CENTRAL BANK OF NIGERIA

GLOBAL FINANCIAL CRISIS IMPACT IN NIGERIA, NIGERIAN FINANCIAL REFORMS AND THE ROLES OF MULTILATERAL DEVELOPMENT BANKS AND IMF

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Submission to the House Financial Services Committee of the US Congress Hearing on the Global Financial Crisis.

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1.0 Introduction

The recent global financial crisis had a deleterious impact on the world economy, especially on the financial system in most countries, whether developed, emerging market or developing countries. In the wake of the devastating effects of the crisis, governments as well as central banks all around the world adopted several measures including some unconventional ones to deal with the crisis. The effects of the financial crisis still lingers too date as countries continue to struggle to bring back their financial institutions and markets to a stage where public confidence is fully restored and financial institutions, especially banks resume their intermediation role through resumption of lending activities.

Like most developing countries, Nigeria felt the effects of the financial crisis largely through trade and capital flows because of the openness of the economy and the near total reliance on crude oil exports for government revenue and foreign exchange earnings. The impact of the crisis through the financial system was not as direct or devastating as those of developed and emerging market economies where there was a near obliteration of the entire financial system because of the limited integration with the global financial markets. However, when the impact of the crisis permeated Nigeria's financial system, the soundness and stability of the system was seriously threatened prompting a decisive intervention of the Central Bank of Nigeria (CBN) to mitigate the emerging crisis and restore public confidence.

The objective of this paper, therefore, is to review the impact of the recent global financial in Nigeria and the reforms put in place to mitigate the effects of the crisis on Nigerian banks. To this end, the remainder of the paper is divided six sections. Following this introduction, section II provides a brief overview of the

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genesis/causes of the crisis. Section III discusses Nigeria's experience highlighting the policy responses by the authorities. Section IV examines the role played by multilateral organizations to support Nigeria in the face of the crisis while section V discusses the recent banking sector crisis in Nigeria and reforms embarked on to address it. Section VI presents the way forward while section VII concludes the paper.

2.0 The Recent Global Financial Crisis (GFC)

2.1 The Genesis of the Crisis

The deregulation of financial markets in the United States which replaced prudential supervision with risk pricing in the 1990s led to an increase in financial assets in which there were many obscure market players and bonds replaced bank loans. During the mortgage boom of pre-2007, mortgage brokers enticed buyers with poor credit to accept housing mortgages with little or no down payments and without credit checks. As a result conventional mortgage was not offered because the lender viewed the borrower as having a larger-than-average risk of default on loans. Lending institutions charged interest on sub-prime mortgages at rates that were higher than a conventional mortgage in order to compensate for carrying more risk. Banks and financial institutions repackaged these debts with other high risk debts such as Collateralized Debt Obligations (CDOs) and Credit Default Swaps (CDS) and sold them to global investors. Collateral Debt Obligations (CDOs) no doubt increased the liquidity in the system but at the same time encouraged reckless lending practices. By 2005, one (1) out of five (5) mortgage lending in the US was sub-prime. The rates for the sub-prime were higher because they had Adjustable Rate Mortgages (ARMs). The rates were fixed for two years; thereafter the rates were marked to the Fed interest rates which rose substantially. The magnitude of the repossession that followed as rates reset to market rates, coupled with the mortgage company's inability to renegotiate loans, led to the collapse of the government-backed mortgages.

Financial contagion resonated worldwide owing to the integration of the global financial system and stocks in all major exchanges tumbled steadily as the crisis grew. By September 2008, the crisis had worsened as stock markets around the globe crashed and became highly volatile, while consumer confidence dipped. Apart from the US where the crisis of confidence that started with the Indy-Mac Bank spread to other depository and mortgage institutions, including Freddie Mac and Fanny Mae, to mention a few, it also led to the bankruptcy and eventual collapse of the third largest mortgage lender. The contagion effect was in no time felt across Europe, Asia and other emerging economies in such depth that was comparable with the Great Depression of the 1930's and the Great Inflation of the 1970's.

The reality of serious economic downturn led various governments to initiate unprecedented financial bail outs, coupled with subsequent massive fiscal stimuli to reverse the trend and bring the world economies out of the doldrums. The policies adopted varied from interest rates cuts, bail-out packages, nationalization of financial institutions, swaps arrangements, coordinated rates cuts among central banks, etc. In the United States for instance, temporary swaps of treasury bills for mortgage-backed securities and ban on short selling of 799 financial stocks in September 2008 were also adopted. Others included the sale of Bear Stearns, bail-outs of American International Group (AIG), Fannie Mae and Freddie Mac, and Citigroup, among others. In the Euro zone, the European Central Bank (ECB) injected about US$84.0 billion into the economy to ease liquidity problem. It engaged in coordinated rate cuts with six major central banks (the Federal Reserve, Bank of England, Bank of Japan, RBA, Bank of China, and Swiss National Bank). It also used swap lines from the Fed to support its US dollar operations, among others.

