A REVIEW OF THE CENTRAL BANK'S ROLE AS PRUDENTIAL REGULATOR IN NIGERIA: AN ANALYSIS OF A SEPARATE SUPERVISORY AGENCY

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Abstract: In the aftermath of the global financial crisis that rocked the world in 2007, there has been growing efforts to review the oversight of financial markets and specifically financial institutions globally. The crisis which saw the demise of long standing institutions such as Lehman Brothers underscored the importance of the regulation of global financial markets. Central Banks worldwide have been apportioned some of the blame in the episode for falling asleep at the wheel, investigations and inquiries into the crisis exposed the fact that many Central Bankers were not in tangent with the developments in the financial markets and in some cases did not have a clear handle and understanding of the many instruments that were introduced into the markets. Consequently, many governments have made radical changes to their Central Banking operations in a bid to ensure better oversight of their economies. The main discourse over Central Banking has been the separation or alignment of the two main activities of the banks –microeconomic and macroeconomic regulation. There is no clear cut consensus from studies into these variants that one option supersedes the other. Thus it can be argued that there are other variables in specific economies that should come in to play in arriving at this decision. Whatever approach may be adopted, it is a very important role that sets the tone for economic development in any country. Like its counterparts worldwide, the Central Bank of Nigeria also contemplated making changes to its operational structure. This work reviewed the role of the Central Bank of Nigeria in prudential regulation and recommended an approach that would work for a developing country like Nigeria.

Index Terms: **Central Bank, Financial Markets, Regulators**

I. BACKGROUND OF THE STUDY

Prudential regulation is an important part of the key activities of any economy involving the supervision of financial institutions. They are important players in the financial markets and should have their activities under surveillance to ensure that there is stability in the financial system and deposits taken from the public are safe and secure. The occurrence of the sub-prime crisis in late 2007 showed the importance of this role by
Central Bankers and also the enormous influence that financial institutions wield within the global economy. The effect of the meltdown during that period still reverberates globally with many economies struggling to recover from the attendant downturn that occurred.

In every region there is a lot of rhetoric on the structure of Central Banking and where prudential regulation should be placed in that structure. This study highlights the fact that there is no model that fits all situations. There are pros and cons to whichever method is adopted by regulatory authorities and it is also dependent on other factors such as the level of development and sophistication in the economy being considered. The main focus will be on the prudential regulation activities of the Central Bank of Nigeria and will attempt a review of the effectiveness of the adopted structure. As with many structural policies that emanate from developed countries, it has been widely acknowledged that these policies require adaption to work in developing countries.

Overall, this paper will seek to recommend appropriate structures that can be applicable in developing/third world countries. Key issues to be discussed here will be the corruption pervasive in the country as a whole and capacity building in the Central Bank at large.

II. The Role of Central Banks

Central banks perform two main functions namely macroeconomic and microeconomic regulation. These activities are very closely inter-related because the achievement of monetary and price stability rests on maintaining micro-level financial stability in the payments and banking system (Goodhart, 2000). However in the last decade there has been more and more separation of these two

functions by policy makers. Examples where this has occurred include the United Kingdom where the Financial Services Authority (FSA) was established in June 1998 to supervise Financial Institutions.
Following this move by the United Kingdom, we had more and more European countries follow the same trend (Masciandaro, Quintyn, 2009). Between the years 1998-2008, many countries also made changes to their supervisory structure (Masciandaro, Quintyn, 2009). It is noteworthy that in studies conducted, countries with a developed financial system did not have central bank exclusivity over banking supervision but rather this was the case in less developed countries.
The reason for these changes are the more complex nature of financial markets and the seeming blur between the various kinds of financial institutions operating in the markets. However in light of the rude awakening in2007-2008 with the global crisis, there are attempts worldwide by policy makers to revisit their regulatory structure. It has been established that the two roles of the Central Bank are interlinked and thus one would rationally expect that the roles would be kept in a single entity however the policy reforms of the decade 1998 -2008 proved otherwise and we shall examine the argument for and against separation of the banking supervision mandate of the Central Bank.

Arguments for the Separation of Banking Supervision

Despite the interconnectedness of both roles of the Central Bank, many policy makers went ahead to separate both functions with the most notable being the United Kingdom.

