The Foreign Exchange Operations examination report contains the Examiner's comments on the bank's:
    - Volume of operation;
    - Whether the bank's established open position as computed from its statement of sources and application of forex agrees with its approved limit and FEM Nostro accounts aggregate balance;
    - Record keeping lapses;
    - Non compliance with laws and regulations on interest repatriation and distribution;
    - Interest repatriation and distribution;
    - Rendition of returns on customers who defaulted in submission of their customs bill of entry within 90 days after negotiation.
    - Non rendition of returns on interbank transactions;
    - Weaknesses in Internal Controls (confirmation of CRI and other key foreign exchange documents);
    - Nostro Accounts and Reconciliation.

MONEY LAUNDERING SURVEILLANCE

50. The money laundering surveillance measures examination captures comments on:
    - inaccurate or non-rendition of returns on International transfers in excess of US$10,000.
    - inaccurate or non-rendition of returns on Local transactions in excess of N1 million and N5 million for individuals and corporate bodies respectively;
    - non-inclusion of money laundering training in its training programmes;
    - non-incorporation of money laundering in its audit programme and non-conduct of money laundering compliance audit;
    - lack of money laundering compliant officer at the bank's branches;

- failure to display conspicuously, the notice affirming the bank's obligations to report transactions of certain magnitude to the Regulatory Authorities under the MLA as amended.

EXIT DISCUSSION

51. Having concluded the examination of the bank's operations, all major findings are discussed with the bank's Management Team in the presence of its External Auditors. This affords the bank's Management Team a unique opportunity to put things in the correct perspective and minimize possible areas of controversy.

ISSUANCE OF THE REPORT

52. The examination report is sent to the Deputy Governor (Financial Sector Surveillance) of the CBN who vets and forwards it with a covering letter to the MD/CEO and Chairman, directing the bank to convene, within four weeks of the receipt of the Report, a meeting of the Board of Directors for the purpose of presenting the Examination Report before the Board. A copy of the Report is also sent to the bank's External Auditors who are also invited to the Board meeting.

At the end of the presentation which is normally led by the Director of Bank Examination or his representative, the Board is expected to forward its detailed comments on the various issues raised in the Report within two weeks of the Board meeting. Thereafter, a follow-up Team visits the bank to confirm compliance with the directives/recommendation.

PART IV: CONCLUDING REMARKS

53. Despite the frequency of examination, some general problems which could lead to distress and failure of banks persist. These problems include illiquidity, poor asset quality, lack of transparency, inadequate capital, Board and management squabbles, insider abuse, frauds and forgeries, foreign exchange abuse, poor record keeping, non-compliance with the laws, rules and regulations, and deliberate setting aside of Examiners' recommendations.

It is hoped that the shift from the present approach of compliance examination to a risk-focused approach would go a long way in resolving most of these problems.

Thank you all.

Financial System Surveillance:
The Operators Perspective

By

Godwin Emefiele[*]

The chambers Dictionary defines surveillance as a watch kept over someone or something or vigilant supervision by an authority.

Financial System Surveillance can be defined therefore as monitoring of operations/activities of the financial industry operators by the regulators to ensure compliance with standards, ethical rules and industry best practices aimed at avoiding instability and financial distress in the system.

In other words, the monitors are expected to perform the function of a watchdog with a view to ensuring the integrity and the development of the financial system.

REGULATORY/SURVEILLANCE AUTHORITIES IN THE NIGERIAN FINANCIAL SYSTEM AND THEIR FUNCTIONS/ ROLES

The following authorities had been set up by law to monitor the Nigeria financial system in line with the various mandates given to them:

1. **The Central Bank of Nigeria (CBN),** which monitors activities of all banks in the system and co-ordinates the overall monetary policies of the country.

2. **The Nigerian Deposit Insurance Corporation (NDIC)** has the responsibility of ensuring the safety of insured depositors' money with the banks.

3. **The Nigerian Drug Law Enforcement Agency (NDLEA)** has the function of monitoring activities of financial institutions both locally and abroad with a view to preventing money laundering.

---

[*] **Godwin Emefiele is the Deputy Managing Director Zenith Bank Limited**

4. **Securities and Exchange Commission (SEC),** in pursuant to Investment and Securities Act (ISA) of 1999 regulates the capital market to ensure that operators conform to capital market rules and regulations.

5. **Nigerian Stock Exchange (NSE)** Quoted financial institutions must also subject themselves to stock exchange rules and regulations which include monitoring the information and reports presented to investors.

6. **External Auditors** who have the responsibility of ensuring that financial statements of companies as reported are fairly stated and prepared in line with generally accepted accounting standards.

7. **Economic and Financial Crimes Commission** which derives its powers from the EFCC Act (2003) and has the responsibility for identifying and prosecuting perpetrators of all economic and financial crimes in the country.

8. **National Insurance Commission (NAICOM)** by virtue of the Insurance Act of 2003 has the overall responsibility for regulating the insurance industry which is part of the financial system.

WEAKNESSES OF THE NIGERIAN FINANCIAL SYSTEM:

Like any other financial system, the Nigerian Financial System has a number of weaknesses and limitations, key among these are:

(a) Weak corporate governance practices, which have adversely affected the Nigerian Financial System and businesses. Prominent amongst weak corporate governance practices is insider abuses through bad/unpaid loans by financial system operators.

(b) Inability of operators to develop strong internal control systems to protect customers and businesses to forestall instability. This has often times resulted in the large-scale fraud being perpetrated by fraudsters.

(c) Non-compliance with established rules guiding financial system operators. In Nigeria, the financial system is regulated by certain laws namely: BOFI ACT, NDIC ACT, NDLEA, EFCC ACT, ISA etc. Experience has shown that operators have flagrantly worked against these laws meant to protect their businesses.

(d) Inadequate training for staff and management, hence their inability to imbibe the requisite skills in a changing world of globalization.

(e) Inexperience on the part of operators arising from the explosion in the number of financial institutions and the concomitant thinning down of breathe of management.

(f) General decay in the moral and ethical ethos of the Nigerian society.

THE IMPERATIVE FOR SURVEILLANCE ON THE FINANCIAL SYSTEM IN NIGERIA

The fact that the financial system operators are human and therefore, have their limitations, makes it imperative that impartial external bodies should check their activities so as to ensure compliance with laid-down rules and regulations.

The following are some of the compelling reasons for surveillance on the financial system:

(a) To avoid the huge costs associated with financial distress/instability. The loss of depositors' funds as well as its negative effects on the economy constitute great cost, which must be avoided through effective surveillance.

(b) Increased pressure from international community and international monitoring organisations concerning business due diligence particularly as it affects Financial Action Task Force Regulators (FATF), money laundering activities, etc.

(c) The need for quality control and to maintain uniform standards and the best practices.

(d) High Country Risks arising from pervasive frauds and forgeries. The activities of fraudsters particularly through 419 have also constituted great embarrassment to the country hence a great need for surveillance.

(e) Inability of operators to show commitment towards the doctrine of Know Your Customer (KYC), particularly regarding account opening documentation and other business dealings.

(f) Non-adherence by management and staff to code of ethics and professionalism, as enunciated by the Bankers Committee and such other bodies that set standards.

Arising from the foregoing weaknesses in the financial system and of the operators, there is an enormous challenge on the part of Regulatory Institutions charged with the responsibility of surveillance of any financial system, particularly in Nigeria.

HISTORICAL PERSPECTIVE: THE CHALLENGE OF FINANCIAL SYSTEM SURVEILLANCE

As a result of the increasing sophistication of fraud and forgeries, particularly given the weaknesses highlighted above on the part of operators, the regulators have a great role to play in regulating the financial system so as to avoid financial crisis with its huge associated cost.

ILLUSTRATION: THE BARINGS DEBACLE

The collapse of Britain's Barings bank in February 1995 is not only the quintessential tale of financial risk management gone wrong, but also a failure of internal control system. The failure was completely unexpected, but could have been avoided if surveillance was strong. Over a course of days, the bank went from apparent strength to bankruptcy. Barings was Britain's oldest merchant bank. It had financed the Napoleonic wars, the Louisiana purchase, and the Erie Canal. Barings was the Queen's bank but it failed. What really drew the world attention was the fact that the failure was caused by the actions of a single trader based at a small office in Singapore.

ISSUES OF CONCERN IN THE BARINGS' DEBACLE:

- ♦ Nick Leeson was a young man aged 28 years.
- ♦ He was not sufficiently grounded in the business and responsibilities entrusted in him by his bank.
- ♦ Leeson wore MULTIPLE HATS: He combined the responsibility of the GM with Head Trader, and Head of Back Office/Operations. Such arrangement should have rung alarm bells but no one within

Barings' Senior Management seemed to notice the blatant conflict of interest.

- Leeson took unauthorised, speculative positions primarily in futures linked to the Nikkei 225.
- Leeson accumulated staggering losses due to wrong positions taken, and senior management did not notice it due to poor segregation of duties and lack of supervision.
- To pay for the losses, Leeson falsified accounts and made various misrepresentations to secure funding from within Barings Organisation without senior management noticing it.
- Again, management and board of directors should be considered as very weak.
- There was no risk management function in Singapore. Only London, Tokyo and Hong Kong had the department in 1994.
- Leeson had no single supervisor within the Barings organisation. He was the key man as well as the operator.

The main lessons from the above are two folds:

- The collapse of internal control in the oldest Merchant Bank in U.K. (223 years old). By extension, it is also a failure on the part of the Bank of England for not having the right tools to carry out an effective surveillance of the U.K. Banking system.
- The sole activity of Nick Leeson, a staff in one arm of Barings Bank (Singapore) resulted in the collapse of the bank. There are lots of parallels that can be drawn in various cases of collapsed/liquidated or sanctioned banks in Nigeria.

ENRON:

Closely related to the Barings case is the Enron case. Enron was an Energy trading company, once hailed as a pioneer for the creation of new markets. It is now, the subject of lengthy congressional investigations in the United States of America. However, the striking clues about what really happened to Enron boarders primarily on bad Corporate Governance.

CONCLUSION/RECOMMENDATIONS

To avoid the pitfalls highlighted in Barings and Enron, regulators of the Nigerian Financial System must play active surveillance roles through:

- Constant on-site and off-site inspection to identify problems with a view to nipping such problems in the bud.

- Insist that internal control systems of operators are strong enough to identify red signals.

- Hold management and board of operator institutions responsible for breaches of laid-down standards, ethics and regulations that could precipitate failure and by extension financial system distress.

- Regulators must continue to conduct surveillance of the Financial System with the primary aim of identifying emerging trends and potential vulnerabilities. This should be with a view to compelling operators to adopt international best practices in risk management and corporate governance in the Financial System.

- Since self-regulation remains the best form of regulation, it is imperative that the surveillance/regulatory authorities thoroughly screen applicants for licenses to operate/run financial institutions whether as owners or managers to avoid a situation whereby ill qualified and even dishonest people are given licences to own and run financial institutions.

- Our legal system should be such that violators are punished and justice is seen to be done in good time. Also, there may be need for specialized courts to quickly dispose of cases related to the financial system and its operations.

- The need for the surveillance authorities themselves to invest in the best people and the best technology so as to keep pace with the sophistication and complexities of the financial system. It is only a surveillance officer with a sound knowledge of computer that can effectively monitor an operator whose operations are fully computerized and wholly information technology driven. The regulators must be able to attract the best and brightest people if they will be effective in their surveillance activities.

The Constraints and Prospects of Effective Financial Surveillance in Nigeria

By

I. U. Kama*

INTRODUCTION

The topic, "Constraints and Prospects of Effective Financial Surveillance in Nigeria" appears to be very wide. In the circumstance, the discussion in this paper will focus largely on the constraints and prospects of effective regulation and supervision of banks and other financial institutions.