In emerging Asian economies, the People's Bank of China reduced interest rate on October 8, 2008 by 0.27 per cent to 6.93 per cent from 7.2 per cent to reduce borrowing costs, while the Government created a stimulus plan in November, 2008. The Bank of Japan injected 2 trillion yen (£11.67 bn) into the money market. Indonesia, in line with the move adopted by several countries, reduced its overnight repo rate by two percentage points to 10.25 percent. The government also introduced safety net regulations that allowed the government and the central bank to quickly address financial sector weakness. It revised the year's budget to reduce financing needs, pledged to respect the free movement of capital and also set up a task force to manage the crisis.

African economies that were considered relatively insulated from the contagion became as vulnerable as other regions. The South African Stock Exchange lost 27.0 per cent and the rand slipped by almost 30.0 per cent, while in Nigeria, the impact of the global financial crisis manifested first in the Nigerian stock market from the second quarter of 2008 following speculations and perceived uncertainties that led to the divestments by many foreign portfolio investors from the country. This was later followed by the falling price of crude oil at the international market which triggered a subsequent depreciation of the naira against the US dollar, particularly from November 2008.

3.0 Nigeria's Experience

Given that Nigeria's economic growth and development in the last decade has to a large extent been influenced by massive inflows of venture capital, equity/portfolio and other foreign direct investments, it was obvious that Nigeria could not be isolated from the happenings in the global financial system. There was the initial belief that the Nigerian financial system and, indeed, the economy were shielded from the crisis. The perception was rooted in the recent banking sector reforms particularly the recapitalization exercise which repositioned them as global competitors. Nevertheless, a great deal of financial integration had interlocked Nigeria's financial system to that of the larger world.

3.1 Impact of the GFC on the Nigerian Economy

The Nigerian economy was not insulated from the impact of the global financial crisis that affected most of the world economies. It is pertinent, therefore, to explore the impact of the global crisis on the Nigerian economy with a view to highlighting the various intervention measures that were applied to mitigate the deleterious effects on the economy. The impact of the GFC on Nigeria was not direct as the financial institutions in Nigeria were not fully integrated into the global financial market and as such did not have the financial instruments that created the crisis in their balance sheets. However, the effect was felt through the second-round effects when the GFC culminated into an economic crisis by early-to-mid 2008.

The GFC impacted the Nigerian economy through several channels amongst which were:

- Lower crude oil demand
- Lower crude oil price
- Lower revenue
- Lower foreign exchange earnings/export receipts
- Lower capital inflow

- Higher capital outflow – divestment from capital market particularly of portfolio investments
- Drying-up of lines of credit to Nigerian banks

The decline in foreign exchange earnings led to a reduction in revenue and expenditure profiles of the three tiers of government as a result of the steady fall in the monthly allocations from the Federation Account. The wider implication of this was the limited implementation of government projects, with the financing of capital projects limited to the priority sectors leading to non-realization of key government programmes such as the Millennium Development Goals.

The fiscal operations of the Federal government relied heavily on funds raised through issuance of FGN bonds, which led to the crowding-out of the private sector in the credit market resulting in higher interest rates and other additional charges. The fall in government revenue necessitated the revision of the 2009 Federal Government Budget, which negatively affected the welfare programmes and government plans to build and renovate dilapidated infrastructure.

Output growth fell slightly from 6.45 per cent in 2007 to 5.98 per cent in 2008, but recovered to 6.67 per cent in 2009 and projected to rise to 7.75 per cent by end-2010. The decline in output was largely associated with higher cost of obtaining working capital by industries, as banks increased interest rates and reviewed collaterals for their loans as securities such as shares lost value. Industries were also faced with high cost of procuring inputs that were mainly imported in the face of exchange rate volatility and risk. Overall, the consequences were increased unemployment, de-industrialization and higher inflation.

The crisis led to a de-accumulation of external reserves owing to the sharp fall in crude oil prices and the attendant decline in crude oil export earnings. The crisis also precipitated the decline in global financial flows to Nigeria in the form of foreign direct investment, portfolio investment, Oversea Development Assistance and remittances as a result of the restriction by developed economies battling to stabilize their own economies. Owing to the global credit squeeze, the prospects of contracting new concessional and non-concessional loans to bridge the financing gap were dimmed.

The Financial sector was the hardest hit by the crisis. The capital market recorded significant divestment as foreign investors, notably portfolio investors divested to meet their obligations back home in the face of credit squeeze. Consequently, there was a continuous drop in the All-Share Index as well as the volume of traded securities at the Nigeria Stock Exchange. The market capitalization which was N13.0 trillion in September 2008 fell to N7.2 trillion at end of first quarter, 2009.

The continued depression of the capital market led to higher loss provisioning by banks, owing to the significant exposure through margin lending and share-backed collateral lending thereby depressing profitability and weakening their lending ability. The contraction of bank profit led to retrenchment in some of the banks.

