THE GLOBAL FINANCIAL CRISIS AND FINANCIAL REFORMS IN NIGERIA

HEARING

BEFORE THE

SUBCOMMITTEE ON
INTERNATIONAL MONETARY
POLICY AND TRADE

OF THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

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THE GLOBAL FINANCIAL CRISIS AND FINANCIAL REFORMS IN NIGERIA

Tuesday, November 16, 2010

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON INTERNATIONAL
MONETARY POLICY AND TRADE,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 3:10 p.m., in room 2128, Rayburn House Office Building, Hon. Gregory W. Meeks [chairman of the subcommittee] presiding.

Members present: Representatives Meeks, Driehaus; and Miller of California.

Chairman MEEKS. This hearing of the Subcommittee on International Monetary Policy and Trade will come to order.

We will have opening statements for the record, and without objection, all members opening statements will be made a part of the record.

We have some extraordinary witnesses here today.

I will recognize myself for the first opening statement, and we will move on. I hope that we are not interrupted by votes, but we will try to do as much as we can as we are trying to wrap up the 111th Congress. So there is a lot that is going on.

But, before I begin, I would like to thank Representative Miller for working hard and helping organize and bringing this critical hearing on the financial crisis impact on Africa and the reforms being implemented by Nigeria. He has been an extraordinary partner in the 111th Congress, and I look forward to continuing to work with him in the reverse roles in the 112th Congress.

Mr. MILLER OF CALIFORNIA. Absolutely.

Chairman MEEKS. I think that how we have worked and conducted ourselves on this subcommittee is an indication of what America wants, folks working together. You have been very cooperative, and we have been working very closely together, and I look forward to continuing to do that.

I would also like to thank our distinguished witnesses for agreeing to testify before Congress today. In particular, I would like to thank Governor Sanusi and Director Oteh for traveling all the way from Nigeria to testify before the subcommittee.

It is quite uncommon for senior government officials from another country to agree to testify before the United States Congress, but these are unusual times in which we live in. The global financial crisis from which the world is only beginning to emerge continues to hang over many nations' recovery plans. Most emerging

markets, including Nigeria, were adversely impacted by the secondary effects of the crises in the form of collapsing demand and prices for their primary exports as well as dramatic decrease in remittances.

Over the past 2 years, I have been privileged to lead two bipartisan congressional delegations to the continent of Africa. These bipartisan delegations focused on the impact of the financial crises and global recession in Africa, the programs implemented by the multilateral institutions to prepare African nations for the expected effects of the crises, as well as the support the continent received to cushion the impact of the crises.

In February of 2010, Chairman Melvin Watt and I co-led a bipartisan delegation to Nigeria where we had the privilege of meeting with Mr. Sanusi, the Governor of the Central Bank of Nigeria, whom I'm delighted to see here today.

Our working lunch meeting with the Governor followed an overnight flight to Nigeria and no rest at all before engaging in an aggressive meeting scheduled that day. Jet lagged and tired meant that we were struggling to stay focused in some of our meetings. But as soon as the Central Bank Governor began to speak, every single person in attendance caught a second wind. We got pumped up, as they say.

Our working lunch went well over the allotted time as we discussed and debated the impact of the financial crisis in Nigeria, the tough decisions he and his colleagues had to make as they evaluated the health of the nation's leading banks, and the political and economic pitfalls of bailing out failing financial institutions, as well as the initiatives to establish a so-called "bad bank" to acquire the toxic assets from these banks' balance sheets to get the banks lending again.

It was also fascinating to hear how Nigeria held the leaders of the failing banks accountable in a way that many Americans wish had also been done here for the leaders of financial institutions that benefited from the taxpayer-funded bailouts.

Governor Sanusi also engaged members in a great discussion about the need to reform the entire financial sector in Nigeria, which he will address in his testimony today.

But one point in particular strikes me as something we struggled with here, also. Creating differentiated banking licenses allows specialized banks to emerge serving critical parts of the market with targeted products and services. Yet each such institution must be subject to appropriate oversight and strong regulatory framework so as to not trigger regulatory shopping or regulatory rates at the bottom as we arguably witnessed in this country. Increased capital requirements and more stringent risk management structures for the most systemically significant institutions will help Nigeria and Africa, as a whole, mitigate systemic risk going forward.

Lastly, improved regulation of capital markets to promote transparency will be critical to attract the necessary capital to finance Nigeria's exceptional growth potential and private-sector development needs.

In many ways, the discussion we had in the hotel conference room in Nigeria reflects the debates we are having here in the

United States as we consider necessary reforms to our own financial sector.

Following the meeting, all members in attendance agreed that we had to invite the Governor and his colleague, Ms. Oteh, as well as the incredibly knowledgeable Mr. Moss from the Center for Global Development to testify before Congress and to tell Nigeria and Africa's story. Hearing this and listening to our witnesses today will better inform our support for assistance and reforms in emerging markets.

In closing, I would like to point out that much of the work that we have done here in this subcommittee to push the international institutions seems to have yielded results, as Africa seems to have endured fairly well through the crises and may be on track to resume on the positive growth path it was on prior to the financial crisis.

So, with that, I would like to once again thank our distinguished witnesses for making the long journey across the Atlantic to appear before this committee today, and I look forward to having a spirited and informative discussion. Thank you for your participation here today.

I now turn over for an opening statement to my friend and colleague, Mr. Miller.

Mr. MILLER OF CALIFORNIA. I want to thank my friend, Chairman Meeks, for convening this hearing on reforms under way in Nigeria's financial system. And I say "my friend" because it is true. He is my friend. Politics should never be personal. In our case, it never has been; and it never will be. He is my friend, and I believe I'm his friend.

Financial crisis has hit all nations. Many nations like Nigeria were victims of the follow-on effects of a recession as capital that once flowed to Nigerian institutions quickly left the country. This withdrawal harmed businesses and individuals in the country and exposed some remaining flaws in the financial services sector.

Fortunately, there are individuals who have worked to right the system, bring stability to the country, and provide the foundation for prosperous economic growth going forward. I want to thank them for their efforts they have done, and I look forward to working with them in the future and hearing your insight.