PURPOSE OF SURVEILLANCE/SUPERVISION

Safety and Soundness of the Financial System

The need to regulate/supervise banks and other financial institutions cannot be over-emphasized. Although banks and other financial institutions have profit motive and the operators make profit related decisions in their daily operations, financial services have generally been viewed as a matter of public interest. Consequently, in recognition of the systemic implications of economic and financial crisis which may occur in a financial system, regulatory and supervisory initiatives must be taken to promote the safety and soundness of financial markets, institutions and products.

Efficient and Competitive Financial System

One aspect of a good financial system is that customers are provided quality services at competitive prices. One of the purposes of financial services regulation, therefore, is to create a regulatory framework that encourages efficiency and competition. Efficiency is defined as getting the greatest production from a given set of resources. Competition is a vehicle for achieving this efficiency since, in a competitive financial system, banks and other financial institutions are forced to operate efficiently if they are to keep their customers and remain in business. Without such competition, individual banks and other financial institutions might attempt to gain higher prices for

---

* **I. U. Kama is an Assistant Director, Banking Supervision Dept., Central Bank Of Nigeria**

their services by restricting output or colluding with other institutions. Competition and efficiency depend on the number of banks and other financial institutions operating in the market, the freedom of entry and the ability to achieve an appropriate size to serve the customers.

Protection of Depositors:

One of the basic reasons for regulating financial institutions, with particular reference to banks is depositor protection. The need for protection arises as the public begins making financial transactions through banks and corporate entities and individuals increasingly begin to deposit significant portion of their funds in banks.

Banking poses a number of unique problems for customers and creditors. Many customers may only want to make payments and carry out other financial transactions through a bank. To do so, they must maintain deposit accounts. As a consequence bank customers assume the position of bank creditors and become linked with the fortunes of the bank. This contrasts with most other retail businesses, where customers simply pay for goods or services and never become creditors of the firm. In some cases, banks adopt hazardous strategies against their customers in order to achieve short-term advantages. It is therefore through regulation/ supervision that banks' excesses can be curbed and the customers will also have all or part of their deposits insured implicitly or explicitly.

CONSTRAINTS TO EFFECTIVE SUPERVISION/ SURVEILLANCE

Banks and financial institutions regulators/supervisors have been facing a lot of challenges in monitoring the institutions under their purview. Despite several actions already taken by the regulatory authorities to lay a solid foundation and engender credibility in the Nigerian financial system, apprehensions have been expressed at different fora by concerned individuals and groups about the soundness and safety of the financial sector. The apprehensions are attributable to the lack of proper understanding of what regulation is all about and lack of adequate information on the part of the customers on the institutions they are dealing with. Some factors have however been identified as constraints to effective supervision. They include, but not limited to the following:

- poor corporate governance on the part of the operators;
- inability of regulators and some operators to cope with the pace of technological innovations;

- unprofessional and unethical practices among the management and staff of banks and other financial institutions;
- lack of transparency in dealing with regulators often reflected in the rendition of false or unreliable returns and non-compliance with existing laws/guidelines/circulars;
- inadequate capacity building;
- inadequate legal framework; and
- the problem of supervising financial conglomerates.

PROSPECTS

With the above-listed constraints, one may wish to know whether the situation in Nigeria is beyond the capabilities of the regulatory authorities. The heartwarming response is that the regulatory authorities are already shaping a brighter future for effective supervision.

The supervisory initiatives in place, both at the domestic and international levels, are indications that regulators have been proactive and determined to adopt best supervisory practices to achieve the objectives of supervision. Some of the initiatives are highlighted below:

SUPERVISION OF FINANCIAL CONGLOMERATES

Financial Services Regulation Co-ordinating Committee (FSRCC):

At the domestic level, the Central Bank of Nigeria facilitated the establishment of the Financial Services Regulation Co-ordinating Committee (FSRCC) in 1994 as one of the steps to address the problem of supervision of financial conglomerates. This is a forum for collaborative efforts among supervisory authorities in Nigeria to ensure co-ordinated supervision of the Financial Services Industry.

Membership of the FSRCC are drawn from the key regulatory and supervisory institutions in the nation's financial system, namely: Central Bank of Nigeria (Chairman), Securities & Exchange Commission (SEC), National Insurance Commission (NAICOM), Corporate Affairs Commission (CAC) and the Federal Ministry of Finance. Specifically, the Committee is charged with the responsibility of co-ordinated supervision of financial institutions especially conglomerates; reduction of arbitrage opportunities usually created by differing regulation and supervision standards amongst supervisory authorities in the economy; deliberations on problems experienced by any member in its relationship with any financial institution;

elimination of information gaps encountered by any regulatory agency in its relationship with any group of financial institutions; and articulation of strategies for the promotion of safe, sound and efficient practices by financial intermediaries.

The Core Principles for Effective Supervision

At the international level, the Basel Committee in its resolve to put in place a measure for effective supervision world-wide, issued the 25 Core Principles for Effective Banking Supervision. The core principles covered:

- Precondition for effective banking supervision;
- Licensing and structure;
- Prudential Regulations and Requirements;
- Methods of on-going Banking Supervision;
- Information Requirements;
- Formal Powers of supervisors; and
- Cross-Border Banking.

The IMF/World Bank Mission monitors the degree of implementation of the Principles by member countries. Regulators in Nigeria stand to gain from the rich experiences of the Mission through its monitoring efforts and corrective measures especially in the area of best international practices.

OTHER MEASURES TO PROMOTE EFFECTIVE SUPERVISION

Risk-Based Supervision

In order to effectively monitor the risks to which financial institutions are exposed, it is imperative that the focus of regulation should shift from compliance issues to a risk-based supervisory framework. Supervisors will have to maintain closer and regular contact with the institutions under their purview in order to make informed judgments of their conditions. The major risks faced by financial institutions include Credit Risk, Market Risk, Liquidity Risk, Operational Risk, Contagion Risk and Reputational Risk. Various steps have been taken by the regulatory agencies to facilitate the shift to the risk-based approach.

Recently (June 2003), the CBN/NDIC and the Financial Services Authority from the United Kingdom (U.K.), organized Banking Supervision Course for Bank Regulators/Supervisors to enhance regulators/supervisors knowledge on the risk-based supervision known as Risk Assessment Tools of

Supervision and Evaluation (RATE). Consolidated Supervision, Internal Controls and Problem Bank Resolution, among others. The risk based approach is one of the measures taken to strengthen efficient and effective supervision.

CAPACITY BUILDING

It is imperative that both the Regulators and staff of financial institutions are properly trained for their assignments and must be numerate and computer literate. As more and more financial institutions, especially banks, engage in business process re-engineering, there would be need for re-training and up-grading of Information Technology (IT) infrastructure, while electronic banking requires different skills from the ones used for the handling of paper-based transactions.

The Regulatory Authorities have vigorously pursued the issue of capacity building including the procurement of equipments to enhance capacity building. The steps taken, if sustained, will go a long way to reduce the problem of poor technological advancement and innovation.

Given that the regulators cannot, at all times, be physically present at financial institutions, the desirability of self-regulation has been advocated. The regulatory authorities would confer recognition on Self-Regulating Organizations (SROS) and provide the enabling environment to perform the specified functions. Self-Regulation requires high ethical standard, probity and transparency from market participants. Through this approach, the problem of unethical and unprofessional practices will be minimized as operators would be expected to honestly address issues within their institutions.

THE FRAMEWORK FOR CONTINGENCY PLANNING FOR BANKING SYSTEMIC CRISIS:

In December 2001, the CBN and the NDIC put in place the framework on contingency planning for systemic crisis for the Nigerian banking system, in line with best practices in other jurisdictions. The CBN/NDIC adopted the Toronto Leadership Forum's definition of systemic crisis as "… those situations where the solvency and/or liquidity of many or most of the banks have suffered shocks that have shaken public confidence."

Details of the contingency plan had been circulated to banks for their guidance and implementation while the regulatory authorities continue to monitor and take appropriate actions when desirable. This is one of the underlining measures for effective supervision in Nigeria.

THE NEW CAPITAL ACCORD

The need for a New Accord arose from the identified weaknesses of the 1998 Accord as well as the need for more flexibility and sensitivity. Among other weaknesses, the 1998 accord focused on a single risk measure – the credit risk, while the new accord expanded the scope to include bank-level management supervision and market discipline. The New Capital Accord consists of three mutually reinforcing pillars, namely, the minimum capital requirement, supervisory review and market discipline. Various committees had been set up by the regulatory authorities in Nigeria not only to begin a sensitization programme, but also to ensure the adoption and implementation of the Accord at the target date of 2006. The overall objective of the accord is to provide a spectrum of approaches for the measurement of both credit and operational risks in determining the capital requirements of a bank. It is also a step forward to enhance efficiency in supervision.

CONCLUSION

In concluding this paper, I wish to summarize as follows:

- Objectives of regulating/supervising financial institutions include the promotion of safety and soundness of financial markets, institutions and products as well as consumer protection.

- There are several constraining factors to Effective Supervision, some of which are outside the powers of the regulatory authorities. The factors include poor corporate governance, poor technological infrastructure, unprofessional and unethical practices, inadequate capacity building, inadequate legal framework and inability of both regulators and operators to keep pace with best international practices.

- Despite the constraining factors, solid foundation has been laid for effective supervision. One of the internationally accepted measures for effective supervision/surveillance is the degree of implementation of the Basel Committee 25 Core Principles of supervision among member countries.

- The emergence of various regulatory agencies and financial conglomerates underscores the need for consolidated supervision as well as co-operation and co-ordination of supervisory activities within Nigeria and on cross border basis. In this connection, there is need for strengthening the Financial Services Regulation Co-ordinating Committee (FSRCC) as well as faithful implementation of the 25 Core Principles for effective supervision.

- Supervisory Authorities have continued to facilitate the implementation of the risk-based approaches.

- Regulators have continued to attach utmost priority to capacity building by continuously up-grading the skills of their staff.

- The existence of good corporate governance in financial institutions would facilitate effective supervision.

- Prospects of effective supervision in Nigeria is high for the following reasons:

    - ♦ Various measures for more effective supervision have been adopted including the risk-based approach, the contingency planning for Banking Systemic crisis and the efforts to effectively supervise financial conglomerates through the Financial Services Regulation Co-ordinating Committee.

    - ♦ In addition, the Central Bank of Nigeria and the Nigeria Deposit Insurance Corporation (NDIC), through the CBN/NDIC Executive Committee on Supervision have been meeting from time to time to deliberate on regulatory/supervisory issues with a view to enhancing effective supervision in Nigeria. The measures put in place both of the international and domestic levels coupled with the unrelenting efforts of regulators, will go a long way towards achieving effective and sustainable supervision in Nigeria.

Thank you for your attention.

REFERENCES

- Banking Regulation, its purpose, implementation and effects, Third Edition by Kenneth Spong, Federal Reserve Bank of Kansas City, 1990.

- Bullion, July/September 1998; CBN Publication.

- Banking Supervision Annual Reports, Central Bank of Nigeria, 2000 and 2001 Publications.

- The Supervision of Cross-Border Banking – Reports by a working group comprising members of the Basle Committee on Banking Supervision and the Off-shore Group of Banking Supervisors, Basle, October 1996.

- Welcome address by Chief (Dr.) J.O. Sanusi (CON), Governor, Central bank of Nigeria, delivered on the occasion of the National Workshop on "Repositioning the Nigerian Financial Markets for Competitiveness in the 21 "Century", organized by the Financial Services Regulation Co-ordinating Committee (FSRCC) at YAR'ADUA Centre, Abuja, June 24 – 26, 2002.

- Keynote Address by Dr. Shamsuddeen Usman, Deputy Governor (FSS), Central Bank of Nigeria, at the opening ceremony of the Banking Supervision Course for Bank Regulators/Supervisors, organized by CBN/NDIC and Financial Services Authority at NICON Hilton Hotel, Abuja, June 23, 2003.