The banking sector consolidation in 2005 was aimed, among others, at repositioning the Nigerian banks to compete internationally. However, the post-bank consolidation exposed a lot of Nigerian banks to global business relationships with some foreign banks that were badly affected by the crisis. Some of them had booked significant credits from some embattled financial institutions and with the credit crunch they were not able to draw on the facilities.

3.2 Policy Responses

Central banks are generally concerned with macroeconomic stability. However, in the wake of the global financial crisis attention appears to have shifted to the maintenance of financial stability through ensuring the proper functioning of the payment and settlement systems. Nigeria has not been an exception to this general trend. Indeed, fiscal policies have been used to ease the pressure of the financial crisis. To supplement government efforts, the CBN also adopted quantitative easing measures to enable the country cope with the impact of the global financial crises (including reduction of the MPR from 10.25 per cent to 9.75 per cent and later to 6.0 per cent in July 2009, reduction in Cash Reserve Requirement (CRR) from 4.0per cent to 1.0 per cent, and reduction in Liquidity Ratio from 40 .0 per cent to 30.0 per cent and later to 25.0 per cent). The Bank also gave banks the option to restructure margin loans. Lending facilities to banks were expanded up to 180 and 360 days, while the CBN opened expanded discount window operations and gave implicit guarantee of bank deposits as well as all interbank transactions.

3.2.1 Response by the Government

The government took the following measures to minimize the impact of the crisis:

- A Presidential Advisory Team on capital market was set up in August 2008 to deliberate on measures to reverse the declining fortunes of the Nigerian capital market. A Presidential Steering Committee on Global Economic Crisis was also, set up in January 2009 to monitor the developments and advise government appropriately.

- The Securities and Exchange Commission, the Nigerian Stock Exchange and all capital market operators reduced their transaction fees by 50 per cent.

- The Nigerian Stock Exchange reviewed trading rules and regulations as well as de-listed 19 moribund companies. Strict enforcement of NSE's listing requirements with zero tolerance for infractions was also put in place.

- The Security and Exchange Commission released guidelines/rules on market makers as well as rules on share buy-back with a limit of 15.0 per cent.

- Introduced a 1.0 per cent maximum downward limit on daily price movement and 5.0 per cent on upward movement. This was harmonized to 5.0 per cent either way at end-October 2008, but was eventually abolished.

- Strict enforcement of NSE listing requirements
- Reviewed budget to cut financing requirements
- Fiscal stimulus through drawdown from oil savings to augment monthly revenue to three tiers of government to mitigate the adverse effect of substantially lower current revenue receipts
- Cut in foreign exchange financed expenditure e.g. overseas trips by government officials

3.2.2 Response by the Central Bank of Nigeria

The Central Bank of Nigeria responded through the following measures in an effort to ensure that there is adequate liquidity in the banking system:

- Reduced the Monetary Policy Rate (MPR) from 10.25 per cent to 9.75 per cent and further reduction to 6.0 per cent, which is the subsisting rate currently.
- Reduced Cash Reserve Requirement (CRR) from 4.0 per cent to 3.0 per cent and to the current rate of 1.0 per cent.

- Reduced Liquidity Ratio from 40.0 per cent to 30.0 per cent and eventually to 25.0 per cent
- Suspended liquidity mop-up operation since September 2009
- Liquidity injection by the Central Bank through the introduction of an expanded discount window and repayment of maturing Open Market bills. This moderated interest rates in the money market and the interbank rates.
- Expanded its lending facilities to banks up to 360 days
- Directed banks that they had the option to restructure margin loans to a longer tenor
- The exchange rate was allowed to adjust to reflect the demand pressures supply; thus, the exchange rate of the naira depreciated from N117 to N135 per US dollar as at end-December 2008.
- Surveillance activities intensified and resident bank examiners introduced in a bid to detect any early warning signal

4.0 Role of Multilateral Organizations

The International Monetary Fund provided some technical support to Nigeria during the financial crisis with respect to the Nigerian banking industry. In this regard, the Fund carried out stress test on the 24 deposit money banks to ascertain the health of the industry.

In addition, the World Bank provided the sum of US$500.0 million to the Federal Government to support the budget in 2009. The African Development Bank (AfDB) also provided US$1.0 million as technical assistance grant for microfinance in Nigeria, US$30.0 million as support for mobile telecommunication and US$78.0 million as loan for water and sanitation project. Furthermore, liquidity supports/lines of credit were granted to some Nigerian banks, namely US$150.0 million to United Bank for Africa; US$50.0 million to Zenith Bank; US$100.0 million to Intercontinental Bank of Nigeria and US$100.0 million to GT. Bank.

5.0 Recent Banking Sector Crisis and Financial Sector Reforms

The global financial crisis strained the gains made in the Nigerian financial services sector from the banking sector consolidation. The experience in the industry in the wake of the crisis, however, mirrored global trends.