I'm looking forward to the witnesses today, and I'm not going to waste any more of our time. Thank you. I yield back the balance of my time.

Chairman MEEKS. I know that Governor Sanusi has given us previously a written statement, but he has also asked to have submitted for the record an appendix to his submission, and I ask that it so be submitted in the record without objection.

We want to jump right into it. We really—for an individual whom I think for this subcommittee needs no more introduction than we talked, we were so impressed with him and what he has done as the Governor of the bank in Nigeria, and I would ask him to start off with an opening statement, and then we will go to Ms. Oteh. But for purposes of trying to save some time, we will go right to Governor Sanusi.

STATEMENT OF LAMIDO SANUSI, GOVERNOR, CENTRAL BANK OF NIGERIA

Mr. SANUSI. Thank you very much, Chairman Meeks and Ranking Member Miller. I would like to thank this committee for being kind enough to invite us to testify. It is an honor for us as representatives of the Nigerian Government to come and speak to the U.S. Congress on what has been happening in Nigeria.

Chairman Meeks has, of course, referred to the meeting we held in February 2010. A lot has happened since then; and I would like to, for purposes of completeness, simply briefly go over the impact of the crisis on Nigeria and the steps we have had to take as regulators. I will try to avoid saying much about the capital market, because Ms. Oteh will handle the capital market side of the reforms.

As mentioned, the Nigerian economy was affected by the second round of impact of the global financial crisis. The Nigerian financial markets were not fully integrated into the world economic system, but certainly we have an economy that is very much dependent on volatility of oil, government revenues, and exchange rates. The level of foreign reserves was intricately tied to the price and volume of oil.

In 2007, as the committee will recall, oil price ranged up as high as $145 to $147 a barrel, and Nigeria was pumping more than 2 million barrels a day. This led to an increase in government revenues and building up of an excess crude reserve, but it also created a lot of liquidity that could not find its way into the real economy and went instead into nonpriority areas, particularly the capital markets. The result was that the Nigerian Stock Exchange grew by more than 5 times, which in 2004 and 2007, the banking sector alone had its value multiplied by over 900 percent in 3 years.

A lot of that was driven by margin lending. It was also driven by a lot of proprietary position hidden in MOF loans, and there was a lot of share price manipulation and fraud by bank executives who set up SPVs to trade on the Stock Exchange.

When the price of oil crashed—and in Nigeria, you will recall we then had the Niger Delta crisis, so we had a double whammy, a collapse in price and a collapse in output—the liquidity was taken out of the system, and the stock market crashed. This was after the collapse of Lehman Brothers, and that exposed inherent weaknesses in the Nigerian banking system.

It soon became clear that a number of banks had deep and serious liquidity problems that were structural in nature. The Central Bank reacted like all other central banks with quantitative easing, reducing cash reserve requirements, reducing liquidity ratio requirements, and opening up an expanded discount window, but none of that addressed the problem.

As I said, I became Governor in June 2009, and it was clear that we had to look much deeper at the root of the problems. We sent in examiners; and, as I briefed the committee, we discovered a number of things.

First of all, we discovered that there were huge concentrations by the banks in the capital market and to all marketing. We also discovered serious governance issues and had to try a number of chief executives. As of October of this year, we have been able to secure the conviction of one of the chief executives and to recover assets

taken from the bank worth about $1.2 billion. These assets were real estate assets in the United States, in South Africa, in Dubai, and in Nigeria.

We have set up an asset management corporation. We—the board has been approved. The AMCON has already announced it is going to purchase 2.2 trillion naira worth of bad loans from the banks, and that will clean up the banking system. We have received a lot of support from the IMF, the World Bank, IFC, Ex-Im, the European Investment Bank, and ADB, as documented in the paper and appendix.

We have had to review the universal banking model and create and insist that banks restrict themselves to banking business. The details of that should come into testimony on exactly how it is going to work.

We have different levels of authorization for the banks, as rightly mentioned—international, national, and regional. We do have specialized banks for mortgages, development, financial institutions, noninterest banks; and this is all in there for healthy development of the Nigerian financial system.

Finally, as we are running out of time, at the heart of the problem with financial crisis is the lack of integration of the financial economy with the real economy; and we have focused on making sure that banks actually lend to the real sector, as opposed to lending for capital markets and speculation. And with AMCON, clearly, as indicated in our appendix, we have gotten the banks to agree to put aside 30 basis points on their balance sheets for 2011 for 10 years. So the banks are, in essence, going to pay the cost of the bailout, and there will be no addition to the fiscal deficit, and that is going through legislation in Nigeria at this moment.

This I think highlights the key features of the intervention of the Central Bank, and there are others that will be taken by Ms. Oteh, and hopefully in discussions we will go into detail. Thank you very much.

[The prepared statement of Governor Sanusi can be found on page 40 of the appendix.]

Chairman MEEKS. Thank you. Thank you for your testimony.

Now, we have Ms. Oteh, who is the Director General for the Securities and Exchange Commission of Nigeria. Welcome.

STATEMENT OF ARUNMA OTEH, DIRECTOR-GENERAL, SECURITIES & EXCHANGE COMMISSION OF NIGERIA

Ms. OTEH. Thank you, Chairman Meeks, and other members of the subcommittee for the invitation to join Governor Sanusi and Mr. Moss to testify at this hearing on the global financial crisis and the financial reforms of Nigeria.

I will focus my testimony primarily on the impact of the global financial crisis on the Nigerian capital markets and the reform agenda that we at the Securities & Exchange Commission in Nigeria have embarked upon since I assumed duty on the 7th of January of this year.

This testimony is both timely and relevant to the challenges that we face in Nigeria, that you face in the United States, and that the rest of the world faces. It is auspicious also as we seek, as the Nigerian Securities and Exchange Commission, to seek to strengthen

our partnership with the U.S. Securities and Exchange Commission. We believe a strong partnership with the U.S. SEC is critical to building a world-class capital market and that it is mutually beneficial in the fight against financial crime, which knows no borders, and in our common objective of maintaining capital markets that are of the highest integrity.