The Peculiarities and Challenges for the Surveillance of Non-bank Financial Institutions

By

E. A. Esezobor*

INTRODUCTION

I thank the management of this Training Centre for the privilege to be part of this important programme.

Apart from the opportunity to facilitate in the programme, the realisation that the authorities of Central Bank of Nigeria (CBN) would also create room to hear from outside banking practitioners on the subject of their everyday concern, gives me strong confidence that the financial system inclusive of non-bank financial institutions are under close monitor and thus, in safe regulatory hands.

In this paper, we shall examine who qualifies as a non- bank financial institution, the regulatory institutions, the peculiarities and challenges of keeping a watchful eye on the sub-sector.

Thus, by the time we are done with this paper, participants should be versed in:-

- The non-bank financial institutions.
- The necessity for surveillance of the sub-sector.
- The statutory regulatory institutions.
- The peculiarities of each member of the sub-sector.
- The challenges for successful surveillance.

NON-BANK FINANCIAL INSTITUTIONS

With the adoption of universal banking in Nigeria from January, 2001, non-bank financial institutions easily stand out as financial intermediaries in specialist sectors but who are not allowed to combine the traditional retail

* **E. A. Esezobor, B.Sc. (Hons), M.Sc., FCIB. Is the Director, Membership and Education, The Chartered Institute of Bankers of Nigeria**

banking function, insurance marketing services and capital market transactions as their lines of business.

According to Nwankwo, G. O. (1985), the following mark out non-bank financial institutions which he also described as financial intermediaries:

- Nearly all their deposit liabilities are fixed for specified periods unlike banks which have short-term deposits repayable on demand.

- Unlike banks that enjoy free funds in current account, all the deposits of non-bank financial institutions attract interest.

- While banks maintain the liquidity principle in banking, the non-bank financial institutions must match their credits against their deposit profile.

- Banks, especially commercial banks, offer retail banking through a network of branches while non-bank financial institutions maintain unit offices or limited branch offices and concentrate on corporate customers in their wholesale services.

- Non-bank financial institutions are specialist lenders in the different sectors of the economy e.g. primary mortgage institutions lend for owner-occupied properties while finance companies and community banks lend for consumer credits structured on installmental repayment.

- Largely, the non-bank financial institutions do not operate current accounts. Customers are therefore expected to, first of all, withdraw their funds, a process called purification, before making payment unlike the privilege of issuing cheques in a current account in conventional banks.

Although some of the non-bank financial institutions bear the word ‘bank’ as part of their name, they are not banks in the real sense of the word because their licensing is not within the provision of section 2 of Banks and Other Financial Institutions Act, 1991 under which, banks are usually licensed. By their functions, they are limited to specified sectors of the economy unlike universal banks that have no limitations. Emphatically, they have no access to the clearing house hence they must negotiate with a Participating Bank in the Nigeria Automated Clearing System to clear their cheques.

With the exception of development finance institutions who are statutorily created and insurance companies who tap their roots from National Insurance Commission (NAICOM), all others must pass the screening test of CBN before creation. At this juncture, it is appropriate to identify the non-bank financial institutions in Nigeria which the Banking Annual Report, 2001 simply lists as:

- Community Banks
- Primary Mortgage Institutions
- Finance Companies
- Bureaux de Change

To these four must be added three other important non-bank financial institutions, such as:

- Development Finance Institutions
- Discount Houses
- Insurance Companies

NEED FOR SURVEILLANCE

The financial system in any economy constitutes the engine room for sustainable growth. It is public confidence that oils the financial system. In order to achieve the latter, government must through its accredited agencies, evolve and review a cocktail of policies from time to time. The main agency of government in the surveillance of the financial system is CBN which was empowered by CBN Act no. 24 of 1991 and Banks and Other Financial Institutions Act (BOFIA) no. 25 of same year.

In promoting and maintaining a sound financial system, CBN takes responsibility for the creation of most of the financial institutions and possibly, supervising them to grave, so to say. Key cradle issues like adequate capital base, fit and proper persons to be in management, workable organization structure must be addressed amongst other things before the operating license is issued to any financial institution. While CBN, as the apex of the financial system, maintains the supervisory control of it, the Nigeria Deposit Insurance Corporation complements the function of protecting depositors and help to promote confidence in banking system through the deposit insurance scheme.

Included in the surveillance team for the financial system are the Securities and Exchange Commission (SEC) for the capital market sub-sector and NAICOM for the insurance sub-sector. The Federal Ministry of Finance as the government organ charged with the enunciation and implementation of fiscal policies also has some influence on monetary policies.

All regulators, including Corporate Affairs Commission constitute the Financial Services Regulation Co-ordinating Committee (FSRCC) who co-ordinate the supervision of the financial institutions in accordance with section 38A of CBN Act no. 24 of 1991.

In a way too, the Banking and Currency Committee of the Senate keeps an eye on the financial system and can summon any person or group of persons to account for a financial event of public interest.

Having licensed an institution to undertake financial business, CBN through guidelines, circulars, visitations and returns keeps surveillance on the financial system to achieve the following purposes:

- to ensure that operational laws and guidelines are complied with;
- to protect the interest of savers; and
- to ensure that professional and ethical issues are upheld in the way
- business is done.

In achieving these broad objectives, CBN must keep tab on all financial institutions including the non-bank financial intermediaries. The supervision should instill public confidence so that no financial institution is allowed to exploit the public or in the extreme case, fail as a surprise with far-reaching consequences on private savings and public confidence.

THE PECULIARITIES OF SURVEILLANCE OF THE NON-BANK FINANCIAL INSTITUTIONS

Non-bank financial institutions have individual peculiarities as follows:

Community Banks (CBs)

CBN conceived and facilitated the setting up of CBs which came on stream in 1991. The Presidency thereafter took over the control through the National Board for Community Banks (NBCB). Rightly, CBs have since come under the surveillance and control of CBN for effective monetary policy management.

Although BOFIA had been amended, NBCB was not repealed. Their role for now, appears advisory. CBN in a circular letter no. BSD/SURV 6/5/Vol.V/66 of November, 1999 mandated CBs to raise their minimum capital from N3 million to N5 million, latest 31st August, 2001. Of the 1,013 CBs licensed, only 747 were found in operation as at 30th. November, 2001. The rest, 266 or 26% were either inactive or had closed shop. On the level of compliance with the new capital requirement, the following table emerged:

Summary of the Minimum Paid-up Capital of CBs as at November, 2001

Paid-up Capital	No. of CBS	%
5 million and above	133	13
3 million – 4.99 million	385	38
Below 3 million	495	49
Total	**1,013**	**100**

Summary of Recommendations

Sch.	Recommended Action	1st. Insp.	2nd. Insp.	Total	%
1.	For licensing	232	50	282	28
2.	Given 6 months to rectify weakness	391	74	465	46
3.	Provisional license to be withdrawn	147	119	266	26
	Total	**770**	**243**	**1013**	**100**

Source: CBN Banking Supervision Annual Report, 2001.

The appeal by NBCB to extend the deadline for compliance with the new capital requirement to 31st December, 2003 was accepted by CBN.

The inspection reports of October, 2000 and November, 2001 showed that the major problems of CBs were two-fold:

Inadequate Capitalisation which was not helped with the requirement of the Community Banking Act that restricts the maximum shareholding of an individual to 5% while 30% of the shares must be held by the Community Development Association (Town Union). Even when the new capital had been raised, the problem of accumulated losses over the years which eroded shareholders' fund had to be addressed.

Poor Management Team made up of unqualified, inexperienced and mostly retrenched staff of distressed banks. The facilities to operate efficiently were hardly ever available.

Primary Mortgage Institutions (PMIs)

Now hardly noticeable in the financial landscape, it was the real thing in the early 90s. Then, the licensing was done by Federal Ministry of Works and Housing (FMWH), as it was called while Federal Mortgage Bank undertook the regulation.

The national budget speech of 1997 transferred the responsibilities of licensing and supervision to CBN. However, BOFIA was not amended to repeal the powers of FMWH and FMB.

Set up primarily to provide funding for owner-occupied property, the old capital of N20 million with time, became grossly inadequate. The directive to raise the capital to N100 million was communicated in a circular letter no. BSD/OFID/PMI/Vol.1/75 of September, 1999 with a compliance deadline of 31st. August, 2001 The capital verification exercise carried out by CBN in October and November, 2001 showed the following development:-

<u>Summary of Findings From Capital Verification Exercise</u>

Category	Findings	No. of PMIs	%
A	Those with paid-up capital of N100 million and above	15	19
B	Those that had asset swap for shares	5	6
C	Those with concrete capitalisation plans	34	44
D	Those that are in existence but unconfirmed capital position	14	18
E	Those no longer in mortgage business	6	8
F	Those that have closed shop	4	5
	Total	78	100

Source: CBN Banking Supervision Annual Report, 2001.

Under item B above, operators of PMIs indulged in capital contribution in kind which clearly contravened one of the conditions for the increase in the minimum paid-up capital.

The appeal by Mortgage Banking Association of Nigeria to extend the deadline for compliance with the new capital requirement to 31st. December, 2003 was also accepted by CBN.

Finance Companies (FCs)

Finance companies are expected to operate in the money market.

By circular letter no. BSD/ofid/Vol.1/99 of April, 1999, all finance companies were mandated to increase their minimum capital from N5 million to N20 million, latest 30th August, 2001. In raising the capital, they were cautioned against capitalisation through either assets revaluation or capital contribution in kind.

It is a matter of interest that because of the huge number and geographical spread of FCs, the confirmation of compliance with this circular posed an operational problem of supervision to CBN as at the time of their report for year 2001.

Many of the finance companies operated at the upper end of risk taking especially in credit approvals and merchandising and in the process, burnt their fingers. The smart alecs amongst the operators found a way out to trade both in the money and capital markets by adopting titles like 'Finance and Investment' along with their names. In the event of the money market aspect, 'Finance', failing, they switched immediately to the capital market business, 'Investment'. CBN no longer accepts such clever names. Those who did it in the past, were told to revert to their core business.

Bureaux de Change (BDC)

Although in small holdings, they perform the vital function of exchange of foreign currencies and travellers cheques.

Until CBN circular letter no. BSD/CR/4/99 of September, 1999 which gave them up to 31st August, 2001 to have a minimum capital of N10 million, they operated freely with whatever capital they could raise.

In recent times, they were granted the freedom to sell travellers cheques. They are expected to meet the minimum capital requirement before contracting with Travellers Worldwide, the supplier of travellers cheques, for regular supplies.

The operators would need a great deal of training to develop their confidence, knowledge, skill and attitude for the challenges of competing with universal banks in the handling of foreign currencies and travellers cheques. It is hardly necessary to add that for a long time, many of the operators were not educated beyond the use of simple calculators for conversion.

The verification exercise by CBN to non-bank financial institutions could not cover their activities before the Banking Supervision Annual Report for 2001 was published. It will be interesting to know how effective their level of compliance is, not only with the minimum capital requirement but on the quality of monthly returns which the Foreign Exchange Instructions Manual mandate.

Development Finance Institutions (DFIs)

They are sub-sector institutions statutorily created to solve finance problems and gaps in their respective sub-sectors.

The two main DFIs are Bank of Industry (BOI) and Nigerian Agricultural, Co-operative and Rural Development Bank (NACRDB). BOI is an amalgam of the former Nigerian Industrial Development Bank, the Nigerian Bank for Commerce and Industry and National Economic Reconstruction Fund (NERFUND). NACRDB, on the other hand, emerged from the ashes of Peoples Bank of Nigeria, the Nigerian Agricultural, Co-operative and Rural Development Bank and Family Economic Advancement Programme (FEAP). To the two, could be added the proposed Nigerian National Mortgage Bank (NinamBank), a merger of Federal Mortgage Bank of Nigeria (FMBN) and Federal Mortgage Finance Ltd. (FMFL). NinamBank is expected to accelerate housing development and enhance the implementation of a property development company for site identification, appraisal and approval of projects.