The following were the rationale for splitting the functions :

Conflict of Interest

The conflict of interest argument is hinged on the possibility that supervisory concern about the fragility of the banking system might influence the central bank to allow a more accommodating monetary policy regime to ensure for price stability (ECB, 2001). It is reasoned that with sole discretion of monetising financial distress, a central bank can even fuel a systemic risk because bailing out the financial system can ultimately derail monetary policy and aggravate financial instability.
Expanding on the conflict of interest argument, Goodhart and Schoemaker (1995) further argued that the cyclical effects of both regulatory and monetary policy tend to conflict. They opined that monetary policy tend to be counter-cyclical whilst regulation is pro-cyclical stating further that it is harder to increase capital during a recession when bank costs are high and profits are very low. Studies by Heller (1991) have shown that inflation rates are higher in economies where the central bank partakes in regulation of banks. This is also corroborated in studies by Di Giorgio and Di Noia (1999) which revealed that in countries where the central bank is the sole supervisor, inflation rates are twice as high as in other economies.
European Central Bank, “The role of Central Bank in Prudential Supervision” (2001)

Excessive Power

One of the reasons against the supervision of banks by the central bank is excessive power in the hands of select individuals whose accountability may be weak (Llewellyn,
2006). If a central bank has the sole discretion to set interest rates in addition to supervisory powers for the banking sector it is considered risky to allow the concentration of such powers in the hands of unelected officials (Masciandaro, 2006).
One of the consequences of above is a moral hazard issue which sends a wrong signal to the public that the safety net implicit guarantee by the central banks is available to every
type of deposit institution (Herring, Carmassi, 2008).

Reputation Risks

A clamour for separation is rooted in the fact that the risk of reputational losses increases when a central bank has sole responsibility for banking supervision. This is occasioned by the fact that supervision entails a higher visibility of failures than flagships (Goodhart, Llewellyn,2006) and Herring, Carmassi (2008). This further cause’s complicity where in order to stem reputational losses the bank may accommodate bail out pressures using liquidity tools (Masciandaro et al,2010) Because reputation and credibility are crucial for effectiveness of monetary policy, central banks are better off veering away from banking supervision.

The Changing Structure of the Financial System

Hitherto, banking was limited to financial intermediation by commercial banks and with the onset of other non-bank financial institutions there were clear cut demarcation between the activities of the various institutions (Goodhart, 2000). The regulation of these activities would be mainly protecting consumer interest and welfare which were issues that were of little significance to the central bank (Blei, 2005). These previously determinable distinctions are now blurred with the advent of universal banking and the sophistication in financial instruments (Borio, Filosa, 1994). Many policy makers made changes in the regulatory structure to accommodate the changing landscape of the market

III. Arguments for Unifying Banking Supervision

Information Related Synergies

Because prudential regulation is closely related to macro-economic policy, it has been argued widely that both operations should reside in a unified agency. Data from the banking sector is a critical input into the formation of macroeconomic policy thus there is a consensus that central banks ought to have direct involvement in this key variable for proper interpretation (Bernanke, 2007). Splitting the functions into two will be costly as there will be duplication of effort in collecting the information (Llewellyn, 2006).

He stated further that central banks require information about the liquidity and solvency of banks when considering its lender of last resort role. Other arguments are that it is more difficult to coordinate between institutions than it is to coordinate between departments and institutions have an aversion for sharing information (Blei, 2005)

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The Systemic Risk Argument

Central Banks have a mandate for systemic risk which is a function of the prudential regulation of banks and the risk for the financial market as a whole thus it is more practical for banking supervision to be undertaken by the central bank (ECB, 2001).

The central banks focus on systemic stability allows them better perspective of the likelihood and potential impact of macro-shocks in both domestic and international markets whereas a separate agency focuses on issues bordering on investor protection (ECB, 2001).

Independence of Central Banks

Central Banks are more likely to be independent from political and other external interference in carrying out banking supervision function. They are also more likely to be immune from regulatory capture by the supervised institutions which is largely predominant in developing countries (Davis, Obasi, 2009).

Skilled Staff

Proponents of the unified regulatory system have argued that central banks have the ability to hire more qualified staff (Quintyn, Taylor 2007). Due to its status and prestige, it is able to attract more qualified staff into the institution than an agency that is the offshoot of the central bank. This is all the more valid when regulators have to compete with the market to attract qualified personnel as supervisors.

Further Determinants of Banking Supervision Structure

Apart from the clear cut pros and cons of either separation and unification of regulatory roles, there are other variables that have come about in the discourse of this topic which are discussed below.

Emerging/Developing Country

Goodhart (2000) postulated in his paper that the arguments enumerated above will be secondary in the case of emerging countries and developing economies. Firstly, this is because the banking in developing countries is not as complex and sophisticated as obtained in developed countries. It is mainly restricted to core commercial banking thus the blurring of the boundaries between financial intermediaries and complexity of markets that give rise to structural changes in regulation are absent. Goodhart (2000) also advanced the second reason as the tendency to focus more on systemic risk than prudential regulation and consumer interest because developing nations are more prone to systemic disturbances. Lastly the issue of personnel quality and status of the central bank in an emerging country is a key variable because they play important roles as specialist experts in international financial dealings and the perception of other central bankers is vital in maintaining confidence in the country's economy. The above explanations sheds more light on the unified approach of most developing countries, if there are any changes at all many are responding just like their counterparts worldwide on strengthening the structure of their regulation.

Corporate Governance

Corporate governance as it relates to regulatory and supervisory organisation is a key consideration in organising the regulatory framework of any economy as a sound governance structure will enhance the reputation, credibility and effectiveness of an agency (Llewellyn, 2006). It is also pertinent that an agency is able to demonstrate its independence, integrity, transparency and accountability.