Following from the impact of the global financial crisis, a section of the banking industry was badly affected as some banks were in grave condition and faced liquidity problems, owing to their significant exposure to the capital market in the form of margin trading loans, which stood at about N900.0 billion as at end-December 2008. The amount represented about 12.0 per cent of the aggregate credit of the industry or 31.9 per cent of shareholders' funds. Furthermore, in the wake of the high oil prices, a section of the industry extended huge facilities to the operators in the oil and gas sectors, particularly those operating at the downstream segment. As crude oil prices tumbled, most of these facilities became non-performing and banks that were significantly exposed to the sector were badly affected. As at end-December, 2008, banks' total exposure to the oil industry stood at over N754.0 billion, representing over 10.0 per cent of the industry total and over 27.0 per cent of the shareholders' funds.

The excessive exposures resulted in the weaknesses (liquidity problems) exhibited by some of the banks towards the end of 2008. As part of its liquidity support, the CBN Discount Window was expanded in October 2008 to accommodate money market instruments such as Bankers' Acceptances and Commercial Papers in order to avert a liquidity crisis.

As at June 2009, the banks' total commitments under the EDW was over N2, 688.84 billion, while the outstanding commitments was over N256.0 billion, most of which was owed by less than half of the banks in operation. When the CBN closed down the EDW and, in its place, guaranteed inter-bank placements, it was observed that the same number of banks were the main net-takers under the guarantee arrangement, indicating that they had a deep-rooted liquidity problem.

5.1 What Went Wrong

In addition to the above, eight (8) main internally interdependent factors led to the crisis experienced in the financial services sector post-consolidation and the wake of the global financial crisis and hence the subsequent reforms. These include:

5.1.1 Sudden capital inflows and Macro-economic instability

Volatility in monthly disbursement of oil revenues made it difficult for governments to manage economic development. Also, it led to volatile liquidity regimes in the banking system. Moreover, the lack of an effective fiscal quarantining mechanism meant that the fiscal authorities could not prevent this phenomenon from spreading to the domestic banking system. Banking system liquidity closely mirrored international oil price volatility. As amounts held in bank deposits increased, banks were able to increase their lending. Thus, from 2004 to 2009 banking assets grew on average by 76% per annum post-consolidation. Indeed, the economy was not able to absorb of the excess liquidity from oil revenues and foreign investments in productive sectors. This resulted in significant flows to non-priority sectors and to the capital markets, mostly in the form of margin loans and proprietary trading camouflaged as loans. Market capitalization of the NSE increased 5.3 times between 2004 and 2007, and the market capitalization of bank stocks increased 9 times during the same period. This set the stage for a financial asset bubble particularly in bank stocks. The rapid rise in asset prices and the over-concentration of bank shares in the stock market index were clear indications of a potential financial crisis. In 2007, the Nigerian Stock Exchange was “the best performing” bourse in the world even though there was no evidence to suggest a commensurate improvement in the fundamentals of the real economy. The macro-prudential management of the CBN did not sufficiently address the impact of these oil-related inflows, and with the fiscal policy being pro-cyclical, this exacerbated the crisis.

5.1.2 Poor corporate governance and Character failure

Corporate governance in many banks failed because their boards ignored significant unethical practices as they were misled by executive management, and in some instances participated themselves in obtaining unsecured loans. Some management staff did not have the qualifications to enforce good governance practices in banks. In addition, the audit process in most banks appeared not to have taken fully into account the rapid slowdown of the economy and, hence, the need for adequate provisioning against risky assets. The chairmen/CEOs of some banks often had an overbearing influence on their board and, in some case, board members lacked independence. Furthermore, some of the board committees were also often ineffective or dormant.

5.1.3 Lack of investor and consumer sophistication

Lack of investor and consumer sophistication also contributed to the crisis by failing to impose market discipline, thus, allowing banks to take advantage of consumers. Investors, many new to the market, were unaware of the risks they were taking and consumers were often subjected to poor service and, sometimes, hidden fees. Nigeria does not have a tradition of consumer activism or investor protection and, as a consequence, many Nigerians made investments without a proper understanding of the risks involved. Limited consumer protection framework existed in Nigeria, although, the framework was inadequate and as a result consumer rights were not sufficiently protected.

5.1.4 Inadequate Disclosure and lack of transparency

Inadequate disclosure by the banks was another major factor to the crisis. Banks' returns to the CBN and information to investors, often, were inaccurate, incomplete and late, misleading the CBN in effectively supervising the industry and investors in making informed investment decisions. With inaccurate information, investors made ill-advised decisions regarding bank stocks, enticed by speculative market bubble, which was partly fuelled by the banks through the practice of margin lending.

Moreover, some banks even engaged in manipulating their books by colluding with other banks to artificially enhance financial positions and, therefore, stock prices. Practices such as conversion of non-performing loans into commercial papers and bankers acceptances and setting up off-balance sheet special purpose vehicles to hide losses were rampant. The CBN has recently put an end to these practices and the collapse of the equity markets effectively put an end to stock price manipulation.