We do believe that for our country, Nigeria, despite its enormous wealth, that whether in terms of natural resources or in terms of human resources that we are yet to truly realize our potential as a country. We believe that world-class capital markets will clearly enable us to do so for a number of reasons. Because world-class capital markets foster a meritocracy, they foster good corporate governance, they encourage innovation and entrepreneurship, which in our view will create job opportunities that will harness the skills and entrepreneurial zeal of the many hardworking Nigerians that Nigeria has been blessed with.

As the ethics regulator of the Nigerian capital markets, whose mandate it is to regulate and develop these markets, the goal of our reform agenda of the SEC is to build a world-class market that will enable Nigeria to diversify its economy, finance its huge infrastructure needs, and enhance its business climate and environment.

What we consider a world-class capital market is one that always engenders investor confidence, that has the breadth and depth in terms of product offerings and is characterized by market integrity, and also has a strong regulatory framework and a strong and transparent disclosure and accountability regime. We believe that it is also one that is fair, it is robust and has an efficient marketplace.

While the global financial crisis has been devastating, we believe that it has created an opportunity for us to refocus on building a world-class capital market and to leverage the lessons that we learn from our own experience as well as the lessons that other jurisdictions have had.

The testimony that we have submitted outlines the impact of a crisis on Nigeria in general and then outlines the key elements of the reform agenda that we have embarked on. It also encourages and asks you to continue to support the relationship that your country, the United States, has with our country and to continue to encourage the multilateral agencies to support us in our endeavors.

As Governor Sanusi mentioned, the global financial crisis was very multifaceted. It led to a dwindling of government revenues. It also led to a weakening of our currency. It exposed the weaknesses both in the banking sector and fueled in our mind an unprecedented stock market crash, undermining confidence in the financial sector. We believe that the effect of a crisis would have been worse had it not been some of the progress that our country has made with respect to a sound macroeconomic management, notably since 2003 when we set up the fiscal oil rule, when we embarked on a number of reforms including a very elaborate pension reform which enabled us so far to build up more than $10 billion in pension assets that are managed on a defined contribution basis.

We believe that despite the fact that there was excessive risk-taking in our markets, despite the fact that both retail and institution investors did have huge losses, we feel that some of the measures that we have put in place today are clearly able to prepare our markets for what it should be. We feel that it is important to continue to show that our markets, whether it be the banking sector or whether it be the capital markets, that we will not tolerate anything that is improper. So, like the Governor of the Central Bank, my colleagues and I have been taking enforcement action that we consider has been unprecedented in the history of our stock markets; and I will mention a few of them.

As a fallout from the crisis in the banking sector, we had a joint investigation between ourselves and the Central Bank which led us to identify a number of market abuses that happened in bank reform. As a result of those findings, we have taken 260 individuals and entities to our investments and securities tribunal. We are expecting that illegally gained profits will be dislodged and that, where possible, that investors will be restituted. We have also taken steps to strengthen the Nigerian Stock Exchange so that it can continue to play the role that it should play as the visible symbol of our stock markets.

I will focus—I look forward to you reading the rest of my submission. But I do want to, through you, thank the U.S. Securities and Exchange Commission for the relationship that we have built in such a short time.

One of the things that we were fortunate to have happen is to have a team from the U.S. SEC come and visit us very early in my tenure to evaluate and peer review our capital markets. Through the work that they have done and the recommendations that they have made, we are able to support some of our own work and our views on how we can build a truly world-class capital market. We are also leveraging our relationship with other international securities commissions and indeed have been a member of the International Organization of Securities Commissions for several years.

I was recently elected as the Chairperson of the African Middle East Regional Committee of IOSCO, and we are proud to note that we are signatory "A" of the IOSCO memorandum of understanding.

Like the Central Bank Governor said, we have also received great support from all the multilateral agencies; and indeed in building our fixed income market we have a resident adviser who was sponsored by the World Bank.

I hope that my submission has contributed to an understanding of the impact of the impact of the global financial crisis on the Nigerian capital market. As I have indicated, while the impact of the financial crisis has been devastating, the silver lining is the opportunity that it gives us to build a world-class market, as this is critical to Nigeria's economic and social progress.

Once again, I wish to sincerely thank this honorable body for the opportunity to give this testimonial and I look forward to your continued support. Thank you.

[The prepared statement of Director-General Oteh can be found on page 27 of the appendix.]

Chairman MEEKS. Thank you so very much for your testimony.

Now, we are delighted to have with us Mr. Moss, who is a Vice President and Senior Fellow at the Center for Global Development. Thank you for being here.

STATEMENT OF TODD J. MOSS, VICE PRESIDENT AND SENIOR FELLOW, CENTER FOR GLOBAL DEVELOPMENT

Mr. MOSS. Thank you Chairman Meeks, Ranking Member Miller, and members of the subcommittee. I appreciate the opportunity to appear before you today to discuss the effects of the global financial crisis on Africa and U.S. interests in Nigeria's future.

In 2009, much of Africa saw a sharp slowdown in private capital inflows, and the region's growth rate fell by more than half. But this decline was mitigated and the outlook today for Africa is much brighter in large part due to the aggressive response of the multilateral development banks which accelerated lending to compensate for this drop-off in private capital. For this reason, my first point today for the subcommittee is that the multilaterals are critical to the recovery of the global economy and worthy of robust U.S. support.

I would urge Congress to look favorably upon the soft loan window replenishments and the general capital increases for the African Development Bank and the World Bank in particular. These are investments that leverage U.S. contributions, build global markets, and help to expand the circle of prosperity.

Now, turning to Nigeria specifically, I want to make just three points.

The first point is that the global economic crisis may turn out to be a good thing for Nigeria. That country's banking troubles are largely local in nature, but the pressure of the crisis exposed the hidden problems and forced the actions of the Nigerian authorities. In the long run, I believe this will make Nigeria's financial sector stronger and more competitive.

It is worth noting that real change was not a foregone conclusion. The actions of Governor Sanusi have been decisive, credible, and transparent.

My second point is that, even while the steps so far have been meaningful, Nigeria's reforms are still incomplete. The Central Bank must contain the final cost of the bailout, sell off the seized banks in a fair and transparent manner, and enforce rules to prevent a repeat crisis.