Regulatory Capture

The literature of supervisory architecture has also been viewed from the political economy prism – this is the relationship between politics, government and bank supervision (Davis, Obasi, 2009) with all policymakers regarded as politicians. Two approaches have been identified in this arena called the public interest view and the private interest view (Barth et al, 2004). The public interest view is where banks are directly regulated by government in every aspect from ownership to types of lending.

This is evident in powerful supervisory agencies that have the power to completely oversee and discipline banks. The reverse is the case with private interest view where regulation is light and banks are allowed a free reign in their operations such that they can't capture" regulations and subvert the system to work in their interests (Barth et al,2004).

The foregoing shows that there is no optimal regulatory structure but it would be dependent on the variables that are prevalent in the economy in question. Above all the political economy variable is a very important and crucial one that sets the tone for the direction that policy makers tow especially in a developing economy (Barth, Caprio, Levine, 2004).

Central Bank of Nigeria's Financial Regulatory Structure

The CBN was established by the Central Bank Act 1958 (as amended) and commenced operation in July 1959. In 1969, the Banking Decree was also enacted giving full authority regarding banking business in the country. The mandate of CBN was as follows

i. Issuance of legal tender
ii. Maintain the external reserves of the country
iii. Promote monetary stability and a sound financial environment
iv. Lender of last resort
v. Financial Adviser to the Government

In 1991, the Banking Act of 1959 and the Banking Decree of 1969 were repealed and replaced with the Banks and other Financial Institutions (BOFI) Decrees 24 and 25 to strengthen CBN"s position in its oversight of enacting monetary policy, banking regulation and supervision of all financial institutions in the country. The new decree brought non-bank financial intermediaries under the supervision of CBN.

CBN lost its limited autonomy in 1997 with the enactment of the CBN Amendment

Decree No.3 and BOFI (Amended) Decree No. 4. With the enactments of these laws, the CBN was effectively brought back under the control of the Ministry of Finance with regards to bank supervision and regulation. Under this regime the CBN played a relatively ineffective role in bank supervision and lacked any powers to carry out its duties judiciously.

In 1998, the 1997 Decrees were repealed by the CBN Amendment Decree No. 37 and

Bank and other Financial Institutions Decree No. 38 of 1998. These new decrees restored some measure of autonomy to the CBN. Specifically, they empowered the CBN to review or revoke banking licenses. In 1999 a further amendment to the BOFI decree was made - Bank and other Financial Institutions Decree No. 40 of 1999 allowing CBN to remove the officers of any financial institution and apply the rules applicable to failed banks to other non-bank financial institutions. A major change was the enactment of the

CBN Act 2007 which repealed the CBN Act of 1991 and all its amendments. The consequence of the Act was that CBN became a fully autonomous body as regulator and its powers were enlarged to include serving as economic advisor to the Federal Government.

In 1994, the CBN in a bid to ensure that there was some form of coordination in the activities of all the regulatory agencies for effective oversight of the financial sector established the Financial Services Regulation Coordinating Committee (FSRCC). It is noteworthy that the committee was only accorded legal status by the amendment to the

CBN Act 1991 in 1998 and was formally inaugurated in 1999. The following institutions were members of the committee :

i. Central Bank of Nigeria (Chairman)
ii. Corporate Affairs Commission
iii. Securities and Exchange Commission
iv. Ministry of Finance
v. Nigeria Insurance Commission

The Nigerian Deposit Insurance Corporation (NDIC)

NDIC was established by the promulgation of Decree No.22 of 1988 due to the identified need to safeguard depositor's funds. With the liberalisation policy on the back of the Structural Adjustment Programme of the government in 1986, there was a proliferation of banks in Nigeria. The number of banks in Nigeria increased from 40 to 120 between the periods 1986 – 1992 such that the banking landscape became mired in problems. These problems include the following:

i. Sharp practices due to increased competition in the industry
ii. Unscrupulous individuals became promoters of financial institutions
iii. Inadequate Skilled Manpower

In 2006, the decree was repealed and replaced with the NDIC Act No. 16 of 2006 with the following public policy objectives,

i. Protect small uninformed investors and less financially sophisticated depositors by providing an orderly means of compensation in the event of failure of financial institutions.
ii. Contribute to the financial system by making incidence of bank runs less likely
iii. Enhancing public confidence and systemic stability by providing a framework for the resolution and orderly exit mechanisms for failing and failed institutions

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Securities and Exchange Commission (SEC)

Another key institution in the financial landscape in Nigeria is the Securities and Exchange Commission responsible for the oversight of Nigeria's capital market. SEC was promulgated under the SEC Decree number 71 of 1979 to replace the Capital Issues Commission. Prior to promulgation of SEC, the capital market regulation was carried out under the supervision of the CBN. The SEC Decree no 71 was repealed by the SEC Decree number 29 of 1998 and two further amendments were made in 1999 and 2007. SEC is

currently governed by the Investment and Securities Act Number 29 of 2007. SEC is a member of the FSRCC and rightly so because of the importance of the capital market as a strong pillar for economic development in any country. The Nigerian capital market has a long run as one of the most profitable stock exchanges in the world and was the toast of many international investors but this trend reversed after the global financial crisis. Investigations into the slump of the capital market could be attributed partly to bank regulation failure which will be discussed later in this paper.