These various mergers became expedient in 2000 in order to give the new institutions better focus on their functions, which under the old order, appeared to overlap. While BOI provides financial and advisory services to enterprises, NACRDB undertakes commercial development banking functions. NinamBank will engage only in wholesale and retail mortgage business.

Discount Houses (DHs)

CBN's Guidelines for Discount Houses dated 27th December, 1991 when the operational groundwork for the innovation was being laid, defined DHs as:

> *'any financial institutions in Nigeria who transact a discount business which in the main, consists of trading in and holding of treasury bills, commercial bills and other securities and whose operations are in the opinion of the CBN those of a discount house*.'

With only 3 at inception in 1993, two others joined in 1995 and 1996. Their business is highly geared hence the Guidelines allowed a ratio of 50:1 between borrowed funds and shareholders' funds.

The Guidelines also restrict them to the money market in facilitating the business in government securities and acting as intermediaries between CBN and banks. They also provide portfolio and funds management services.

In view of their restricted lines of operation, they rank least in terms of difficulties of surveillance to CBN. However, in recent times, the operators have been kicking to be allowed to:-

Operate in the capital market in the issuing and underwriting of public and corporate instruments.

Lead the way in the futures and options markets which are still not developed in Nigeria.

Wholly or partly underwrite treasury bills issued by the government through CBN. Generally, operate as universal banks.

Insurance Companies

They are as old as banks in the country. They operate under the Insurance Act of 1991 and are supervised by NAICOM.

Without doubt, taking the statistics of the registered insurance companies, brokerage firms and re-insurance companies as well as regulating their activities, is a mouthful for NAICOM.

The chance to get integrated into the financial system with the coming of universal banking was stoutly resisted by the operators and NAICOM who saw the move as a surreptitious way to subordinate them to CBN as the lead regulator of universal banking. The sub-sector too is noted for quacks who are smart to get business but far-fetched in honouring commitments.

Obviously, the entry of banks into the sub-sector has far-reaching implications for capacity building in the areas of manpower and infrastructure, which will make the sub-sector better and more competitive.

CHALLENGES OF SURVEILLANCE OF NON-BANK FINANCIAL INSTITUTIONS

All the issues in supervision highlighted in the Banking Supervision Annual Report, 2001 also affect non-bank financial institutions in varying degrees. In view of this reservation, we may only itemize the issues as follows:

- The habit by banks in procuring foreign loans for on-lending with the attendant risks on gearing and foreign debt management.
- Staff poaching and the need to develop a sustainable tempo of training and staff development.
- Proliferation of soft wares which makes standardization of operation and monitoring, difficult.
- Multiple directorship in banks and the necessity to eliminate conflict of interest and guard against arbitrage practice by institutions with common interests.
- The importance of responsible auditing by external auditors and collaboration with bank inspectors.
- Effects of economic crimes in the financial industry and the bandwagon reputational and operational risks caused.

For the regulators, especially CBN that has to keep tab on all the banks, discount houses, finance companies, primary mortgage institutions, bureaux de change, community banks and development finance institutions along with effectively conducting business in other areas of their operation, they need to build and review capacity regularly. Qualified and experienced hands must respectively be recruited fresh from higher institutions of learning and from the financial industry. The requisite surveillance equipment money can buy from anywhere in the globe must be obtained and put at their disposal in sufficient quantities.

Having been here a couple of times to facilitate in programmes, I am satisfied that training and manpower development is in the front burner of the Bank's management. The efforts of the Training Centre should be supported with programmed 'shop floor training' and regular attachments of greyhounds to the on-site and off-site teams for development. Overseas training is good for morale and exposure to techniques adopted in other countries in surveillance and monetary control. Regulators, including self-regulating agencies like

The Chartered Institute of Bankers and Financial Institutions Training Centre should step up training programmes for non-bank financial institutions.

Accommodation always seems a problem to CBN and should not surprise anybody who understands the enormity of his or her responsibilities. The mammoth office complex under construction in Abuja will go a long way in solving this problem. Branch Offices of CBN in state capitals may have to be beefed up with skeletal representatives of the various departments including, Banking Supervision, Bank Examination and Other Financial Institutions Departments.

Staff emoluments should keep pace with what is prevailing in the banking industry. The experience of the time past when staff salaries in CBN were almost same as the civil service should never be allowed to re-occur because both jobs are different with also, different risk levels.

There is a strong wind of ethical revolution sweeping across the banking and finance industry. Originating from CBN, the stakes must be maintained in order to enthrone uprightness in the way business is done. Any allegation of bribe, 'settlement', or conflicting interests in the midst of regulators must be thoroughly investigated and visited with appropriate disciplinary action.

The regulators under the aegis of FSRCC should programme visiting the members of conglomerates in a fell swoop. This will help to expose executive malpractices and also stem in the bud, the problem of contagion among them. Regular meetings of FSRCC will help regulators to share information and devise proactive measures to cope with the challenges of regulating a huge financial market like Nigeria.

CONCLUSION

If things are done properly as and when due by operators of non-bank financial institutions, surveillance will be a light job essentially to correct mistakes. Unfortunately, surveillance is seen in Nigeria as something vindictive and a ploy to run persons down.

Perhaps, CBN will need to do more enlightenment to operators in the banking and finance sector generally, on the subject so that the relationship will be that of co-operation in the overall interest of the country. Sanctions should be de-emphasised except in chronic cases of infractions.

I sincerely thank you for listening.

REFERENCES

- Adegbite, M. A. Challenges Facing Nigerian Discount Houses in The Medium To Long Term. The Nigerian Banker, January- June, 2001.

- Central Bank of Nigeria Banking Supervision Annual Report, 2001.

- Ibid, Bullion, Volume 27, No. 1, January/March, 2003.

- Ibid, Foreign Exchange Instructions Manual, Trade and Exchange Department, 1995.

- Esezobor, E. A. Ethical and Professional Imperatives in the Implementation of Nigeria Automated Clearing System. Paper delivered at the Seminar on Nigeria Automated Clearing System organised by CBN Training Centre on 28th.August, 2003.

- Hayatu-Deen, M. Monetary and Financial Management of the Economy in year, 2001: Expectations of Banks. Paper delivered at the National Workshop on Monetary and Financial Policies Management organised by CIBN, 31st January, 2001.

- Nwankwo, G.O. Basic Economics for West African Students, Cambridge University Press, Cambridge, 1985.

- Ojo, M. O. Reflections on some Critical Aspects of Economic Management in Nigeria. Presidential Address delivered during the Annual Conference of the Nigerian Economic Society, Lagos, 6-9, June, 1995.

The Bankers' Committee Code of Ethics and Professionalism in the Banking and Finance Industry, 2001.

Official Safety-nets for the Nigerian Financial System: *The Role of the Nigeria Deposit Insurance System*

By

G. A. Ogunleye (OFR)[*]

INTRODUCTION

The role of banks in economic development has been richly articulated in the literature. Pioneer contribution of Schumpeter (1934) was of the view that financial institutions are necessary condition for economic development. This view has been variously corroborated by other scholars like Goldsmith (1969), Cameron et al (1972) and Patrick (1966). In view of the importance of the banking sector in economic development, bank failures are widely regarded in all countries as more damaging to the economy than failures of other types of firms. For instance, bank failures may produce losses to depositors and other creditors, break long-standing bank - customer loan relationships, disrupt the payments system and spill over in a domino fashion to other banks, financial institutions and markets, and even to the entire macro-economy (Kaufman, 1996).

The foregoing is often a popular justification for government - provided safety nets (Kaufman & Senlig, 2000). A deposit insurance scheme (DIS) is one of the components of the official safety-nets. The other components of the official safety-nets are effective supervision and lender-of-last-resort facility by a central bank through the provision of temporary liquidity support to solvent depository institutions. Essentially, a bank deposit insurance scheme (DIS), is a financial guarantee to depositors, particularly the small ones, in the event of a bank failure. Bank deposit insurance schemes developed out of the need to protect depositors, especially the uninformed, from the risk of loss; and to also protect the banking system from instability occasioned by runs and loss of confidence.

The practice of the DIS in Nigeria commenced with the promulgation of Decree 22 of 1988, which established the Nigeria Deposit Insurance

[*] **G. A. Ogunleye (OFR), is the Managing Director/Chief Executive Officer, Nigeria Deposit Insurance Corporation.**

Corporation (NDIC), the Agency vested with the responsibility of implementing the scheme in the country. The NDIC commenced operations in March 1989. The scheme was introduced to provide a further layer of protection to depositors and complement the role of prudent bank management as well as the Central Bank of Nigeria's (CBN's) supervisory activities in ensuring a safe and sound banking system. It was also considered as an additional framework to serve as a vehicle for addressing some of the challenges that followed the deregulation of the financial system under the Structural Adjustment Programme (SAP) which was introduced in 1986.

The DIS, being implemented by the NDIC, was not designed as a **Pay-box** but rather as a **Risk Minimiser**, with powers and responsibilities to insure deposits, monitor the health of insured institutions and provide an orderly failure resolution mechanism, as clearly enunciated in the Corporation's enabling law.

The purpose of this paper is to highlight the role of the DIS being implemented by the NDIC as a component of the official safety-nets in the Nigerian financial system. For ease of comprehension, the rest of the paper is organised into five parts. In the next section, (Section 2), we review the public policy objectives of a DIS. This is followed in Section 3 by a discussion of the functions of the NDIC. In Section 4, we briefly examine the role of the NDIC. The challenges facing the scheme as well as the prospects for the scheme in Nigeria are examined in Section 5. Section 6 summarises and concludes the paper.

DIS POLICY OBJECTIVES

The decision to establish a DIS is usually influenced by a number of considerations. Generally, there are two main public policy objectives for any DIS. (Sundararajan, 2002) These are:

Provision of Deposit Protection to Financially Unsophisticated Depositors

The less-financially sophisticated depositors are often distinguished by the small size of their deposits. This class of depositors are singled out for protection because they do not have the means and/or capability of carrying out the complex task of monitoring and assessing the condition of their financial institutions. This is often not the case with financially sophisticated depositors with large volume of deposits. A DIS is therefore put in place to address the inequity that exists between financially sophisticated and unsophisticated depositors.

Proponents of deposit insurance argue that it is neither reasonable nor fair to expect unsophisticated individuals to monitor banks whose portfolios of assets consist largely of information - intensive assets - loans. The costs of monitoring a bank for small depositors may outweigh the benefits, and therefore, it may be rational for them to not actively monitor the condition of their bank. Instead, rationally ignorant small depositors will seek to protect their interests by withdrawing their deposits whenever they are presented with information that causes them to question the solvency of their banks - that is, they will run on their banks. Rational ignorance by small depositors may also prevent them from distinguishing between good information on the condition of their depository institution and false rumors, hence, they may participate in runs on solvent banks.

It is however, important to indicate that although a DIS protects depositors against the consequences associated with the failure of an insured institution, it is not designed to protect banks and/or any other deposit-taking financial institutions from failing.

Contribution to Financial Stability by Promoting Confidence and the Stability of the Banking System

This objective is based on a concern that depositors may lose confidence in an institution under certain circumstances. A well designed DIS contributes to the stability of a country's financial system by reducing the incentives for depositors to withdraw their insured deposits from banks because of loss of confidence. The ability of the DIS to contribute to financial stability is largely affected by the level and scope of coverage, the speed with which insured deposits are repaid and the credibility of the underlying guarantee. Also, public attitudes and expectations play a particular role in reinforcing the credibility and effectiveness of a DIS.