Yet the future of Nigeria's banking sector goes well beyond monetary policy. Reforming the oil and gas sector is critical to nurturing the domestic capital markets by allowing local banks to finally participate in joint investments that are—much of which are currently financed through the budget.

The fiscal situation is also urgent. Savings in the excess crude account stood at $20 billion just 20 short months ago, and now are almost completely depleted. For this reason, Nigeria's outlook was downgraded by the credit rating agencies last month.

Success in banking ultimately depends in Nigeria on other steps to make the real sectors of Nigeria's economy more competitive. A broken electricity system must be fixed. The fight against corruption, which had been so promising a few short years ago, has waned badly over the last 3 years. This fight must be renewed. And

of course, and perhaps most importantly, Nigeria needs a credible election in the spring. This is essential if the country is going to restore confidence and get back on track.

And this leads to my final point, which is that Nigeria's success is undeniably in the U.S. national interest. The United States needs a strong, capable, and stable Nigeria. Nigeria is the key to regional security. It is the neighborhood enforcer in places like Liberia and other hot spots of interest to the United States. Nigeria is vital to U.S. energy security. It is not only the 5th largest source of U.S. oil imports, but instability in the Niger Delta can spike international oil prices, and this affects the wallet of every American.

Nigeria is also the linchpin in our fight against the 21st Century transnational threats such as terrorism, disease, and arms trafficking. A weak Nigeria is a source of these dangers. A strong Nigeria can be an indispensable ally to contain these threats.

Last Christmas was a stark reminder of the risks of a weakened Nigeria. The would-be bomber on Northwest Airlines Flight 253 was Nigerian. Yet during that emergency there was no partner for the United States on the other end of the line. The United States was under terrorist attack and President Yar'Adua was literally missing in action, leaving a power vacuum that was dangerous for Nigeria and dangerous for the United States.

Now counterterrorism may seem disconnected from the financial sector issues that we are discussing today, but it is in fact closely linked to the capacity and credibility of the Nigerian Government. Banking is the vanguard of Nigeria's economy. Fixing the financial sector is a prerequisite if the country is going to modernize and join the international community as a responsible and dependable partner.

Let me end my testimony with a quick pitch for a new idea, and this is one where Nigeria may be able to learn something from our own experience here in America. In the 1980's, the State of Alaska began paying dividends from earnings on oil savings directly to State residents. It did this as a deliberate way to check the power and wasteful spending of government.

New technology like iris scanning and mobile banking now make it feasible and affordable for any government to make direct payments to their citizens. Cash transfers are now being used in Mexico, Brazil, South Africa, Bolivia, Mongolia, and elsewhere. They may be useful in the Niger Delta, too, where billions of dollars have been spent with few tangible benefits on the ground. This waste and corruption is one cause of the Delta violence today. The Government of Nigeria has an opportunity with some political courage and a little creativity to finally break that vicious cycle.

Thank you.

[The prepared statement of Mr. Moss can be found on page 25 of the appendix.]

Chairman MEEKS. Thank you so very much for your testimony.

I thought I saw my colleague earlier from Ohio. Steve Driehaus was here, and I was going to allow him to say a few words, but if he should come back, we will do that then.

I guess we will just open it up to questions and have a little give-and-take back and forth, and I will start with Governor Sanusi by

asking, could you please tell us more about the stress tests that you conducted on your banks and what support, if any, that you got from the IMF and the policy and the regulatory implications of the findings that you received from the stress tests that you implemented?

Mr. SANUSI. Thank you, Mr. Chairman.

When we were going to embark on the audits, it was very clear to us that there was a problem in the industry, but the problem was not evenly distributed. Some banks clearly had liquidity problems that were coming to the discount window. Other banks had a lot of money sitting in the Central Bank. So the interbank markets had collapsed. We had big banks that had a lot of money and a lot of capital but who didn't trust the other banks enough to place money with them. The money was in the Central Bank earning 1 percent.

Now to make sure that as the result of examinations we identified the banks that posed the systemic risk, we worked with IMF based on bank balance sheets. What we did was to give them the 24 Nigerian banks without giving them the names of the banks and their financial statements, and they ran a blind stress test. And five banks came out as banks that were at risk in terms of poor asset quality, poor liquidity, and probably bubble capital.

Now those five banks were exactly the five banks that were permanently at the expanded discount window. So there was already a process of self-selection. So when we sent in examiners to the first set of 10 banks, we made sure that those 5 banks were included; and the findings were consistent with what we expected. If anything, they were much worse. Because, clearly, the problem was much deeper than we thought it was for a number of reasons.

First of all, the asset quality problem was much more severe than we had thought, the level of exposure to capital market was much higher than the banks had previously disclosed, and what was sad was that a number of issues we then discovered were not just about asset quality or concentration but fraud.

In the case of the CEO who was recently convicted, $1.2 billion, that is the value of total depositors' funds taken through special purpose vehicles and basically used to purchase property in different parts of the world. On the books of the banks, they were loans, but it was actually money that was taken out of the banks. And we were able to trace the property in Dubai, some property here in Maryland, some property in South Africa, some property in Nigeria and get—of that property. But the IMF was extremely useful in helping us identify what were the most likely areas to look at first, and that helped us deal with the problem very quickly.

Chairman MEEKS. Let me ask this question. We have also made stress tests mandatory in our regulatory reform framework, especially Central-Bank-driven stress tests for the larger banks. And what we have also decided to do was to make the results of the test public, that it be mandatory so that we could give information or better inform the markets of the risks that they bear. Do you have any thoughts or any idea of implementing something similar in regards to implementing this in Nigeria?

Mr. SANUSI. Yes. In fact, a few weeks ago, we had the IMF Financial Market Division come to Nigeria to do training on the

stress testing for the Nigerian Central Bank officials and for Nigerian banks. We do hope as soon as the banks go through their mergers and acquisition to give them guidance on stress tests. This will be run on their December balance sheets and their March balance sheets. What we would like to do is, after the M&A do a stress test, then invite the bank to raise more capital and do a second stress test after 6 months to make sure that all the banks have been adequately capitalized.

But I should add that in the case of American banks, there are other things that need to be done beyond stress testing, including looking at the root cause of some of those issues. A stress test, for instance, will not solve the problem of a rating agency that gives an investment grade rating to a bad loan. A stress test will not solve the problem of an investment bank that influences those ratings. So there are serious governance issues that need to be addressed.