The Banking Supervision Structure

Until 1965, the CBN operated a "scrutiny section" whose primary responsibility was the off-site supervision of banks with the Ministry of Finance taking charge of the on-site examination functions through the Banking Examination Department (BED). The banking supervision function was transferred fully to CBN in 1966 with the BED transferred and merged with the hitherto scrutiny section. The status quo held till 1977when the BED was renamed Banking Supervision Department (BSD) with four additional divisions created – Central Supervision, Field Examination, Financial Sector Development Division and Foreign Exchange inspectorate Division.

In 1986, the Federal Government embarked on a liberalisation of the banking sector with the adoption of the Structural Adjustment Programme. As highlighted earlier the number of banks surged dramatically from 40 in 1986 to 120 in 1992 with a number of unscrupulous practices introduced into the sector. This led to the establishment of the NDIC as depositors‟ funds insurer and also to complement activities of CBN with on-site and off-site supervision. Accordingly, the BSD was now split into BED and BSD and assigned on-site and off-site responsibilities. The Central Bank continued to operate this method until the outbreak of the subprime crisis which led to major reforms in the banking supervision mandate of the bank.

As banking regulator in Nigeria, a developing country, CBN plays an important role in the development of the economy. Banks which are under its purview are a major factoring the stimulating of economic activity in their role as financial intermediaries. In light of the recent global financial crisis we will in particular assess the effectiveness of prudential regulation by looking at banking reforms attempts and attendant bank failures in Nigeriato date and reasons that can be attributed to the situation.

IV. NIGERIAN BANKING SECTOR AND THE GLOBAL FINANCIAL CRISIS

The Effect on the Banking Sector

The Subprime crisis that engulfed the world in 2007 reverberated in all economies.

Developing economies like Nigeria's did not feel the first wave of the crisis as the financial sector is not fully integrated with the global markets; it was the second wave that hit Nigeria and exposed the sordid on goings in the financial sector. The first hit for the Nigerian economy was the reduction in oil revenue for government as this was a major source of income for the country. Government has to resort to dipping into the excess crude oil account and domestic borrowing to meet its obligations with the attendant effect of a devaluation of the currency. Foreign direct investment and foreign trade finance lines for banks were significantly reduced but the greatest impact was in the capital market. Nigeria's capital market the darling of foreign investors saw a huge withdrawal of these funds when the crisis kicked in, the Nigeria Stock Exchange all share index which gained a record 74.73% in 2007 has slumped by 45.8% as at close of 2008 (Oteh, 2010).

These twin effects – the reduction in global oil prices and the slump in the Nigerian stock exchange threatened to pull down the entire banking sector. Between 2004 and 2008, there was an upswing in oil prices culminating in huge foreign exchange inflow and attendant increase in economic growth. Consequently, there was huge liquidity in the system and the excess was channeled to the stock market explaining its impressive performance. Also banks used this as an opportunity to bolster their capital base. By the end of 2008, banking stocks made up 60% of the market capitalisation.

In a bid to utilize the significant capital and liquidity at their disposal, banks set about creating risk assets where they had no expertise especially margin lending and oil and gas financing. By end of December 2008, the banks' total exposure to the oil and gas industry had accumulated to N750bn, representing 10% of industry assets and over 27% of shareholders' funds whilst exposure to the stock market was N1.6 trillion. In the words of the CBN Governor "when the global financial crisis set in mid-2008 the domestic financial system was already engulfed by several interdependent factors that led to the re-emergence of an extremely fragile financial system to pre-consolidation era. Indeed, the Nigerian banking sector was thrown into severe crisis as many banks became distressed.

CBN took various initiatives to contain the distress but the banking system remained fragile and was virtually at the point of collapse. One of the measures taken by the CBN was the expansion of its discount window to 360 days to allow banks restructure their margin loans. Similar measures included progressive reduction of cash reserve ratio from

4.0% to 1.0% and liquidity ratio from 40.0% to 25.0% to further ease the liquidity crunch. Despite these far-reaching measures, nine banks remained perpetual borrowers at the discount window and posed a risk to the collapse of the financial system.

With a view to solving the problem, a special joint audit of all banks was embarked upon by the CBN and NDIC to assess the true financial condition of the banks; the result of this audit exhumed the rot that had hitherto plagued the banking system in Nigeria and resulted in the removal of 8 bank managing directors.