5.1.5 Critical gaps in regulatory framework and regulations

Lack of co-ordination among regulators was one reason the CBN did not have a comprehensive consolidated bank view of banks' activities. In spite of the widespread knowledge of bank malpractice and propensity for regulatory arbitrage, the Financial Services Regulatory Coordinating Committee (FSRCC), the coordinating body for financial regulators did not meet for two years during this time. Whilst excess capital gave rise to strong growth in lending, banks were also allowed to use the capital to enter into many other non-lending activities such as stock market investments, most of which were hived off to subsidiaries, thus, escaping supervisory scrutiny of the CBN. The CBN did not receive examination reports from the SEC covering bank subsidiaries, nor was there a framework for consolidated bank examination. Nigerian set of regulations was not as comprehensive relative to international best practice. For example, there was no legal and regulatory framework governing the margin lending activity.

5.1.6 Uneven supervision and enforcement

Uneven supervision and inadequate enforcement also played a significant role in exacerbating the problems associated with the crisis. Regulators were ineffective in foreseeing and supervising the massive changes in the industry or in eliminating the pervasive corporate governance failures. The Supervision Department within the CBN was not structured to supervise effectively and to enforce regulation. No one was held accountable for addressing the key industry issues such as risk management, corporate governance, fraud, money laundering, cross-regulatory co-ordination, enforcement, legal prosecution or for ensuring examination policies and procedures were well adapted to the prevailing environment. Moreover, the geographic separation of on-site and off-site examiners hindered the building of integrated and effective supervisory teams. Critical processes, like enforcement, pre-examination planning and people development were not delivering the results required to effectively supervise and engage banks to enforce good conduct.

There were many instances of weaknesses in the supervision and enforcement process. For example, bank examinations were not conducted on a bank consolidated basis. Pre-examination planning did not question banks' use of the Expanded Discount Window nor did it include a review of prior SEC or NAICOM reports (if any) on bank subsidiaries. In addition, the CBN did not provide input to the SEC in planning its examinations of bank activities. Also, the ratings and depth of analysis was not sufficient to capture the issues. For example, the CAMEL ratings did not differentiate between the performance of successful and failed banks. While some examinations identified critical risk management issues, many issues that caused the crisis escaped examination, though they were well known in the industry. Sense of urgency was low with some examinations taking between 9 months to more than a year to complete. Enforcement was the biggest failure among surveillance processes, despite the CBN having all the powers it needed to enforce examination recommendations. Financial penalties were inadequate to enforce bank compliance. By paying fines, banks effectively annulled key aspects of the examination reports. With examination cycles between 6 and 12 months, follow-up on examination recommendations rolled into the following year's examination.

There was insufficient discipline in holding the banks to clear remedial programmes. While banks responded to examination reports, they seldom committed to specific deliverables, timing or executive responsibility for implementation. Hence, it was difficult to measure bank progress against compliance with some of the major recommendations. Banks' compliance record was poor. They frequently ignored the examiners recommendations in spite of the seriousness of the issues. The consequence to the banks of noncompliance was not sufficient to change behavior. Directors faced no personal consequences for non-compliance.

5.1.7 Weaknesses within the CBN

Governance and internal processes were unstructured and this compromised the CBN's ability to supervise the industry. Corporate governance at the CBN was laissez-faire and there were inadequate committee structures and processes to ensure the CBN Board's independence in assessing whether the CBN was fulfilling its mission.

The CBN was not organized to adequately monitor and analyze the macroeconomic issues and systemic risks inherent in the financial sector. There was no overarching architecture to manage the risks in the banking system, linking economic indicators to macro-prudential guidelines and to individual bank prudential guidelines. As a consequence, managing the risks in the banking system from the impact of oil price volatility, cross-border capital flows, asset price bubbles and weak corporate governance did not have the necessary urgency within the CBN itself. Management information to analyze the risks in the banking system was inefficient. There were also data quality issues, which negatively affected the CBN's internal reporting system.

5.1.8 Weaknesses in the business environment

The lack of a sufficiently developed infrastructure and business environment has had a negative influence on the banking industry. The legal process, an absence of reliable credit rating agencies and poor infrastructure all contributed to non-standard banking practices.

Nigeria's legal process is long and expensive and banks seldom pursue borrowers in court. Few banks were able to foreclose on borrowers, and this led to borrowers abusing the system. Lack of basic credit information on customers, largely because there was no uniform way to identify customers, has held back the development of credit bureaus and hampered customer credit assessment at banks, increasing the stock of bad debt in the system. These factors acting in concert brought the entire Nigerian financial system to jeopardy.

The foregoing necessitated further investigation by the regulators. Thus, a joint special examination by the CBN/NDIC of 10 out of the 24 banks as at May 31, 2009 revealed that some of the banks exhibited the following symptoms:

- Substantial non-performing loans;
- Poor corporate governance (weaknesses in governance and management)
- Weaknesses in capital adequacy; and
- Illiquidity

It was against this background that the CBN moved decisively to strengthen the industry, protect depositors and creditors' funds, safeguard the integrity of the industry and restore public confidence.