We have tried to address both the governance issues and the capital adequacy issues, and perhaps we are trying to avoid the mistake of thinking that capital alone will solve the problem. It is human beings, and of course we have to look at human beings who played a role in this crisis.

Chairman MEEKS. Thank you.

Let me squeeze in a question to Ms. Oteh before I turn it over to Mr. Miller.

I have had a number of individuals recently who have just come back from Nigeria actually, and they said that the first time—these are individuals—some are on Wall Street, some are friends—that they are looking at investing in Africa, and in Nigeria in particular, and they said they have been looking at it for a long time, but they now see that there is potential on the continent. But some are starting to look and feel there is also may be a speculative bubble. And I was wondering if you had any thoughts on whether Africa may in fact be experiencing somewhat of a foreign direct investment bubble and what systems you have in place to monitor and/or to react to the same.

Ms. OTEH. Thank you, Mr. Chairman, for the issues that you raised.

Our view is that this is really the "Decade of Africa" in the sense that over the last 20 years, across Africa, there have been first-generation reforms as well as second-generation reforms and some of what we are seeing are the dividends of those reforms. In Nigeria specifically, they are huge investment requirements. And I don't believe that the level of FDI is sufficient to either take advantage of the investment opportunities that we see across several sectors, whether it be in sectors—in infrastructure.

You yourself had mentioned and Mr. Moss also mentioned some of the challenges that we face in the power sector. There are clearly opportunities both for private-sector investment and for additional aid going to other infrastructure.

There are opportunities in the consumer goods sector that come for Nigeria from the size of its population. As you know, Nigeria's population is estimated to be about 150 million people.

Some of the examples of what has happened in the telecom sector and how the telecom sector has evolved in Nigeria and other

African countries show or give credence to the advantage—fast mover advantage which is those who are looking seriously at Africa, to Nigeria in particular, are able to observe. Thank you.

Chairman MEEKS. Mr. Miller.

Mr. MILLER OF CALIFORNIA. The economic peak of your economy was driven by oil revenue. How dependent is Nigerian oil revenue today and has the economy developed other sources of revenue since the drop in oil prices?

Anyone can answer that.

Mr. SANUSI. Thank you very much.

It certainly is a big problem. Because if you take Nigerian GDP, 42 of gross domestic product is agriculture, but the bulk of agriculture is primary production, and we have not taken full advantage of agricultural policies or built a value chain and move us from primary production into processing, which is really what you need to do, move from primary production to processing to manufacturing. And I will give you a few examples.

Nigeria is the world's leading produce of cassava, but we don't produce any starch or ethanol. The leather products in northern Nigeria, the leather is called Moroccan leather, but Nigerian tanneries produce what is called wet blue, which is the basic level of processing that gives them profits of 2 cents per square foot. Whereas from Morocco, from the same leather base, companies are producing leather used by companies like Goodyear and Yves St. Laurent.

We have crude oil. Our refineries are not working. So the real challenge of the economy is to fill those gaps and those externalities and economic policies geared towards that.

Now building agricultural productivity and moving up the value chain and also fixing the issues of power and infrastructure are critical to building manufacturing base. Only 4 percent of GDP is manufacturing. And this basically ties again to Chairman Meeks' question. The potential for the Nigerian economy is so great, however, they have to be harnessed with the right economic policies. We don't have enough foreign direct investment coming in.

But, historically, we have learned a lesson. We had huge inflows coming into the capital market, hot money. So there is a bubble. And I think what we want to do is make sure that we attract the right investment, turn investment into power, investment into infrastructure, into manufacturing, into agriculture, as opposed to investment into speculative asset price bubbles.

Mr. MILLER OF CALIFORNIA. Are you seeing capital inflow starting to increase recently? And if that is occurring, you have talked about reforming your financial sector and your banks. Are they allocating capital in the more transparent merit-based fashion they were before?

Mr. SANUSI. Yes. We are, for instance, as regulators having a closer look on the type of inflows that are coming in. We have seen plans by, for instance, power companies to come in and set up a power plant; and that is the kind of investment that we didn't have 2 or 3 years ago.

But, obviously, we didn't have those investments because the reforms of the power sector themselves had not taken place. So what we are pushing at Central Bank and as regulators is to get the

right economic policies that will attract the right type of investment. Otherwise, we continue attracting hedge funds that just buy shares.

Now, clearly, we have seen also investment in the capital market. Nigerian companies are really trading, many banks are trading at below book value. So there is a bargain in there. So many people actually see, with the resolution with the asset management corporation, with the mergers and acquisition, people see a big upside in buying bank shares now; and, therefore, we have seen some inflows in that area over the last few weeks. But we would like to see more money go into infrastructure, into power, into manufacturing; and that is really where the growth will come.

Mr. MILLER OF CALIFORNIA. It seems like foreign investments on your equity markets have been very volatile, especially recently. How do you plan to mitigate the impact of that in the future and stabilize it in some fashion? We have had the conversations about questionable graft or corruption that might be occurring that sends a perception that things are not stable enough to create investment that is worthwhile.

Mr. SANUSI. Well, a number of things. First of all, we have to continue working on improving the transparency of the system; and I think once people understand that markets are transparent and disclosure is good and we are fighting corruption, they are going to have more confidence in the system.

A lot of the volatility we saw in 2008 was out of recognition that perhaps people were not getting the true story. And I think what we have done both at the Central Bank and at SEC is to tell investors that this is the problem, we have disclosed the problem very openly and transparently; and we are dealing with it in a very effective manner. The fact that some of the most powerful bankers and powerful stockbrokers are actually being put in jail lets investors know that there is a lot of political support for this process and that the country as a whole is determined to clean it up, and I think this is the first and most important element.

The second element, of course, is to broaden and deepen the markets themselves, because that is extremely important. There is a limit to how much money can come in to the capital markets. A bubble gets created, and then people start selling, and you have a bust. But if we actually opened up those areas that are in need of investment and fantastic returns are made—we produce 3,000, 4,000 megawatts of power, and that is for a country of 150 million people. Now that is about what Ethiopia will produce in 2012. So just imagine the potential for the power. It is bigger than the telecoms. If you look at what MTN has done, what AT Satellite has done in Nigeria with telecommunications, power is potentially bigger than that.