3.1.1 – The CBN/NDIC Special Bank Audit

As highlighted above, with the threat of imminent collapse of the financial sector, the
CBN/NDIC commenced a special investigation into the books of the 25 banks that also included a diagnostic audit carried out through independent consultants. The results of the tests showed that 9 banks were technically insolvent on account of capital, liquidity and corporate governance problems revealing illegal activities that had been taking place in a few of the affected banks.(CBN, 2011 statistical bulletin).
Five of these banks were in grave danger and constituted a systemic risk to the sector at large such that the CBN had to guarantee all inter-bank loans to these banks to prop up the market. Available results from the tests showed that the five banks had aggregate nonperforming loan portfolios of 40.8% and accounted for a significant proportion of total bank exposure to the stock market and oil and gas sector. Furthermore the banks accounted for 39.93% of total sector loans, 29.99% of deposits and 31.47% of total assets as at the 31st May 2009.
On the basis of the report of the special audit and invoking the powers of the CBN governor as contained in Sections 33 and 35 of the Banks and other Financial Institutions
Act 1991, the Managing Director and the Executive Directors of the following banks were removed :
1. Afribank Plc
2. Intercontinental Bank Plc
3. Union Bank of Nigeria Plc
4. Oceanic Bank International Plc
5. Finbank Plc
The CBN also went further to inject N400bn into the banks in the form of Tier 2 capital to be repaid from the proceeds of future capitalisation of the banks. The funds would be divested as soon as new investors took over the banks. In addition to the above, the CBN broke the traditional banker-customer relationship by publishing the names of all the bad debtors of these banks in the daily newspapers and collaborated with the law enforcement and anti-corruption agencies to recover the loans.

V. CAUSE OF BANK FAILURES IN NIGERIA

The sacking of Managing Directors and Executive Directors in the five banks was an event that was long overdue in Nigeria. The report of the special audit into the activity of banks did not reveal anything radically different from the earliest failures in the market in the pre-independence days and late 1980‟s. In the following section we will look at the specific problems highlighted in the banks from these prisms – Institutional, Economic and Political Factors (Ogunleye , 2010),

Institutional Factors

Weak Corporate Governance/Insider Loans

At the heart of every bank failure in Nigeria is the discovery that there are weak corporate governance measures in the banks. Many banking licensees in Nigeria had been given to people who were highly connected to the government so there was difficulty in ensuring that corporate governance standards were adhered to. It was a known fact that decisions were given social and political considerations rather than implementing decisions that were in the best interest of the institution. In addition many private investors saw the banks as a personal business with children and family members who were not qualified in any way occupying key positions in the bank. With the proliferation in the 1980‟s, most of Nigeria's elite families had key stake holdings with the public perception that this was their bank. The consequence of this quantum leap in the number of banks was the lack of skilled personnel in the industry. A number of bankers rose rapidly through the ranks by moving jobs frequently giving rise to many inexperienced senior managers in the sector. The CBN Governor did acknowledge that this was the principal factor contributing to the financial crisis.
Examples of the extent of the criminality exhibited by bank management included the establishment of Special Purpose Vehicles to lend money to themselves for stock price manipulation and purchase of real estate all over the world. One of the troubled banks borrowed money to buy jets only to have them registered in the CEO‟s sons name – he was the Chief Operating Officer of the bank! In another bank, the management set up 100 fake companies for the sake of perpetuating fraud. Suffice to say, CBN did have corporate governances codes in place but these were not enforced in any way.
It is instructive to note that many of the directors of these banks had taken these loans with no intention of paying back. The banks usually manipulated their books to clear out these loans. Sanusi, (2010), Code of Corporate Governance Post Consolidation – Central Bank of Nigeria (2006)

ii. Inadequate Risk Asset Management
Many banks did not have credit policies in place to guide them in the creation of risk assets and even when they were in place, they were not strictly adhered to by the banks.
Loans were given out without due consideration to the ability of the customer to repay, many loans were given out as order from above in the case of many institutions to friends and associates of the directors and owners of the business. In addition many loans

were given out with highly overvalued assets as collateral and in some cases no collateral at all gambling with depositors funds. There was also a large asset and liability mismatch in the balance sheet of many banks, a lot had hitherto relied on public sector funding for liability generation and when these funds were recalled from banks threw many into serious problems. Expectedly, this put a lot of strain on the capital of banks and is clearly reflected in CBN's response by regularly increasing the capital limit at every banking policy reform.

iii. Inadequate Disclosure

It is widely acknowledge amongst banking operators in Nigeria that only very few banks report accurate data to CBN in their monthly returns. Therefore with inaccurate data it would be extremely difficult for the CBN to understand what is truly going on in the banking sector. It is also unnerving to note that some of the banks that have failed in the wake of subprime also had positive ratings from reputable credit agencies such as Fitch.

The banks were also able to sway the banking public with selective disclosure of certain aspects of their balance sheets highlighting their ever-increasing billion naira albeit non-existent profits. This sent out the wrong message to the investing populace with many unwary investors drawn to the banking stocks in the capital market.