In that regard, the CBN replaced the chief executives/executive directors of the banks identified as the source of instability in the industry and injected the sum of N620.0 billion into the banks in an effort to prevent a systemic crisis. The injection of Tier II capital into these banks was considered sufficient to resolve and stabilize the system and to enable the banks to continue normal business operations. Arrangements were also made to recover non-performing loans from the banks' debtors, while guaranteeing all foreign credits and correspondent banking commitments of some of the affected banks.

5.2 Recent Financial Policy and Regulation Reform Measures

Following the banking crisis, the CBN introduced various policies and financial reform measures to strengthen the industry, protect depositors' fund, restore confidence and safeguard the integrity of the Nigerian banking industry. Part of the measures was the creation of an Asset Management Corporation of Nigeria (AMCON). The AMCON has already been passed by the National Assembly and signed into law by the President. In Addition, a ten-man board of directors has been approved by the National Assembly while AMCON has commenced operations with the approval to purchase about N2.2 trillion of the non-performing assets of the CBN-intervened banks. The AMCON, as a resolution vehicle, is also expected to facilitate the recapitalization of these banks.

Furthermore, the Bank in collaboration with the fiscal authorities is improving the macroeconomic environment so as to achieve robust monetary and financial policies in particular and, the overall macroeconomic objectives of the government, in general. In this regard, the Bank is collaborating with the Federal Government to raise N500.00 billion for power/infrastructure development. This is expected to provide favorable environment that would encourage operators in the industry. In addition, N200.00 billion has recently been provided wholly by the CBN for SMEs and manufacturing sector financing.

CBN is also collaborating with the Securities and Exchange Commission (SEC) and the Nigerian Stock Exchange (NSE) to reduce the cost of transactions, particularly bond issuance so as to diversify funding sources away from banks, as well as attract more foreign portfolio investors into the sector. Efforts are also being intensified towards strengthening regulatory and supervisory framework and enhancing monitoring of the operations of the Deposit Money Banks (DMBs) to ensure that they remain safe, sound and healthy. In addition, these efforts will also ensure the sustainance of public confidence through the enforcement of appropriate disclosures and reinvigorating the policy of zero tolerance on all unprofessional and unethical banking practice and greater emphasis on enforcement of Code of Corporate Governance. Standby teams of target examiners are being deployed to any bank at any time to ensure timely regulatory actions, if necessary.

To further engender public confidence in the banking system and enhance customer protection, the CBN established the Consumer and Financial Protection Division to provide a platform through which consumers can seek redress. In the first three months of its operation, about 600 consumer complaints were received by the Division which was a manifestation of the absence of an effective consumer complaints resolution mechanism in banks. The CBN has also issued a directive to banks to establish Customer Help Desks at their head offices and branches. In addition, the CBN has commenced a comprehensive review of the Guideline on Bank Charges with a view to making the charges realistic and consumer friendly. Furthermore, the Consumer and Financial Protection Division is expected to commence a programme of consumer education and enlightenment and is also collaborating with the Consumer Protection Council on the review of the Consumer Protection Council Act No. 66 of 1992, to regulate and enforce discipline in the market.

The CBN has taken steps to integrate the banking system into the global best practices in financial reporting and disclosure through the gradual adoption of some aspects of the International Financial Reporting Standards (IFRS) in the Nigerian Banking Sector by end 2010, while full adoption is slated for 2012. This is expected to enhance market discipline, and reduce uncertainties which limit the risk of unwarranted contagion. The CBN is also, closely collaborating with other stakeholders like the Nigerian Accounting Standard Board (NASB), Federal Ministry of Finance (FMF), NDIC, SEC, NAICOM, PENCOM, Federal Inland Revenue Service (FIRS), and the Institute of Chartered Accountant of Nigeria (ICAN), among others, towards ensuring a seamless adoption of IFRS in the Nigerian banking sector by 2012. These efforts are being pursued under the aegis of the Roadmap Committee of Stakeholders on the Adoption of IFRS in Nigeria inaugurated by the NASB and facilitated by the World Bank.

The universal banking (UB) model adopted in 2001, allowed banks to diversify into non-bank financial businesses. Following the consolidation programme, banks became awash with capital, which was deployed to multiples of financial services. In effect, the laudable objectives of the UB model were abused by operators with banks operating as financial supermarkets to the detriment of core banking practices. To address the observed challenges, the CBN has abolished the UB model and issued guidelines on the type of banks/banking licenses to refocus the banks on core banking business. The rationale for the abolition of the UB model is to ring fence depositors' funds which the UB model was used by banks for speculative and proprietary trading, thereby, exposing them to unnecessary risks. It is also aimed at repositioning the financial system to effectively carry out their intermediation role by financial the real economy, a role hitherto neglected under the UB model. Under the new model, banks are not allowed to invest in non-bank subsidiaries, while banks with such investments are required to either divest or spin-off the businesses to holding companies that will be licensed by the CBN as other financial institutions. The three categories of banks approved for banking businesses in Nigeria are: commercial banking with three classes of licenses (regional, national and international); merchant banking; and specialized banking such as microfinance, mortgage, non-interest (regional, and national) and development finance institutions. The new banking model is expected to formally take-off effective November 15, 2010.