And the capital market that we have does not list the bulk of the economy. All companies are not listed. The telecom companies are not listed. Many of the large manufacturers are not listed and not the SMEs. So broadening and deepening the capital market and continuing economic reforms are, in my view, the way to attract investment on an ongoing basis.

Mr. MILLER OF CALIFORNIA. Mr. Moss, do you have a comment on that?

Mr. MOSS. I think that even if you had an ideal financial sector—and I think the other witnesses today have taken tremendous steps to try to right Nigeria's financial sector; it is wonderful to have an efficient financial sector—but you can only go so far with the financial sector if the real sector behind it isn't competitive. So until the oil sector reforms are implemented and implemented well, we are not going to really see the banking sector be able to take off in the way that it could.

Similarly, with infrastructure, it would be great—the demand for power in Nigeria is tremendous. This should be a huge opportunity for domestic and foreign power companies to come in. Nigeria is still flaring a lot of its natural gas. There is no reason that couldn't be turned into power.

But the environment is still so difficult. There is no way, given the uncertainties with tariff structure, and uncertainties with contract enforcement, that you would put billions of dollars into the power sector right now until you had some more clarity on what else was going, what else was going to happen. So, in a sense, I'm extremely—I have been watching from the outside extremely impressed with the steps the financial sector has taken, but there is only so far you can go with those reforms until the rest of the economy has to catch up.

Mr. MILLER OF CALIFORNIA. Thank you.

Chairman MEEKS. I saw Mr. Sanusi get very antsy, wanting to reply.

Mr. SANUSI. Yes. I want to thank Mr. Moss. I want to give an update on what is happening with the power sector.

The government has actually started the process of reviewing the tariffs. We have a new regulatory body in place. We are working with the World Bank, and the Minister of Finance is going to obtain partial risk guarantees for that sector, and therefore the reforms that were halted 3 years ago are actually on course.

We believe the only reason that stopped people from investing at this moment is the other issue mentioned, the uncertainty over the elections. But in terms of the reforms themselves, all the right things have been done by President Jonathan; and we do think we are going to get a lot of progress in that very shortly.

Chairman MEEKS. Mr. Moss, let me ask you a quick question about your thoughts on how the "bad bank" model has been most effectively applied in the past crises. And I was going to ask this question to Mr. Sanusi, also, but let me start with you. What do you think Nigeria needs to do to get right to ensure that there is success in Nigeria, also?

Mr. MOSS. I'm not going to be so bold as to make banking regulatory advice with Governor Sanusi at the same table. I'm not a banking regulator.

What I would say, though, is that the most important aspect from the outside if you are an investor considering putting money into the Nigerian financial sector is the credibility and transparency of the system. You know there were rumblings even before the crisis about lots of—we should call it what it is—collusion between the banks to lend to each other. Even the push to try to harmonize financial reporting years was resisted, and the assumption from the financial community in London and New York was that

is because there is at lot of lending going on between the banks to kind of boost the balance sheet just before the reporting period.

So that is just one example where the credibility of the system has been broken and broken quite badly.

So the greater transparency that the Central Bank and others can bring back to the system, then that will help rebuild confidence in the financial community in Nigeria.

Chairman MEEKS. Governor?

Mr. SANUSI. Thank you very much.

Two things on transparency. As we have said in our presentation, we have forced the banks to adopt a common year end. All banks now publish December 31st. We have pushed for IFRS, and that will start from 2012. We have also pushed through certain governance changes, change in auditors. Auditors have to be changed after a maximum of 10 years, and nonexecutive directors have to leave the board after 12 years, and CEOs cannot be there more than 10 years. So we have actually put in through changes that end up improving transparency.

On the specific question of the "bad bank," last year we studied the experiences of different countries, including the United States Resolution Trust Company, the Japanese experience with—Island, and the Asian financial crisis. And what we did with our own asset management corporation was to take two companies that are doing two different things in Malaysia, the Danaharta and the Danamodal, and put them in as one.

So we have an asset management corporation that is unique in the sense that none has been done like that before anywhere. It does two things. On the one hand, it purchases nonperforming loans, but, on the other hand, it also is a recapitalization vehicle, a resolution vehicle in every sense of the word.

The first stage is to purchase the nonperforming loans. But in the event that banks require capital after the purchase of the loan, then the asset management corporation can actually inject capital into the banks and then take them from there into a merger and acquisition situation. So AMCON is critical to resolving the problems of these eight to ten undercapitalized banks.

We studied the Malaysian model. We talked to the Governor who, as Deputy Governor, was part of the process of setting up the two different companies. But because of the legislative process, what we did was, rather than to go for two different bills, went for one bill that gave us one company that would do all of this.

We believe that AMCON will be a major part, and it will lead to—I think it would be—it is critical. Right now, we have about six banks that have reached advanced stages of discussion with merger partners. AMCON has already disclosed the basis of valuation, that transparency. It discloses that to lock up those assets for at least 2 years before selling. That is, again, transparency. And when AMCON is going to sell shares it will announce that it will sell and the terms and conditions of the sale the month it will be sold. So there is a process there that makes sure that we have a transparent and credible process all through.

And on the board of AMCON we have the Director General of the SEC, we have the MD of NDIC, we have the Deputy Governor of

Central Bank, the government Minister of Finance, nonexecutive director. So it is really a well-regulated institution.

Chairman MEEKS. I'm about to close, but I don't get this opportunity to have distinguished individuals come testify before the committee from all the way from across the Atlantic Ocean.

But my final question is this, and this is a question that we always have. We have had recently here in the United States—it is an issue that comes up—and that is the tension that arises between consumer protection and safety and soundness of the institutions and whether or not a Central Bank can do both at the same time.

And then I think in the special context with—in context with Nigeria, because of literacy rates being low and dealing with micro finance banks, I was wondering whether or not there was anything or any provisions being put in place so that you could protect the most vulnerable clients from any kind of bank fraud and/or abuse?