Economic Factors

Nigeria is a mono income country relying mainly on oil revenue for economic growth. In every cycle of bank failure, oil price volatility has always been a trigger in straining the system due to inadequate policy response.

During the banking failures in the late 1980"s the collapse of oil prices was the main trigger that brought about low economic growth and high level of inflation making it difficult for existing borrowers to service their loans. To address these concerns, the Structural Adjustment Programme was embarked upon in 1986 with measures including liberalisation of bank licensing and deregulation of interest and exchange rates. Whilst liberalising interest rates put pressure on borrowers, banks profited massively from the exchange rate deregulation by simply purchasing foreign exchange from CBN and selling same at the parallel/black market. At this time, CBN also decided to withdraw public sector funds from banks thereby exacerbating the problem thus it was no surprise that within a decade over 20 banks had collapsed.

The third wave of the banking crisis had its roots in the oil price increase between 2004and 2008. Government spending was in tandem with the increase in oil prices with the excess liquidity finding its way into the banking system. Banking assets increased four times between these years with foray into margin loans and the oil and gas business. A lot of margin loans by the banks were actually proprietary trading activities disguised as loans. Consequently the Nigeria Stock Exchange index increased fivefold at its peak in 2007 whilst banking stocks increased nine fold. The stock exchange attracted massive foreign investment for the best performance in the world; it was thus no surprise the dire crash that occurred once fortunes reversed at the onset of subprime. Regulatory authorities did not take adequate measures to ensure the massive liquidity did not flow into the banking market but rather embarked on a consolidation exercise which worsened the situation – after the consolidation banking assets grew by 76% annually.

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Political Factors

Political instability in Nigeria also has its place in the discourse of banking failures. The tension between military and democratic rule took its toll on the banking sector in the late 1980"s to early 1990"s with the panicking populace withdrawing massively from the banks.

The licensing of banks in Nigeria was also a very political process. Many banks today count amongst the majority shareholders Nigeria's social elite and retired military officers. Of equal importance is the political will to fight the menace in the banking industry, the CBN sometimes is handicapped because a lot of the bank failure culprits are the untouchables of society. In fact the first significant step to bring bank defaulters to book was the promulgation of the Failed Banks and Financial Malpractices Act of 1994and the setting up of a failed bank tribunal. Prior to this, many borrowers saw bank loans as their "share of the national cake". The tribunal had 139 cases filed by the CBN with 44judgments delivered and 144 people convicted. Suffice to say there were only very few "big fish" apprehended as those convicted were usually the managers in the bank taking instructions from above, many cases were transferred to the state courts with the closure of the tribunal culminating in a drastic slowdown in delivering judgments. In my opinion, it is fair to rationalise the problems in the banking sector as an expression of the endemic corruption the country.

Central Bank of Nigeria's Role in Banking Crisis

The aim in this part of the paper is to review the role of CBN as banking supervisor and regulator from the same three prisms used to highlight the banks failures. Evidently CBN also carries some of the blame in the debacle that has occurred in the banking crisis especially the third wave in the wake of the global financial crisis. It would be apt to say that CBN fell asleep at the wheel in its function as banking supervisor and regulator.

Institutional Factors

CBN was unable to unearth the practices going on at the banks not just because of an inadequate number of personnel but also skilled personnel. With the liberalization of the banking sector and the enormous jump in number of banks in the late 1980"s, CBN was simply unable to cope as banking supervisor. As a result of this, many banks went through the accounting year without an on-site

examination by banking supervisors and when this even happened the examination cycle which ought to have been yearly was conducted at intervals of two to three years. The implication of this trend was that problems were always detected very late.

Another significant issue was the fact that CBN banking examiners lacked the required expertise to detect fraudulent practices at the banks. The proliferation of banking institutions in Nigeria brought with it an information technology era thereby making it easy for data to be manipulated to facilitate window dressing of their balance sheets. The submission of monthly returns by banks to CBN was also plagued by inaccurate data inhibiting any quality trend analysis in many banks. It is however pertinent to mention that until the release of Statement of Accounting Standards No. 10 in 1990, there was no uniform reporting standard making it easy for inadequate disclosure by banks.

CBN put in place an electronic rendition system (Financial Analysis and Surveillance System) to address this trend as part of the banking reform agenda in 2004. However the effect of this new application is not apparent as this problem of false data was still an issue in the banking crisis of 2008. Data from the banking sector is a key component of macroeconomic policies of any country thus reliance on this data did not augur well for the enactment of any meaningful policies. The emphasis on credit risks by the regulatory authorities also made them miss problems in the banks. It is only recently in line with international standards that the risk-based approach has been adopted by CBN banking supervisors.

One of the problems with CBN as admitted by the Governor is the poor structure of the banking supervision department which has hindered effective monitoring and enforcement of regulation. There were no specific individuals allocated to cover various aspects of the supervisory role, the on-site and off-site supervisory teams worked unilaterally as they were not even based in the same location. A major lapse that also came to light was that there were no exhaustive pre and post consolidation exercises even after the bank consolidation reform agenda was announced in 2004.