Other measures included: the strengthening of institutional coordination through the Financial Services Regulation Coordinating Committee (FSRCC), adoption of common accounting year end for all banks, aimed at improving data integrity and comparability; conducting own-risk assessments and relying less on classifications by rating agencies; limiting the tenor of Chief Executives of Banks to 10 years; sound and timely regulation and supervision of the financial sector; stringent demand for transparency in the financial sector; and transparency in structured credit instruments to be improved upon for easy assessment of associated risk.

6.0 The Way Forward

Efficient and effective functioning of the financial sector is of immense benefit to the larger economy. To realize the huge potential of the Nigeria economy, monetary authorities in Nigeria remain focused on promoting a banking system that is sound, stable and efficient. Following the financial crisis and the observed corporate governance failure, the immediate policy actions focused on restoring confidence in the banking system through adequate capitalization of the industry and provision of sufficient liquidity. Thereafter, appropriate steps were also taken to introduce measures to establish financial stability, enable a healthy evolution of the financial sector and ensure the banking system contributes to the development of the real economy. The measures are encapsulated in the blueprint for reforming the financial system in the next decade built around four pillars namely:

- Enhancing the quality of Banks,
- Establishing financial stability,
- Enhancing healthy financial sector evolution, and
- Ensuring the financial sector contributes to the real economy.

6.1 Enhancing the quality of banks

The CBN has initiated a five part programme to enhance the operations and quality of banks in Nigeria. The programme consists of industry remedial programmes to fix the key causes of the crisis. It also includes the implementation of risk based supervision, reforms of regulations and regulatory framework, enhanced provisions for consumer protection, and internal transformation of the CBN. The industry remedial programmes include a set of initiatives to fix the key causes of the crisis, namely data quality, enforcement, governance, risk management and financial crime. To address failures of corporate governance in the industry, the CBN has established a specialist function focusing on governance issues to ensure best practices are entrenched in the industry. The reform programme will strengthen corporate governance in both banks and the CBN, entrenching a culture across the industry, that good governance is good business. Moreover, CBN has established an internal risk management specialist function to develop Nigerian Capital Adequacy and Enterprise Risk Assessment Process guidelines, based on the ICAAP (UK) and COSO (US) frameworks, to ensure the industry adapts and complies with the highest standards of risk management. Another part of the programme to enhance quality of banks is the regulation and regulatory framework reform programme.

6.2 Establishing financial stability

The second and very crucial pillar in our four pillar reform program is establishing financial stability. The key features of this pillar centre around strengthening the financial stability committee within the CBN, establishment of a hybrid monetary policy and macro-prudential rules, development of directional economic policy and counter-cyclical fiscal policies by the government and further development of capital markets as alternative to bank funding. Nigeria has dramatically underperformed its economic potential. The country can improve its economic performance if it deals squarely with two fundamental issues:

- Volatility and instability caused by over-reliance on oil and sub-optimal management of oil revenue, and
- Ability of the non-oil real economy to productively absorb investment and debt.

While the CBN is a critical player, success will require co-operation from many players in the economy and specifically, fiscal policies to address these two fundamental issues.

New initiatives are being developed by the CBN, the first set of which relates to monetary and macro-prudential policies. In this respect, CBN is strengthening the Financial Stability Committee (FSC) with a focus on maintaining system stability. This Committee will be supported by a strong technical working group. The MPC and the FSC would be at the core of the new macro-prudential framework. Both the MPC and FSC would work together to ensure that monetary policy is shaped by systemic risk trends and consistent with the expanded hybrid goals for asset price stability.

Exchange rate policies are being designed to limit exchange rate volatility which has been shown to impact negatively on growth. Our commitment to maintaining a stable exchange rate has been communicated to the market and measures have been put in place to ensure that stability is maintained. Any significant movement in the exchange rate will be overseen in an orderly way with the rationale for it clearly explained to all concerned.

In addition to the monetary and macro-prudential initiatives, the CBN will champion and encourage the implementation of directional economic policy to improve basic infrastructure, diversify the economy, and increase the absorptive capacity of priority sectors as well as support measures that enable sustainable economic growth. The Bank would like to encourage reforms to improve Nigeria's business environment, including property rights, rule of law, ease of doing business and investor risk.

Further development of Nigeria's capital markets is yet another initiative in progress within the CBN. Individuals and most private sector companies are dependent on banks for funding, but there has been a timing mismatch between lending and borrowing in the Nigerian financial system. There is little long-term lending available, which reduces long-term investment and growth. Nurturing other ways to raise funds could increase competition, thus, reducing costs, encourage best practice lending and better encourage longer term investments. A diverse capital market is a necessary step to developing the financial sector. Improving capital market depth and accessibility by promoting alternative forms of raising finance for priority sectors is, therefore, very much on the CBN agenda. This can be achieved through developing an infrastructure for a corporate bond market, more accessible equity markets, supporting deeper venture capital, micro-financing of new businesses and establishing a sustainable private equity environment with government seed capital. In partnership with the Federal Ministry of Finance, we have sought for Presidential approval for tax waivers to promote the fixed income market. The CBN has also put in place appropriate measures to improve the attractiveness of sub-national bonds to the banking sector.