Other DIS Policy Objectives

In addition to the provision of deposit protection to less financially sophisticated depositors and contribution to financial stability by promoting confidence in the banking system, DISs are also designed to achieve the following other policy objectives:

Provision of a Formal Mechanism for Dealing with Problem Financial Institutions

A DIS, in conjunction with the other regulatory arrangements, provides government with a more formal mechanism for dealing with problem financial institutions with a view to protecting depositors. The introduction of a deposit insurance system may be linked to a country's attempt to put in place laws and mechanisms that deal with failed institutions. Experience suggests that the failure of depository institutions must be handled in unique ways to deal with the tendency of troubled institutions to deteriorate rapidly, while minimising adverse effects on the overall financial system. The introduction of deposit insurance may be linked to the creation of a country's failure-resolution framework for its deposit-taking financial institutions.

Before the establishment of the NDIC, the Government was playing the role of an implicit insurer. It had to bail out banks like the National Bank of Nigeria (NBN), African Continental Bank (ACB), etc. With deregulation, an explicit DIS became imperative.

Contributing to an Orderly Payments System

Deposit Insurance helps to promote financial stability by contributing to the smooth functioning of the payments system. Depository institutions allow individuals and businesses to save and withdraw money when it is needed. By promoting confidence in the system, deposit insurance facilitates the smooth transfer of deposits between parties. For the payments system to function, depositors must be certain that their money in banks is as sound as currency.

Some deposit insurance systems are also able to provide a form of short - term financial assistance, which may involve guaranteeing the payment transactions of troubled institutions. Such assistance may help to avoid interruptions in payment and settlement flows. In so doing, such assistance provides time for safety-net participants to devise long-term solutions to resolve troubled institutions.

Redistributing The Cost Of Failures

In countries where there is no formal deposit insurance system the cost of protecting depositors often falls on the government. Establishment of an explicit deposit insurance system can reduce the government's financial obligation for such protection by limiting coverage and by providing a mechanism through which surviving institutions may cover all or a portion of the costs associated with resolving failures.

Promoting Competition in the Financial Sector by Reducing Competitive Barriers in the Deposit-Taking Industry

By helping smaller institutions compete for deposits against larger institutions, deposit insurance may promote competition. In the absence of deposit protection, depositors are likely to prefer using large, well-known institutions that are perceived to be less risky. The benefit of encouraging new entry and competition may be improved economic efficiency, lowered interest rates and spreads, and increased investment and economic development.

Encouraging Economic Growth

The introduction of deposit insurance may encourage the flow of funds into depository institutions, thereby providing the basis of lending and investment. In addition, the risk premium which depositors may require on their funds could decrease, which may allow insured institutions to lower their lending rates. Lower financing costs, in turn, may stimulate investment and other economic activity. However, it should be noted that deposit insurance could only indirectly stimulate economic growth.

Facilitating the Transition From Full Guarantee to Limited Coverage

Countries may introduce an explicit, limited-coverage deposit insurance system as a way of facilitating the transition away from a full deposit guarantee provided by the government or other public entity. In such cases, deposit insurance systems may allow governments to reduce coverage, and may provide a mechanism for managing the required change in public and market attitudes toward deposit protection. The successful implementation of this public-policy objective requires a well-developed transition plan, a commitment to limited coverage, and a period of relative financial stability.

FUNCTIONS OF THE CORPORATION

The functions or mandate of the Corporation are aptly captured in its **Mission Statement**. The statement which communicates the Corporation's basic identity and purpose for its existence states as follows:-

"Our mission is to protect depositors through effective supervision of insured institutions, provision of financial/technical assistance to eligible insured institutions, prompt payment of guaranteed sums and orderly resolution of failing and failed insured institutions".

It could be drawn from the above statement that NDIC's primary mission is to maintain stability and public confidence in the banking sector by guaranteeing payments to depositors in the event of failure of insured institutions as well as promoting safe and sound banking practices through effective supervision.

To achieve its mission and in accordance with the provision of Section 5 of the NDIC Act No. 22 of 1988 (as amended), the Corporation performs key functions including deposit insurance, supervision, distress resolution and liquidation.

Deposit Insurance (Section 5, 20, 21, 26 & 27 of the NDIC Act)

This is perhaps the most significant and distinct role of the Corporation. As an insurer, NDIC guarantees the payment of deposits up to a maximum of 50,000.00 to a depositor in the event of failure of an insured financial institution. Balances in all deposit accounts held in the same right and capacity by a depositor in all branches of a closed insured institution net of outstanding debts are aggregated to determine the maximum insured amount. NDIC could pay the insured deposit claims either directly (cash/cheque) or through Agent Banks or by way of insured deposit transfer to healthy banks. Upon payment to a depositor, all rights of the depositor shall be subrogated to the Corporation to the extent of the payment made.

If a depositor fails to file claims within eighteen (18) months after the appointment of the Corporation as the Liquidator of the failed institution, such deposit shall fall within the uninsured category. However, due to poor depositors' response, the claim filing period had been extended twice.

Banking Supervision (Sections 5, 16, 17, 18, 19 & 41 of the NDIC Act)

The Corporation supervises banks so as to protect depositors, ensure monetary stability; promote an effective and efficient payment system; and promote competition and innovation in the banking system. Banking supervision is therefore an essential element of a Deposit Insurance Scheme as it seeks to reduce the potential risk of failure and ensures that unsafe and unsound banking practices do not go unchecked. It also provides the oversight required to preserve the integrity of, and promote public confidence in, the banking system.

The Corporation carries out its supervisory responsibilities through the on-site examination and the off-site surveillance of insured banks. NDIC shares the responsibility with and adequately compliments the efforts of the CBN in the supervision of banks.

Distress Resolution (Sections 5, 23, 24, 28, 29 & 34 of the NDIC Act)

One of the primary roles of NDIC is to ensure that failing institutions are resolved in a timely and efficient manner that will result in the least cost to the Deposit Insurance Fund and the banking system. It should be borne in mind that when the banking system was deregulated as part of the Structural Adjustment Programme (SAP) in 1986, the protection of depositors became necessary thus warranting the setting up of NDIC. Indeed, there were distressed banks in the system by the time NDIC was established. Therefore, no sooner had NDIC commenced operations and before it could settle down and acquire the relevant and necessary resources, it had to grapple with the responsibility of resolving distress.

The Corporation is empowered to provide financial and technical assistance to failing or distressed banks in the interest of depositors. The financial assistance can, on the one hand, take the form of loans, guarantee for loan taken by the bank or acceptance of accommodation bills. On the other hand, the technical assistance may include take over of management and control of the bank, changes in management or assisted merger with another viable institution.

The responsibility for distress resolution is also shared with CBN. In fact, the Banks and Other Financial Institutions (BOFI) Act has elaborate provisions on distress resolution which include hand over of distressed banks to NDIC by the CBN. Consequently, NDIC had over the years worked closely with CBN in resolving distress in the banking system.

Bank Liquidation (Sections 25 & 28 of the NDIC Act)

Another core function of the Corporation is bank liquidation. Bank liquidation is always adopted by the Corporation and the CBN when found to be the most cost effective, compared with other distress resolution measures.

Liquidation process involves orderly and efficient closure of the failed institution with minimum disruption to the banking system, cost-effective realization of assets and settlement of claims of depositors, creditors and where possible, shareholders. Depositors are entitled to be paid in priority to all creditors as provided in Section 50 of BOFI Act. This is an essential part of a DIS which many explicit Deposit Insurance Schemes have adopted.

Other Functions

NDIC is required by its enabling Act to assist the monetary authorities, in this case, the CBN in the formulation and implementation of banking policy so as to ensure safe and sound banking system.

THE ROLE OF THE NDIC IN THE SAFETY-NET

The role of the NDIC can be brought into sharper focus when examined within the context of its activities in the discharge of its primary mandate of deposit insurance. The activities undertaken by the Corporation with the aim of insulating the industry from destructive runs and instability are as highlighted below:

Deposit Guarantee

As a deposit insurer, the Corporation guarantees payment to depositors in the event of failure of an insured bank. At the commencement of the scheme, the maximum insurance limit was set at 50,000.00 per depositor and that was applied to settle claims of insured depositors of all banks closed to date. The Corporation had paid about N3.29 billion to depositors, representing 63% of total insured claims to the depositors of 34 banks in liquidation as at the end of June 2003. This has no doubt, gone a long way in engendering depositors' confidence in the nation's banking system.

The proposal to increase deposit insurance coverage to N100,000.00 has been submitted to the National Assembly for consideration since 2001.

Depositors' Protection Through Supervision

Supervision of insured banks is an integral part of the mechanism for ensuring safe and sound banking practices and the Corporation has continued to accord this top priority. This entails on-site examination and off-site surveillance, both of which are mutually reinforcing. The off-site supervision provides early warning signals which is useful in prioritizing on-site examinations and assessing potential problem areas.

The establishment of the NDIC in 1989 and its involvement in on-site examination have significantly shortened the examination cycle such that despite the increase in the number of banks and their branches, banks are now examined annually as against once in three years prior to the establishment of the Corporation.

Failure Resolution in the Banking Industry

It is worth noting that the Corporation was established when the banking system was already in distress. As a matter of fact, there were about seven technically insolvent banks in the system in 1988. The NDIC was nevertheless statutorily required to insure all the banks. It, therefore, had to grapple with the resolution of distressed banks at an early stage of existence.

Depending on the severity and peculiarity of the situation, NDIC in collaboration with the CBN, had, over the years, successfully adopted the following measures, among others, to address bank distress:

1. Accommodation facilities were granted to ten (10) banks which had serious liquidity crises to the tune of 2.3 billion in 1989 following the withdrawal of public sector funds from commercial and merchant banks and the transfer of same to CBN during that year.

2. Take-over of management and control of twenty-five (25) distressed banks by CBN/NDIC to safe guard their assets.

3. Acquisition, restructuring and sale of seven (7) distressed banks to new investors.

4. Closure of 36 terminally distressed banks that failed to respond to various regulatory/supervisory initiatives. While the liquidation of Savannah Bank of Nigeria and Peak Merchant Bank were suspended due to Court action, it is noteworthy that all the banks were closed with minimal disruption to the banking system.

The combined effect of these measures was a significant reduction in the level of distress in the banking system.

As part of failure resolution measures, NDIC continues to serve as the liquidator to 34 closed banks. The Corporation's achievements in this regard include the following:

Payment of Liquidation Dividend to Depositors

In addition to the payment of insured depositors of the closed banks, depositors with credit balances in excess of the insured limit were paid liquidation dividends based on the volume of proceeds of the closed banks' assets realised by the Corporation. As at June 30, 2003, the Corporation had declared an aggregate dividend of 8,796.85 million for 32 out of 34 banks in liquidation. Of the 32 banks, 9 banks had declared a final dividend of 100 percent of total deposits indicating that all their depositors had fully recovered their deposits.

Payment of Liquidation Dividend to General Creditors

Liquidation dividend had also been paid to some general creditors of some of the banks. For example, the general creditors of Pan African Bank (in-liquidation) had been paid a total of about 167.25 million. The amount represented about 67% of the total amount of about 254.00 million declared as liquidation dividend to the creditors of the bank as at the end of March, 2003. Similarly, the general creditors of Rims Merchant Bank (in-liquidation) had been paid the sum of 139.77million out of about 168.1 million declared as at the end of June, 2003. Likewise, Amicable bank declared 100% dividend to its Preferred Creditors and 10% to other creditors. Furthermore, the shareholders of Nigeria Merchant Bank (in-liquidation)) had received liquidation dividend of 620 million.

Other activities of the NDIC which have facilitated the achievement of stability in the banking industry

a. The Implementation of the Failed Banks' Decree

The promulgation and implementation of the Failed Banks (Recovery of Debts) and Financial Malpractices Decree No. 18 of 1994 was to ensure speedy dispensation of justice. The main thrust of the Decree was to assist in the recovery of debts owed to failed banks and to punish individuals involved in the monumental incidence of financial malpractices in the distressed banks.