Another regulatory lapse was the lack of co-ordination between Financial Sector regulators, the CBN and SEC were unable to detect the sharp practices that many banks had adopted to invest in the stock market. Both institutions never exchanged any banking examination reports to enhance their oversight function considering the key importance of the banking sector and capital market as engines of economic growth. On the part of the CBN, there was no comprehensive legal and regulatory framework to ensure that there was a clear mandate for banks to follow in margin lending activity. The FSRCC made up of representatives of the CBN, SEC, Nigeria Insurance Commission, Ministry of Finance and Corporate Affairs Commission did not meet in the two years before the subprime crisis induced failure.

Economic Factors

A major failing of the CBN was inadequate macroeconomic policies to stem the tide of the economic downslide in the country. As already highlighted above, oil is a major revenue stream for Nigeria with the country very vulnerable to the volatility in global oil prices. It is instructive that there was no structure in place by the CBN to ensure that this was adequately managed in tandem with the banking sector. The aggressive lending being undertaken by banks and the financial bubble they created at the stock exchange was seen as indication of a growing and vibrant economy. It was not apparent to the regulators that the growth in these sectors without a commensurate increase in the activity of the real sector indicated that there was a problem at hand. Credit was not extended to vital sectors in the economy, unemployment remained high and many manufacturers were operating well below capacity. Infrastructure development was at its lowest ebb in the country with poor transportation, electricity and inadequate housing for citizens. The human development indices of the United Nations rated Nigeria poorly; the only good news from Nigeria at the time was reporting of record profit levels by banks and accolades on having the most profitable stock exchange.

Interestingly, many Nigerian banks and their Managing Directors received numerous international awards on the growth in the sector and innovation in banking thus giving a false assurance that things could be no better.

Political Factors

The position of CBN Governor is a political appointment by the President; the nomination is forwarded to the legislators for screening and confirmation. It is noteworthy that due to Nigeria's multi-ethnicity, political appointments are made on what is called a zoning basis – shared out amongst the various ethnic zones to ensure a fair representation in government. This methodology is not in the best interest of the country as candidates with consummate expertise are many times over looked for political expediency. This arrangement makes it difficult for a CBN Governor to function effectively and be truly independent. Many of the promoters of banks in Nigeria are well connected politically with a number the major contributors to the campaigns of various members of the political class. Many banks have also been identified as accomplices in money laundering activities by the political class. Banking licenses were awarded based on political connections and also led to regulatory forbearance in many instances.

VI. CONCLUSION AND RECOMMENDATION

Financial Sector and Economic Growth

Nigeria's economic growth has not been commensurate with the potential that is available to her. The growth has been stunted due to fundamental weaknesses like mono product economy and very poor infrastructure. The school of thought that reforming the banking sector without fixing the fundamental issues especially macro-economic stability is flawed, for Nigeria to harness its potential there should be reforms in all key sectors simultaneously. The latest reform agenda by CBN is a laudable plan that can deliver the required transformation if the implementation is right and the political will to make it happen is available.

The growth and transformation of Nigeria's economy hinges on the appropriate management of the volatility and distortions that is experienced by the over-reliance on oil and rejuvenating the non-oil real economy to stimulate employment. Agriculture is an area that is a potential revenue generator for the government and should be encouraged to grow. It is only in addressing these macroeconomic variables alongside banking reforms that lasting change can occur in the banking sector.

Regulatory Agencies Reform

A critical part of the reform agenda is the role of the regulatory agencies. The CBN on its own cannot deliver on the wide remit of the agenda thus all regulatory agencies need to work together to deliver the much required development to the economy. This is a laudable initiative and it is an opportunity to tackle what has long been identified as issues plaguing the nation. One of the key issues for the regulatory agencies themselves is getting skilled and experienced personnel from the banking sector to improve effectiveness of their roles. A key lapse that has come through is the lack of collaboration between the agencies. For instance, during the entire crisis the FSC and FSRCC never had regular meetings to get a holistic picture of the state of the economy.

The regulatory agencies have started on internal reorganizations to meet the challenges and ensure better oversight of the sector. CBN has already started on a massive reorganisation of it departments for effective discharge of its duties. It has also strengthened its workforce with the employment of highly qualified citizens from the pool of talented Nigerians in developed countries.

Similar reorganisation is also ongoing in SEC, many securities firms and stock brokers were named as bad debtors in the name and shame tactic of the CBN and are currently undergoing investigation by SEC.

To facilitate the reforms going on in the sector, a critical piece is the legal landscape of the nation. Judicial reform is vital in helping the agencies fulfill their mandates. In the case of the sacked managing directors in 2009 just one case has been concluded via a plea bargain. The other cases are been adjourned at every opportunity with defense lawyer shaving perfected the method to prolong the cases unnecessarily.