6.3 Creation of a healthy financial Sector

Some of the areas that fall under this include banking industry structure, banking infra-structure such as credit bureaus, registrar, and cost structure of banks and role of the informal economy. Already, the Asset Management Corporation

(AMCON) which has been approved to commence operations will provide the first step towards the resolution of the non performing loan problem in banks and eventually facilitate further consolidation.

Furthermore, in addition to reviewing the universal banking model, we consider it appropriate to introduce greater diversity in bank mandates. In the near-term, it should be possible to have international, national, regional, mono-line and specialized banks such as Islamic banks in the country. Capital requirements will vary with the range and complexity of mandate. We will continue to ensure that our banks are well capitalized bearing in mind that the required capitalization is always relative to risk profile. Indeed, there is evidence that the pressure on banks to deliver high returns to their shareholders after the rapid expansion in their capital base post-consolidation contributed to some of the highly risky behaviour that led to the grave condition in some of the banks.

6.4 Ensuring the financial sector contribute to the real economy

Rapid financial development in Nigeria did not benefit the real economy as much as had been anticipated. Development finance institutions set up for specific purposes such as housing finance, trade finance and urban development have not fulfilled their mandates. Many successful emerging markets have seen proactive government actions to ensure that the financial sector contributes to the real economy. Nigeria can learn from countries with successful track records in creating financial accommodation for economic growth through initiatives such as development finance, foreign direct investment, venture capital and public private partnerships.

To ensure the financial sector contributes to the real economy, the following areas are to be further considered: leveraging the CBN Governor's role as advisor to the President on economic matters to ensure that the financial sector contributes to the real economy; taking the lead in measuring more accurately the relationship between the real economy and financial sector and the transmission mechanism; evaluating continuously the effectiveness of existing development finance initiatives such as agricultural credits and import-export guarantees; taking the public lead in encouraging examination of critical issues for economic development (impact of infrastructure such as power, port and railway); leading further studies on the potential of venture capital and private public partnership initiatives for Nigeria; and cooperating with state government to run a pilot programme in directing the financial sector's contribution to the State's social economic development.

7.0 Conclusion

The future of the banking industry in Nigeria would largely be influenced by the manner in which the challenges facing the industry today are resolved. These challenges are in respect of the macroeconomic environment, quality of manpower and associated corporate governance issues, adoption of appropriate advances in technology, policy and strategy for resolving banking distress and the overall efficacy of bank regulation and supervision. On the macroeconomic front, it is expected that the business environment for banks would be considerably improved and the level of uncertainty reduced with democracy taking firm root. The pursuit of appropriate institutional changes would address issues generating socio-political tensions, entrenching fiscal discipline and improving the effectiveness of monetary policy, diversifying the productive base of the economy through policies that would open-up strategic sectors and sustained improvement of infrastructural facilities. The Nigerian authorities are fully committed to the reform initiatives in the various sectors and would need the support of our development partners to bring these reforms to logical conclusion. Indeed, financial as well as technical assistance in various forms would play a critical role in these endeavors.

SUMMARY OF THE RECENT INITIATIVES OF THE CBN

1. Replacement of the Chief Executive/Executive Directors of the banks in which the CBN intervened
2. Establishment of AMCON to soak the toxic assets of the troubled banks in which the CBN intervened.
3. Collaborating with the Fiscal authorities to improve the macroeconomic, financial and monetary policy environments.
4. Strengthening regulatory and supervisory frameworks to ensure healthy banking industry
5. Establishing of a Consumer and Financial Protection Division to further engender public confidence in the banking system
    - Comprehensive review of the guideline on bank charges.
6. Encouraged banks to adopt the IFRS in the Nigerian Banking Sector by 2012.
7. Abolished the UB model and issued guidelines to refocus the banks on core banking businesses
8. Three types of banks approved for banking businesses are:
    - Commercial banking with three classes of licenses- regional, national and international
    - Merchant banking and
    - Specialized banking such as MFB, Mortgage, non-interest (regional & national) and DFIs
9. The new model is expected to take off effective November 15, 2010
10. Strengthening of institutional coordination through the FSRCC
11. Adoption of common accounting year end for all banks
12. Conducting own-risk assessment and relying less on classifications by rating agencies
13. Limiting the tenor of Chief Executives of banks to 10 years
14. Transparency in structured credit instruments for easy assessment of associated risks
15. Licensing of private credit bureau
16. Establishment of Financial Stability Committee (FSC)
17. Review of supervisory procedures/methodology
18. Creation within the CBN, an anti-money laundering and combating the financing of terrorism (AMLICFT) unit
19. Review of prudential guidelines and related matters
20. Collaboration with SEC and NSE to reduce the cost of transactions.