The highly acclaimed implementation of the *Failed Banks Decree* which was facilitated by the NDIC was indeed a major plank in the resolve to contain distress and promote the soundness of the Nigerian banking system. Following the implementation of the Decree, a reasonable amount of recoveries had been made.

b. Bank Customers' Enlightenment

The Corporation has, since its establishment, been promoting public understanding of banking policies by providing financial information and analysis on insured banks to the general public. Such information which hitherto was not articulated, has enabled the public to know the financial conditions of insured banks. The dissemination of financial information is done through the Corporation's Annual Reports; the NDIC Quarterly and other publications which are available to the public free of charge. These publications are now being regarded by operators and the academia as veritable sources of information on the nation's banking industry.

c. Capacity Building in the Banking Industry

The NDIC, through its high quality courses, seminars, workshops and endowment of Chairs to chosen departments in Nigerian Universities, has remained a reliable partner in capacity building in the nation's banking industry since its establishment.

CHALLENGES AND PROSPECTS OF THE NDIC

Challenges

Although the NDIC had recorded modest achievements as highlighted in the preceding paragraphs, the exercise had not been without its constraints and challenges. The challenges confronting the NDIC in its dual roles of guaranteeing deposits and liquidator of failed banks are quite numerous.

Challenges in Guaranteeing Deposits

The challenges facing NDIC in providing deposit guarantee include the following:

Poor Public Awareness

The level of awareness of the scheme is quite low. Despite the series of efforts made by the NDIC to reach out to the public through publications, seminars, workshops, press briefings and advertisement, the general public seem inadequately aware of the scheme. It is still common to find people confusing deposit insurance with the conventional insurance business. Public ignorance cuts across all sections of the populace including depositors, the primary beneficiary of the scheme. For the deposit insurance to be effective, it is important that the public is well and adequately informed of its benefits and limitations.

Level of Deposit Insurance Coverage

Ideally, the coverage limit should be sufficient enough to protect small depositors so as to prevent them from precipitating bank runs, but not so excessive in order to maintain market discipline and minimize moral hazard. The adequacy or otherwise of the maximum insurance claim had continued to generate a lot of interest and sometimes adverse comments. Coverage limits should normally be adjusted periodically because of inflation, depreciation of the local currency and growth of real income. It is in this regard that the Corporation had proposed an upward review of the insurance limit from N50,000.00 to N100,000.00. This proposal is part of the amendment of the NDIC Act (1988) which is before the National Assembly.

It is important to indicate that best practice and the International Monetary Fund (IMF) recommend a maximum insured amount of not more than two (2) times a country's GDP Per Capita. The proposed maximum coverage of N100,000.00 is about 2.82 times the nation's GDP Per Capita and it is proportionately higher than the maximum coverage vis-a-vis GDP Per Capital in Argentina with 1.39, South Korea with 1.64, Jamaica with 1.91, The Philippines with 2.55, Canada with 1.89, Tanzania with 1.43, and even in the United States of America with 2.79.

Challenges Faced by the Corporation as a Liquidator

The following are some of the challenges faced by the Corporation as a Liquidator of failed banks.

a. Legal Constraints

Legal challenges faced by the NDIC are as follows:

i) **Inadequate Legal Provisions**

A deposit insurer, while acting as a liquidator of closed banks is supposed to be vested with special powers. The special powers are to expedite the liquidation process in order to maintain confidence and stability of the banking system as well as ensure cost effectiveness of the liquidation process. In many jurisdictions including FDIC of USA, the Deposit Insurer is granted such special powers. Liquidations undertaken by the FDIC for instance, are not subject to court decisions.

Contrary to best practices, NDIC has to apply to the Federal High Court to be appointed as a liquidator. NDIC is also subject to the general companies winding-up rules which among others require notice to be issued and advertised before appointment.

ii) **Legal Actions by Owners of Closed Banks**

In spite of the forbearance of the Regulatory Authorities, suits have been brought by owners of banks against CBN/NDIC on the revocation of their banks' licences and appointment of liquidator. The trend if not checked, can threaten the stability of the banking system and erode confidence of the public in our banks. The damage that is associated with protracted litigation is incalculable.

iii) **Cumbersome and Protracted Judicial Process**

The existing court processes and procedures appear slow and cumbersome and therefore cannot assist in the prompt recovery of debts owed to banks and also address the financial malpractices in banks. It is of concern to note that since the dissolution of the Failed Banks Tribunal and the transfer of the cases to the Federal High Court, no conviction had been secured in any criminal case. Series of objections were being raised before the substantive matters are heard and the fiat granted to private prosecutors by the Attorney-General of the Federation is being challenged in spite of a Supreme Court ruling that such fiats are valid.

b. Uncooperative Attitude of Bank Staff and Management

Some members of management and staff of the recently closed banks deliberately refused to cooperate with the provisional liquidator during the recent closing exercises. Some issued threats to their colleagues who were cooperating with NDIC while others sponsored media publications against the regulatory Authorities. These attitudes made the closing operations difficult and protracted. While the concern of some staff about closure of their bank is understandable given the loss of jobs, the confrontational attitude of other staff is not only illegal, but also has serious implications for the banking industry.

c. Recovery of Debts Owed Failed Banks

The Corporation is still faced with some constraints in its debt recovery efforts. Some of the constraints militating against recoveries of debts include business failures, unwillingness to honour obligations and large volumes of unsecured/fraudulently granted loans. Instead of seeking ways to settle their debts, some debtors had challenged the jurisdiction of the Federal High Courts to adjudicate in matters between them and the closed banks and the Court of Appeal had given a ruling in their favour. The Corporation is however, challenging the ruling at the Supreme Court. It is important to stress that unless debts can be expeditiously recovered, uninsured depositors and creditors cannot be paid most of their claims. This has serious consequences for public confidence in, and stability of, the nation's banking industry.

d. Disposal of Physical Assets

NDIC had achieved appreciable success in the disposal of physical assets of closed banks. Nevertheless, there are few prime-landed properties yet to be sold. The inability to dispose of these properties could be as a result of a few problems. The title documents on some of the assets are subjects of litigation while some of them are located in towns where there is low demand for such properties.

OTHER ISSUES CONFRONTING THE IMPLEMENTATION OF DIS IN NIGERIA

In addition to the issues raised above, the advent of democracy as well as the dictates of best practices have added some further dimensions of challenges for the implementation of DIS by the NDIC. Some of these other challenges include the following:

(a) **Threat to Depositors' Fund Arising from Possible Political Affiliation by Operators**

Chances that bankers, particularly influential shareholders who are affiliated to political parties, may wish to obtain loan to bankroll election expenses abound under a democratic regime. Such loans are not likely to be re-paid, especially, if victory is not achieved at the end of the election. Such risks could threaten the safety of depositors' fund. This phenomenon becomes an issue of serious concern to the NDIC because of its role as deposit insurer.

(b) **Threats Posed By Interest Groups**

One of the main advantages of democracy is increased freedom of expression and association. This freedom often leads to increasing role of interest groups, particularly in the area of influencing government policy formulation and legislation. While this situation should normally be an added dividend of democracy, such interest groups may be infiltrated by people with ulterior motives hence, the influenced policies and legislations may be injurious to the society. Such ill-conceived policies may include banking policies which may adversely affect the attainment of the Corporation's objectives.

(c) **Clamour for Private Ownership of the Scheme**

Ownership of DIS worldwide ranges between pure public and pure private ownership. In Nigeria, the DIS was established and fully owned by government. In line with the global move towards market orientation, the Federal Government has since the inception of this administration, put in place so many economic programmes, including privatization programme, aimed at evolving a private sector led economy. Arising from this development, some analysts and observers of the contemporary events in the economy have been calling for the privatization of the DIS in Nigeria.

The above development has become a challenge for the scheme in Nigeria. While private ownership of the scheme may be the practice in some other jurisdictions, the disadvantages of such a practice in a developing economy like Nigeria may far outweigh its merits. For instance, either full or partial private ownership, which may involve the insured institutions, may lead to conflict of interest which may undermine the achievement of the objectives of ensuring adequate protection for depositors as well as contributing to financial stability. Besides, in periods of generalised or systemic crisis, the privately owned scheme might not be in a position to mobilize adequate resources for orderly resolution of the crisis. This is in addition to the fact that under private ownership, participation in the scheme is likely to be voluntary with the associated problem of adverse selection. These and many other reasons have made public ownership quite attractive by many economies including the USA. The same set of reasons would make privately owned schemes even more unattractive for developing countries like Nigeria than for the developed ones.

(d) **Agitation for Adopting Risk-based Premium Assessment System**

One major challenge posed by the dictates of best practices for deposit insurance schemes world-wide relates to the adoption of risk-adjusted premium contribution as against the flat rate approach currently being applied by the Corporation. Under the risk - adjusted premium contribution approach, insured banks are assigned to different contribution categories in accordance with their risk profiles and their ability to manage their risks. Each category of banks is charged a different contribution rate, with banks in the best category paying the lowest rate and vice - versa. This approach has been adjudged as a more efficient approach than the flat rate approach as it ensures equitable allocation of the funding of the scheme amongst the participating institutions and promotes prudent bank management. In spite of the difficulty in the design and implementation of the risk - based premium assessment method, more countries (24 as at June 2000) started to adopt the approach because of its appeal and because it is consistent with one of the dictates of the best practice as enunciated by the IMF. Based on similar reasons, the NDIC has started to explore ways of adopting the risk-based premium assessment approach.

(e) **Increase in Bank Intermediation Cost**

Insurance premiums being paid by banks are passed on to depositors and borrowers in the form of interest rates and other bank charges. This additional expenditure imposed by the establishment of NDIC has been seen as having the effect of increasing the cost of funds by banks and by implication, the cost of borrowing by the users of funds mobilized by banks. It is however, important to observe that the merits of the scheme to the banking system in particular and to the economy in general far outweigh such additional costs to the banks and the borrowers.

Future Prospects

Notwithstanding the challenges facing the Corporation, there are prospects for the effective discharge of its roles in guaranteeing deposits and as a liquidator. The long-term prospects include the following:

a) Strong commitment of the Corporation to promote public awareness about its operations in order for stakeholders to understand and appreciate the benefits and limitations of the deposit insurance scheme.

b) The proposed amendment to the NDIC and BOFI Acts, which are already before the National Assembly for consideration and enactment, will address most of the legal constraints facing the Corporation.

c) The NDIC/CBN will introduce new bank returns that will provide information usually compiled by NDIC when closing a bank. With such information, NDIC could undertake preparatory review of deposit liabilities held by problem banks. In the event that a bank is closed, NDIC would have sufficient information to facilitate early compilation of deposit registers and other relevant reports so as to ensure prompt payment of depositors' claims.

d) The Contingency Planning for Banking Systemic Distress Framework introduced in 2002 if properly implemented will facilitate prompt resolution of problem banks. The framework seeks to reduce the incidence of systemic distress by improving the supervisory processes, providing transparent and objective thresholds for regulatory intervention and promoting self-regulation among banks.

e) It is hoped that Government would sustain the efforts towards a more stable macro-economic environment and favourable business climate that would enable willing debtors to meet their commitment to banks

f) Measures being adopted by the CBN to ensure that only fit and proper persons own and manage banks will go a long way in minimizing the incidence of abusive ownership and mismanagement. With credible and trustworthy persons in charge of banks, the respective roles of NDIC and CBN would be better appreciated and the necessary support and cooperation could be extended to them.

g) It is expected that the inauguration of the Economic and Financial Crimes Commission would once again bring to the fore the need to address financial crimes and ensure that offenders are prosecuted.

h) As part of efforts at further strengthening the existing safety-nets for the Nigerian financial system and in accordance with the provisions of its enabling statute, the Corporation has established a Special Insured Institutions Department (SIID), to enable it extend deposit insurance coverage to other licensed deposit taking financial institutions. Accordingly, arrangements are being finalised to bring the 282 licensed community banks (CBs) as well as the 80 primary mortgage institutions (PMIs), whose licences were recently adopted by CBN, under the scheme.