Mr. SANUSI. Part of what is happening, the reforms, obviously, that we have looked at Central Bank itself and the weaknesses in the governance structures in the Central Bank and as is contained in my testimony we have set up a special risk management department in the Central Bank. We have also set up a special consumer protection department that is working with the banks to make sure that every bank sets up a consumer protection unit, and we take complaints.

We are also working on reforming—on reviewing the Consumer Protections Act. Because a major problem, as rightfully mentioned, was consumers not knowing their rights and being taken advantage of by the financial institutions.

Now should it be done by the Central Bank and is that a Central Banking role? In most developing countries you find that the resources for doing these things are within the Central Bank, and we are best positioned to tie it to our regulatory and supervisory role and call the banks to order in the event of exploitative practices.

So we have put in place structures. We still have a long way to go. We haven't gone as far on the consumer protection and micro financial end as we have, for instance, on the financial stability end. But, obviously, we have been dealing first with the crisis and trying to bring us back from the brink of catastrophe; and then these are the building blocks for making sure there is no recurrence.

Chairman MEEKS. Mr. Miller, anything else?

Mr. MILLER OF CALIFORNIA. Without a doubt, Nigeria has regional influence, and I hope the reforms in your financial sector will have a benefit to your neighboring countries and Africa as a whole. I applaud you for your reforms. I ask you that you keep them up, and your efforts really will benefit your surrounding nations. I thank you for your testimony.

Chairman MEEKS. Let me also thank you for your testimony. Because, as indicated I think by Mr. Moss, the United States needs a strong Nigeria. In fact, all of west Africa needs a strong Nigeria. Because as Nigeria goes, so go many of your neighbors.

And I just was delighted by the interest that I had in some American investors now looking at Nigeria. Whereas just 6, 7 years ago, that would have been unthinkable. And it is just amazing. I

had people calling me up saying, "Hey, I just was over in Abuja and I'm thinking about putting money in there. What do you know?"

And I happened to have told them we are having you here to testify, and I will tell them after our hearing was over, and I'm going back, as I did after we met in Nigeria, that reform is very much on the way and it is a place where we can look at investment and can really make a difference in having a sound partner in Nigeria and moving forward.

So let me again thank you for your testimony. Some members I know that we wanted to be here are not here, so they may submit questions or have additional questions for this panel. Therefore, without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

That being the case, I now adjourn this hearing.

[Whereupon, at 4:00 p.m., the hearing was adjourned.]

A P P E N D I X

November 16, 2010

The Global Financial Crisis and Financial Reforms in Nigeria

November 16, 2010

Representative Meeks Prepared Remarks

Before we begin, I would like to thank the ranking member, Representative Miller, for working with me to organize this critical hearing on the financial crisis impact on Africa, and the reforms being implemented in Nigeria. I would also like to thank our distinguished witnesses for agreeing to testify before Congress today. In particular, I would like to thank Governor Sanusi and Director Oteh for traveling all the way from Nigeria to testify before this subcommittee. It is quite uncommon for senior government officials from another country to agree to testify before the United States Congress. But these are unusual times we live in. The global financial crisis from which the world is only beginning to emerge continues to hang over many nations' recovery plans. Most emerging markets, including Nigeria, were adversely impacted by the secondary effects of the crisis, in the form of collapsing demand and prices for their

primary exports, as well as a dramatic decrease in remittances.

Over the past two years, I have been privileged to lead two bipartisan congressional delegations to Africa. These bipartisan delegations focused on the impact of the financial crisis and global recession in Africa, the programs implemented by the multilateral institutions to prepare African nations for the expected effects of the crisis, as well as the support the continent received to cushion the impacts of the crisis.

In February 2010, Chairman Watt and I co-led a bipartisan delegation to Nigeria, where we had the privilege of meeting with Mr. Sanusi, the Governor of the Central Bank of Nigeria. Our working lunch meeting with the governor followed an overnight flight to Nigeria and no rest at all before engaging in an aggressive meeting schedule that day. Jetlag and the tiredness meant that we were struggling to stay focused in some of our meetings. But as soon as the central bank governor began to speak, every single person

in attendance caught a second wind. Our working lunch went well over the allotted time, as we discussed and debated the impact of the financial crisis in Nigeria, the tough decisions that he and his colleagues had to make as they evaluated the health of the nation's leading banks and the political and economic pitfalls of bailing out failing financial institutions, as well as the initiative to establish a so-called "bad bank" to acquire the toxic assets from these banks' balance sheets to get the banks lending again. It was also fascinating to hear how Nigeria held the leaders of the failing banks accountable in a way that many Americans wish had also been done here for the leaders of financial institutions that benefitted from tax-payer funded bailouts.

Governor Sanusi also engaged members in a great discussion about the need to reform the entire financial sector in Nigeria, which he will address in his testimony today. One point in particular strikes me as something we struggle with here also. Creating differentiated banking licenses allows specialized banks to emerge, serving critical

parts of the market with targeted products and services. Yet each such institution must be subject to appropriate oversight and a strong regulatory framework, so as to not trigger regulatory shopping, or a regulatory race to the bottom as we arguably witnessed in this country. Increased capital requirements and more stringent risk management structures for the most systemically significant institutions will help Nigeria and Africa as a whole mitigate systemic risks going forward. Lastly, improved regulation of capital markets to promote transparency and will be critical to attract the necessary capital to finance Nigeria's exceptional growth potential and private sector development needs. In many ways, the discussion we had, in a hotel conference room in Nigeria, reflected debates we were having here in the U.S. as we considered necessary reforms to our own financial sector.

Following that meeting, all members in attendance agreed that we had to invite the governor, and his colleague Ms. Oteh, as well as the incredibly knowledgeable Mr. Moss from the Center for Global Development, to testify before

Congress and to tell Nigeria and Africa's story. Hearing this, and listening to our witnesses today, will better inform our support for assistance and reforms in emerging markets.

In closing, I would like to point out that much of the work that we have done here in this subcommittee to push the international institutions seems to have yielded results, as Africa seems to have endured fairly well through the crisis, and may be on track to resume on the positive growth path it was on prior to the financial crisis.

So with that, I would like to once again thank our distinguished witnesses for appearing before the committee today, and I look forward to a spirited and informative discussion.