A viable option is to re-introduce special courts to deal with these issues. This was an initiative that worked well with the establishment of the failed banks tribunal after the second banking crisis. This will ensure quick determination of charges against financial market operators and will serve as a deterrent in the market. This is an initiative that should be given urgent consideration because two vital financial market agencies in the market are opportune to have erudite professionals who possess the political will to enforce compliance with the rules no matter whose ox is gored. However these appointments are for a term of five years and it is probable that the individuals will be replaced at the expiration of their tenures in line with zoning method for political appointments in Nigeria. In my opinion, I believe that it is time for the country to ensure that vital agencies that require technical skills are not subjected to political maneuverings but employ a methodology where the mantle falls on the most qualified persons available.

Separate Supervisory Agency?

A review of the banking sector indicates that the major problem is not the lack of a separate agency but rather economic, institutional and political factors as highlighted in this study. The problems stem from regulatory failure by the CBN – directly via negligence of duty and indirectly due to inappropriate macro-economic policies.

Having established this fact, even with both mandates under CBN supervision, there was an inability to pursue their responsibilities effectively. Arguments for separation of supervisory duties suggest that there would be conflict of interest, excessive powers and reputation risks. In the peculiar Nigerian scenario, these issues do not impact regulation as expected because the financial market is not as developed and robust in developing countries. The macroeconomic fundamentals that affect the industry should rather be seen as policy lapses rather than conflict of interest. In terms of excessive power, CBN is actually a weak institution from a political economy perspective. Because the appointment of the governor is a political one, there has been a lot of restraint by CBN governors in enforcing some of the rules.

Regulatory capture also occurred with the CBN due to political pressure as many of the promoters of Nigerian banks are well connected to the ruling class. We thus had a situation where rather than enforce regulation banks were given liquidity support because of their relationship to the government. Another perspective to independence of CBN is the role and motives of the individual. The forthrightness and the boldness of the former CBN governor (Lamido Sanusi) have been attributed to the fact that he is a prince of a prominent ruling Northern family and therefore has the clout to tread where his predecessors did not dare. To buttress this point, he in a speech during his tenor, alerted Nigerians to the fact that their legislators were earning the equivalent of about $1.5m annually! This indeed caused a furore in the populace as it was rather ironic that legislators in one of the world's poorest countries were receiving almost quadruple the $400,000 annual pay of the President of the United States of America. The Governor was invited to the legislative chambers and admonished by legislators to retract this statement and in a live broadcast the stood by his statement and declared he was ready to be relieved of his position.

A key solution to the above problem will be a mechanism to ensure that the political interference is reduced to a bare minimum in the sector. One way this can be done is enforcing corporate governance codes in the banks and finding ways to ensure that financial institutions have diversified holdings. It was Lamido Sanusi who put out a circular directing any Managing Director who had been in office for more than 10 years to stand down from the position and 3 managing directors had to leave office. This is one of the ways that CBN can implement effective supervision in the banks even though it remains to be argued if they are over stepping their boundaries. Having said this, Nigeria is a peculiar environment with its attendant issues and unusual policies that address this peculiarity should be adopted if required. An unconventional method adopted by CBN is the publication of debtors of the banks that had their managing directors removed in the national newspapers. Without doubt the CBN fits the criteria for a unified agency to

allow for information synergies and a better approach for systemic risk which the ongoing reform will address if there is adequate implementation. It will however require the buy in of many governmental agencies such as the Ministries of Finance, Trade and Investment and Infrastructure. In a highly politicized government such as Nigeria's rather than cooperate with this laudable programme of CBN, some ministers may see it as an encroachment of their remit and thus not work in the best interest of the country. It is hoped that the current CBN Governor will have the kind of gut that his predecessor had to surmount the challenges posed by our political environment.

VII. CONCLUSION

Nigeria is a country with great potential and to achieve this potential a vibrant financial sector is required to drive economic growth and development. Two main areas that would drive this are the banking sector and the capital market, the current reform exercise presents an opportunity to tackle fundamental flaws in the system and reposition the economy for greater heights.

It would be of immense benefit if the current reform embarked upon by the CBN is actually incorporated as a national agenda. The initiative is a long term one and it would only deliver if it is implemented as currently articulated. There is a possibility that if anew governor may not follow upon, and as often witnessed in Nigeria, the new governor may want to be seen as initiating something new thereby not giving the reform agenda the priority it requires. Governmental agencies will also need to work with the CBN in actualizing the proper disbursement of the huge resources allotted to the developmental funds created by the CBN on infrastructure, manufacturing, power and aviation. Ideally one would have expected that these initiatives would come from the governmental agencies in charge of these areas.

Undoubtedly, the extent of the reform required to sanitize the banking industry in Nigeria calls for a unified approach to the CBN mandate. The peculiar nature of the environment requires a holistic approach to tackle the fundamental and inter-related issues and necessitates that several agencies work in a cohesive manner in the interest of the country.

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