With this development, it is hoped that public confidence would not only be heightened in the affected sub-sector, it will also be enhanced for the entire financial system because of the inter-relationships that exist among the various sub-sectors within the system. The cumulative effect of the development would be to contribute to the overall stability of the Nigerian financial system with all its attendant positive impacts.

i) In order to ensure a good grasp of the latest international trends in deposit insurance systems and promote exchange with deposit insurance institutions in other countries, the NDIC joined the International Association of Deposit Insurers (IADI) based in Basle, Switzerland as a founding member in May, 2002. In addition, the

Managing Director/Chief Executive of the NDIC was elected and remains a member of the Executive Council of the Association as well as Chairman of the Africa Regional Committee of the Association. Furthermore, the Corporation hosts visits by personnel from foreign deposit insurance organisations and sends its own staff to advanced countries with DISs to learn from their experiences with a view to attaining international standards for the implementation of the DIS in Nigeria.

With its membership of the IADI, the two positions being occupied by its Chief Executive Officer in the association and other efforts at reinforcing cooperation and exchange between deposit insurance organisations of different countries, the NDIC is well positioned to partake in the sharing and exchange of expertise and information on deposit insurance issues.

SUMMARY AND CONCLUSION

The Nigerian government reacted promptly to the imperatives of the current wave of economic deregulation sweeping through the world by establishing a deposit insurance scheme in the country. The NDIC, an organisation charged with the responsibility of managing the scheme, has spent the last 14 years putting in place various measures designed to protect the economy from the risk of deposit runs. Apart from insuring the deposit liabilities of all licensed banks, the establishment of NDIC has no doubt, generated the required stability and confidence through its activities. However, the scheme is still being faced with many challenges which include inability to recover liquidated banks' loans through the courts, wrong public perception of the scheme, weak corporate governance on the part of operators, inadequate power for the NDIC, among others as well as the challenges imposed by the advent of democracy and the dictates of best practice. In spite of the challenges, the series of developments in the system as indicated in Section 6 of the paper have indeed given hope of a bright future for an effective DIS in Nigeria.

October 22, 2003

Financial Regulations in Nigeria and the Challenges of the West African Monetary Zone

By

Dr. Chris O. Itsede*

INTRODUCTION

The global financial system has been undergoing fundamental changes in terms of scope of operation and orientation in applying the rules of the game. These changes were accentuated by the traumatic experience of recent banking crises as well as the explosion in information and communication technology (ICT). Other contributory factors included volatility in interest and exchange rates, and liberalization of exchange control. As rightly observed by Vittas (1992), there is need for a new orientation in financial regulation to capture the contiguous nature of financial crises due to blurring of traditional lines of demarcation among financial services and markets. Considering the dismantling of the traditional line of demarcation among financial services and markets, as well as the contagious nature of financial crises, there is need for a re-direction and a re-positioning of financial regulation.

This paper attempts to provide a discourse of the implications of the Second West African Monetary Zone (WAMZ) for Financial Regulations in Nigeria. Accordingly, section 2 will examine financial regulation in general, typology of financial regulation, the rationale and assessment of the potency of financial regulation. Section 3 will discuss financial regulations in Nigeria both ex-ante and ex-post. The issues on emerging regional financial regulatory framework will form the core of Section 4.

OVERVIEW OF FINANCIAL REGULATION

John Eatwell (1998) noted that there is no commonly accepted set of theoretical principles defining what financial regulation is and that a major

---

* **Dr. Chris Itsede is the Director General of the West African Institute for Financial and Economic Management (WAIFEM). The views expressed in this paper are that of the author and do not represent the opinion of his organization.**

problem in building a coherent theory of regulatory practice is the potential scale of losses associated with extreme events. Nonetheless, an attempt would be made to establish the components of financial regulation. Regulation may be defined as a set of specific rules or agreed behaviour either imposed by some government or external agency or self-imposed by explicit or implied agreement within the industry that constrains the activities and business operations of the institutions in the industry to achieve a defined objective and/or act prudently.

A disaggregation of the above definition into its constituent components indicates that the essence of financial regulation is to:

i) ensure that products and services provided by financial institutions are consistent with the operating legal and regulatory frameworks;

ii) enable each financial institution locate its activities within the boundaries defined by the organic laws and set of regulations that guide its domain of the market;

iii) protect investors and depositors from exploitative vagaries of the financial institutions: and

iv) ensure competitive equity, by creating and maintaining a level playing field among operators.

From the foregoing, financial regulation is central to the stability and efficiency of financial institutions. Financial institutions play a pivotal role in mobilizing savings and efficient transformation of the saving into real capital. Hence, the existence of enormous risks inherent in the process of financial intermediation and maturity transformation poses insuperable obstacles to the efficiency of the financial system. Thus, to build confidence in the system characterised by volatile environment, financial regulation becomes a catalyst for mitigating the existence of market failures arising from externalities, market power and information problems.

To ensure that financial regulation achieves the intended objectives, Long and Vittas (1992) suggested that the potency of financial regulation and structure could be assessed by stability, efficiency and fairness. They argued that stability of the financial system is hinged on the structure as well as its level of capitalisation. It is against this backdrop that new capitalisation rules have been specified by the Basle Committee. The efficiency parameter is quotient of the extent of concentration in financial markets and expansion in the range of financial services.

The issue in most countries is the blurring of the existing boundary in the range of services, which has enhanced competitive equity. There is a growing concern that some financial institutions would become "too big" to control if allowed to engage in several activities. The assessment tool of fairness deals with the extent of protection enjoyed by users of financial services from the clutches and abusive tendency of financial institutions. Fairness also entails the creation of a level playing turf for competitors in the industry and insulating users of financial services from the avarice of financial institutions.

To ensure the attainment of the fundamental objectives of confidence and safety in financial systems, Date (1982) classified regulation into three categories namely, preventive (limiting risks incurred); supportive (rendering assistance such as lenders of last resort) and protective (offering protection in the event of failure). In tandem with this classification, Eatwell and Taylor (1998) argued that for efficient regulation, the domain of the regulator should be the same as the domain of the market that is regulated. They opined that there is need to perform in a coherent manner, the standard tasks of a financial regulator which include authorisation, provision of information, surveillance, enforcement and policy development.

According to Vittas (1992), financial regulation is perhaps the most important determinant of differences in financial structure exhibited by countries at a similar level of development and with access to common technologies. Consequently, Long and Vittas (1992), categorized financial regulations into six main groups: macroeconomic, allocative, structural, prudential, organisational and protective.

Macroeconomic regulations establish reserves requirements, deposit ceilings, restriction in foreign investment as well as interest rate contributions. It guarantees control on economic activity by participants in the industry. Allocative controls emphasises equity in resource allocation by ensuring that priority activities are given preference. Structural regulation examines the reach and depth of the financial systems in terms of entry, expansion, range of activities by a financial institution so as to avoid excessive concentration of market power. Prudential control is concerned with the safety and soundness of the system so as to maintain public confidence. The main hub of organisational regulation is that of ensuring the smooth functioning and integrity of the financial system and information exchanges. The protection of users of financial services especially the small depositors and non-professional investors is the main emphasis of protective control. In addition, it ensures that information are disseminated to consumers and that compensation funds are made available in situations of failure.

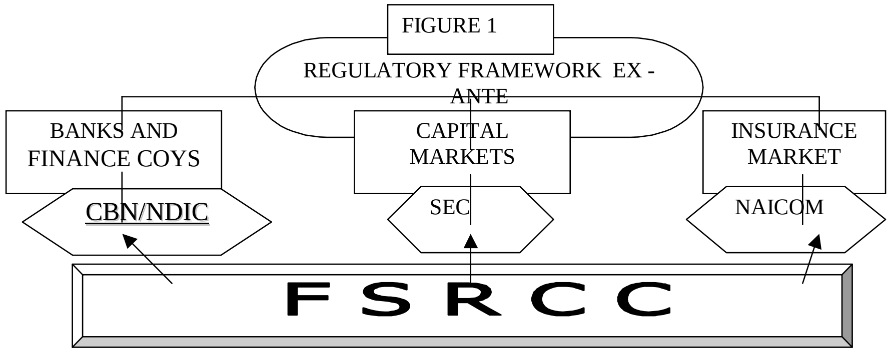
Financial Regulation in Nigeria

The Nigerian financial system has witnessed tremendous changes in terms of size, structure, organisation and scope. These changes could take the form of regulation, deregulation, liberalisation and internationalisation. The above changes have both structural and behavioural implications in the three assessment parameters of stability, efficiency and fairness. Vittas (1992) posited that such changes are reflections of paradoxical development which engenders growing concentration of markets and growing competition. The former is through extensive consolidation process and the latter through the dismantling of barriers inhibiting entry into the provision of certain services, hence the emergence of universal banking.

Within the context of these changes, the regulatory framework in Nigeria could be discussed on ex-ante and ex-post bases so as to capture the imperatives inherent in the framework. At the ex-ante level, there was a distinctive line of services provided by different sub-sectors in the financial system. In short, the system could be segmented into four groups: banks (commercial, merchant etc.); capital markets, insurance business and others (Discount House, Finance House, Mortgage firms, Bureau de Change etc.)

The regulation of the system was on sectoral basis where the Central Bank of Nigeria (CBN) and Nigeria Deposit Insurance Corporation (NDIC) superintended the banks. The capital market was largely supervised by the Securities and Exchange Commission (SEC) while the National Insurance Commission (NAICOM) took charge of the insurance business. The CBN was the supervisory authority for the other financial institutions (OFIs). The above regulatory arrangement is depicted in figure 1

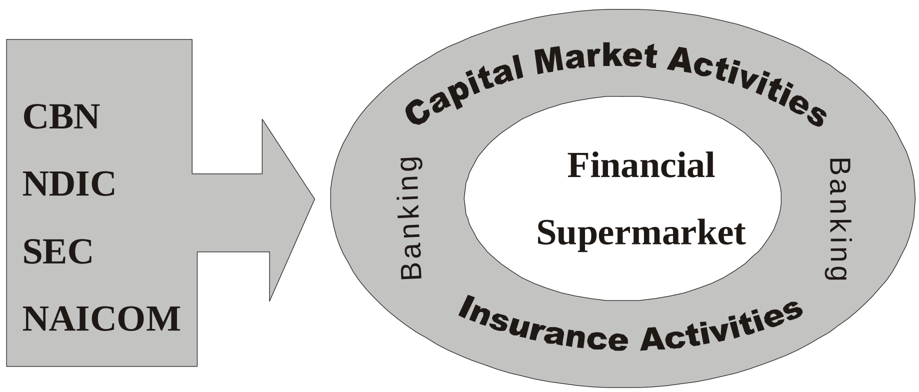
FIGURE 1



In contrast to the ex-ante environment, the regulatory framework in the ex-post environment permits banks to engage in such non-conventional banking functions as insurance and capital market activities. This development has resulted in the emergence of financial supermarkets, which could perform those activities falling under the purview of two or more regulators in the system.

The ensuing guidelines for the practice of universal banking require the institution to comply with the relevant rules of the respective regulator of its multiple functions. The schematic framework is shown in figure 2.

FIGURE 2
REGULATORY ENVIRONMENT: EX-POST



Itsede (2002), suggested the existence of a single legislation that stipulates the capital adequacy of financial supermarkets, taking cognisance of the scope of activities and product mix of the institution. He further stressed the need for a composite licence that would obviate the need for sector-specific licensing. The practice of universal banking should be carried out in such a way that financial institutions are not tempted to engage in ultra-risky activities sequel to opportunities presented by business combinations. Eatwell (1998), argued that in view of the emergence of financial supermarkets and internationalisation of the financial system, regulations should be conceived in conjunction with macroeconomic policy, as the consequences of unstable macroeconomic instability would unsettle the financial system. The analytical link between microeconomic risk taking by the financial institutions and the associated macroeconomic externalities has its counterpart in regulatory practice. In what follows, an attempt is made to situate the practice of universal banking within the context of the Second Monetary Zone in West Africa.

The West African Monetary Zone (WAMZ)

This section assumes background information about the establishment of the WAMZ as well as the costs and benefits of monetary integration. Hence, the discourse shall be limited to the regulatory challenges emanating from the process.

With the establishment of WAMZ, the West African sub-region under the ECOWAS framework is seeking to fast track the monetary integration process of the entire sub-region. The process involves the establishment of new institutions such as the West African Central Bank (WACB) and the proposed West African Financial Supervisory Authority (WAFSA). Each of the institutions requires the setting up of organizational coordination mechanisms among the integrating countries. The main focus of this section is on WAFSA in order to place our discussion in proper perspective, we shall briefly examine the features of WACB. According to Article 6, Part III of the statutes establishing the WACB, the main functions of the Bank shall be to:

i) issue a common convertible currency within the WAMZ;
ii) define and implement the monetary policy of the WAMZ;
iii) conduct foreign exchange operations consistent with the provisions and objectives of price stability;
iv) hold and manage the official foreign reserves of member states;
v) promote the smooth operation of the payment systems;
vi) serve as banker to financial institutions and fiscal agents to government;
vii) exercise prudential supervision over credit and financial institutions.

A consequence of the establishment of WACB is that the existing central banks of the integrating countries shall become national branches of the WACB. Article 15 directs member states to ensure that the statutes of their National Central Banks (NCBs) and other relevant national legislations are compatible with the WAMZ Agreement and statute. Article 6.1 (v) vests licensing, regulation and supervision of financial and credit institutions in the NCBs of the WACB. In pursuance of its monetary policy objectives, Article 21.1 prescribes the minimum reserve requirements. It empowers WACB to make regulations concerning the calculation and determination of minimum reserves required for financial institutions established in member states. Under the regulations, the WACB may require financial institutions to hold minimum reserves with it. The WACB may levy penalty and impose sanctions with comparable effect in cases where financial institutions fail to comply.

Establishment of the West African Financial Supervisory Authority (WAFSA)

Recognising the enormous task of managing the emerging mega financial system in the WAMZ, the governments of The Gambia, Ghana, Guinea, Nigeria and Sierra Leone at the seventh meeting of the convergence council of the WAMZ in April 2002, in Freetown, Sierra Leone agreed to establish a centralised regional supervisory body. The organisation is to be known as the West African Financial Supervisory Authority (WAFSA) and the objective is to ensure financial stability in the banking systems of member states. This development is in consonance with the long-term objective of fusing the West African Economic and Monetary Union (WAEMU) and the WAMZ into a single united entity within the framework of ECOWAS Monetary Cooperation Programme.

To appreciate the need for the establishment of WAFSA, it would be helpful to highlight the diversity/size, and structure of the financial systems in WAMZ. According to a recent study by the West African Monetary Institute (WAMI), there were a total of 1,562 licensed financial institutions as at December, 2002. They included 125 deposit money banks (commercial and merchant), and 1,437 other financial institutions (Community banks – 399, Bureau de Change – 612, Insurance Companies – 167, etc.) Nigeria accounted for over 60 per cent of the financial institutions in the WAMZ.

In terms of assets size, the deposit money banks accounted for a whopping amount equivalent to US$22.1 billion as at the end of 2002 which is about 92 per cent of total financial assets in the WAMZ with Nigeria accounting for over 87 per cent. The ownership structure of deposit money banks in the zone was skewed to the private sector with 80% share. Except in Nigeria where 95% of the banks were domestically owned, foreign owned banks dominate in the other countries of the zone. However, these foreign owned banks were locally incorporated. As at year end 2002, there were only 8 banks with cross-border ownership.

Given the quantum of financial assets in the zone, the establishment of WAFSA is a welcome development. However, there is need to address the following questions/issues:

(i) What will be the status of the existing national regulatory authorities

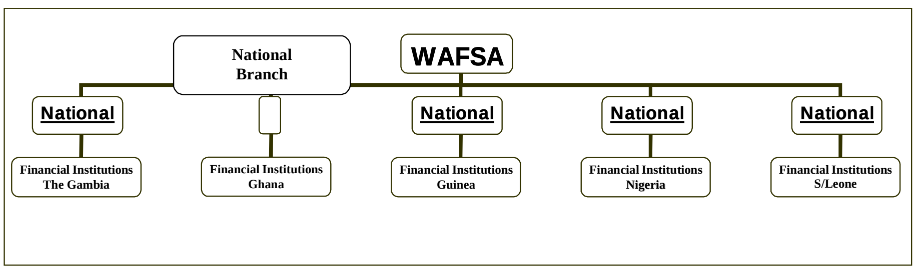
(ii) What are the current regulatory framework in WAMZ countries?

(iii) What will be the powers of WAFSA?

There are efforts in all countries of the WAMZ to introduce changes in the legal and regulatory frameworks underpinning the financial system in order to conform to the Basel Core Principles of Banking Supervision. Each of the WAMZ country is undertaking a restructuring strategy ranging from revision of Financial Institution Acts, in terms of guaranteeing operational independence of regulators to the establishment of new institutions to deal with financial crimes.

A schematic display (figure 3) of the proposed structure of WAFSA shows that the zone will have a single regulatory/supervisory agency with national branches. WAFSA is expected to be an independent agency working closely with the WACB. To shield the organisation from political interference, it is suggested that the Governor/President of the WACB should be the Chairman of the Board of WAFSA. However, the issue of headship of WAFSA has not been settled.

FIGURE 3



A comparative study of the regulatory frameworks in four of the WAMZ countries shows some degree of disparity in the application of rules and procedures. Except in Nigeria, universal banking has not commenced in the other countries, save for Ghana where there are rudiments of the system. There are differences in regulatory approaches as depicted in the table below. Nigeria is the only member country with explicit deposit insurance.

TABLE 1

Regulatory Variable	The Gambia	Ghana	Nigeria	Sierra Leone
Bank Participation in Securities Activities	Prohibited	Permitted	Permitted	Prohibited
Bank Participation in Insurance Activities	Prohibited	Permitted	Restricted	Prohibited
Bank Participation in Real Estate Activities	Prohibited (except for Islamic Banking)	Permitted	Restricted	Prohibited
Bank ownership of non financial firm	Restricted (may acquire less than 100% equity)	Permitted (limited to a bank's equity capital)	Permitted	Prohibited
Bank ownership by non financial firm	Permitted	Unrestricted	Unrestricted	Restricted
Loan Classification: Sub – Standard Doubtful Loss	 90 days 180 days 180 – 365 days	 90 days 180 days 540 days	 90 days 180 days 360 days	 90 days 180 days 360 days
Min Provisioning: Sub – Standard Doubtful Loss	 20% 50% 100%	 25% 50% 100%	 10% 50% 100%	 25% 50% 100%
Existence of Explicit Deposit Insurance Scheme	None	None	In Place	None
Minimum Capital Requirement (US $ Equivalent)	None	US $ 7m	US $17m	US $0.35m
Capital Adequacy Requirement	8%	6%	8%	15%

What are the challenges for WAMZ and Nigeria?

From the comparative study, there is still a lacuna in the mechanism for measuring, monitoring and controlling market and other forms of risks in the financial system. Though there is an insignificant level of cross-border banking in the WAMZ, it is important to develop techniques for consolidated analysis and supervision. For effectiveness of the integration process, there is need to:

i) harmonise the existing financial regulatory environments of member countries of the zone in order to reduce the current incidence of divergence in the applications of rules and procedures which may result in supervisory arbitrage and leakages in the system;

ii) build adequate regulatory capacity to ensure optimal utilization and efficiency of supervisors especially in the area of information technology and the New Capital Accord. Also, there is need for inter-country supervisory attachment of supervisors to enhance their capacity; and

iii) establish a code of conduct for staff of regulatory and supervisory agencies to ensure conformity with established standards.

Areas for harmonization may include:

i) Basic prudential ratios and rules
ii) Accounting Plan
iii) Information Reporting and Disclosure Formats
iv) Loan Loss Provisioning, Loan Valuation and Recovery
v) Policies and Procedures for Resolving Problem Banks or Bank Failure (i.e. establishment of explicit deposit insurance scheme)

However, as suggested by WAMI (2003), taking into consideration the relative size of each country, there should be country-specific minimum capital requirement for entry.

CONCLUSION

The challenge before the architects of the WAMZ regulatory framework is to harmonise the existing financial regulations in the zone with due consideration for country peculiarities. The pessimist might argue that the existence of WAFSA will lead to ceding regulatory sovereignty to such authority, but as Hutton (1999) observed, the capital adequacy requirements of banks in Iowa are determined by a committee sitting in Basel that is not accountable to the US Congress, because of the consensual decision – making process of Basel G – 10 Committees. Hence, the establishment of WAFSA will further strengthen the regulatory environment in the zone as peer pressure will be brought to bear on non-conforming member.

REFERENCES

- Bain, A. D (1992): The Economics of the Financial System (2nd Edition). Blackwell.

- Bies, S.S (2002): Banking Supervision and its Application in Developing Countries.

- Chatterje, C and A. Lefconteh (2001): Supervision and Surveillance. Financial World Publishing.

- Eatwell, J (1998): The Challenges Facing International Financial Regulation.

- Itsede, C. O. (2002): Legislative and Regulatory Imperatives for a Financial Supermarket. A paper presented at Workshop organised by Monas Associates, Sheraton Hotel, Lagos.

- Moskow, M. H (2001): Regulatory Efforts to Prevent Banking Crises: Lessons from Recent Global Bank Failure EDI Development Studies

- Vittas, D (1992): Impact of Regulation on Financial Internationalization in Financial Regulation (ed). EDI World Bank.

- WAMI (2003): Towards Common Banking Supervision in WAMZ - The Way Forward.

- Afolabi, J. A. (2002); Deposit Insurance Scheme in Democratic Governance in Nigeria: Challenges and Prospects, NDIC Quarterly, Vol. 12, No. 1, March 2002.

- Ahmad, M.K. (2002); Mandate, Structure and Operational Activities of the NDIC, NDIC Quarterly, Vol. 12, No. 1, March 2002.

- Alashi, S.O. (2002); Conceptual Framework and Practice of Deposit Insurance Scheme in Nigeria, NDIC Quarterly, Vol. 12, No. 1, March 2002.

- Cameron, R. (1972) Banking and Economic Development: Some Lessons of History . New York : Oxford University Press, 1972

- Central Bank of Nigeria (CBN) (2001) Annual Report

- ——————— (2001) Banking Supervision Annual Report.

- Nigeria Deposit Insurance Corporation (2002), Annual Report and Statement of Accounts. Ogunleye, G.A. (1999) "A Review of Banking Activities and its Regulatory Framework in Nigeria: The Past, Present and Future" NDIC Quarterly Vol. 9 No. 4

- Sandrarajan, V. (2002), "The Role of Deposit Insurance", Paper Presented at the International Workshop On Deposit Insurance, Shanghai, China.

- Schumpeter, J.A. (1934) ***The Theory of Economic Development*** Cambridge Mass: Harvard University Press.

- Uchendu, O.A. (1998) "Concentration in the Commercial Banking Industry in Nigeria" Economic and Financial Review, Vol. 40 No.3 Central Bank of Nigeria.