U.S. Interests in Nigeria's Success with Financial Reform

Testimony before the House Subcommittee on International Monetary Policy and Trade

Todd J. Moss
Vice President and Senior Fellow
Center for Global Development
November 16, 2010

Thank you Chairman Meeks, Ranking Member Miller, and other members of the Subcommittee. I appreciate the opportunity to appear before you today to discuss the effects of the global financial crisis on Africa and U.S. interests in Nigeria's future.

The global financial crisis of 2008-09 hit developing countries particularly hard. Much of Africa saw a sharp slowdown in private capital flows, and the region's growth rate fell by more than half last year. The decline was mitigated, and the outlook today is much brighter, in large part due to the aggressive response of the multilateral development banks which accelerated lending to compensate for the drop-off in private capital.

For this reason, my first point today is that the multilaterals are critical to the recovery of the global economy, and worthy of robust U.S. support. I would urge Congress to look favorably upon the soft loan window replenishments and general capital increases for the African Development Bank and the World Bank in particular. These are investments that leverage U.S. contributions, build global markets, and expand the circle of prosperity.

Turning to Nigeria specifically, I want to make three points. First, the global economic crisis may turn out to be a good thing for Nigeria. That country's banking troubles are largely local in nature, and the pressure of the global crisis both exposed the hidden problems and forced the actions of the Nigerian authorities. In the long run I believe this will make Nigeria's financial sector stronger and more competitive.

It is worth highlighting that real change was not a foregone conclusion. The actions of Governor Sanusi have been decisive, credible, and transparent. In a short period of time, the Central Bank conducted an emergency audit of all banks, initiated a multi-billion dollar bailout, seized control of 8 failing banks and fired their management, pursued aggressive prosecution of executives for fraud, and is now moving quickly with the Asset Management Company (Amcon) to exchange bad loans for government bonds. Particularly notable is the listing in newspapers of debtors, including many powerful and high profile people, as part of a successful name-and-shame campaign. The Governor and his team should be congratulated.

My second point is that the steps so far are meaningful, but Nigeria's reforms are incomplete. There is much left to be done in the financial sector, such as containing the final cost of the bailout, selling off the seized banks in a fair and transparent manner, and enforcing rules to prevent a repeat of the frenzy of insider trading, misreporting, and irresponsible practices.

Yet the future of Nigeria's banking sector goes well beyond monetary policy. A petroleum bill sitting with parliament is necessary to both rationalizing the oil and gas sector and, pertinent to

our discussion today, fostering the domestic capital markets by using local banks to source joint investments currently financed through the budget.

Dealing with a deteriorating fiscal situation is also urgent. The savings in the Excess Crude Account stood at $20 billion just 20 months ago and now are almost completely depleted. For this reason Nigeria's outlook was downgraded by the credit rating agencies last month.

More broadly, success in banking ultimately depends on other necessary steps to make real sectors in the Nigerian economy more competitive. The fight against corruption, which had been so promising a few short years ago, has waned badly over the past three years. A broken electricity system is holding back Nigeria's potential. Spending more capital on the power sector, including public investment and credit from the central bank, cannot alone overcome the other policy constraints squelching the energy sector.

And of course, perhaps most importantly, a credible election next spring is essential if the country is going to restore confidence and get back on track.

This leads to my final point. Nigeria's success is undeniably in the U.S. national interest. The United States needs a strong, capable, and stable Nigeria.

Nigeria is the key to regional security. It is the regional powerhouse and has been the neighborhood enforcer when necessary, with its troops helping to provide security in Liberia and other hotspots.

Nigeria is vital to U.S. energy security. It is not only the 5th largest source of U.S. oil imports, but instability in the Niger Delta can spike international oil prices, affecting the wallet of every American.

Nigeria is also a lynchpin in our fight against 21st Century transnational threats such as terrorism, disease, and drug and arms trafficking. A weak Nigeria is a source of these dangers. A strong Nigeria can be an indispensable ally to contain these threats.

Last Christmas was a stark reminder of the risks of a weakened Nigeria. The would-be bomber on Northwest Airlines Flight 253 was Nigerian. Yet during that emergency, there was no partner for the United States on the other end of the line. The U.S. was under terrorist attack and President Yar'Adua was literally missing-in-action. The power vacuum was dangerous for Nigeria and the United States.

This incident and counterterrorism more generally may seem disconnected from the financial sector issues we are discussing today. But they are in fact closely linked to the capacity and credibility of the Nigerian government. Banking is the leading edge, and a leading light, of Nigeria's economy. Fixing the financial sector is a prerequisite if the country is going to modernize, become middle-income, and join the international community as a responsible and dependable partner.

Let me end with a pitch for a new idea—and one where Nigeria may be able to learn from our own American experience. In the 1980s, Alaska began paying dividends from earnings on oil savings directly to state residents as a way to check the power and wasteful spending of government. New technology, like iris scanning and mobile banking, now make it feasible and affordable for any government to make payments directly to its citizens.[1] Cash transfers, which are being used now in Mexico, Brazil, South Africa, Bolivia, and Mongolia, may be worth considering in the Niger Delta where billions of dollars have been spent with few tangible benefits on the ground. This waste and corruption is the root of Delta violence today. The government has an opportunity, with some political courage and creativity, to finally break that vicious cycle.

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[1] See CGD's *Oil-to-Cash* initiative at http://www.cgdev.org/section/initiatives/_active/revenues_distribution

TESTIMONY ON "THE GLOBAL FINANCIAL CRISIS AND FINANCIAL REFORM IN NIGERIA: A CAPITAL MARKET PERSPECTIVE"

BY

MS. ARUNMA OTEH
DIRECTOR-GENERAL
SECURITIES & EXCHANGE COMMISSION, NIGERIA

BEFORE THE UNITED STATES HOUSE OF REPRESENTATIVES COMMITTEE ON FINANCIAL SERVICES SUB-COMMITTEE ON INTERNATIONAL MONETARY POLICY AND TRADE

TUESDAY, NOVEMBER 16, 2010

0

Introduction

Thank you, Honorable Gregory W. Meeks and other members of the sub-committee for the invitation to testify at this hearing on the Global Financial Crisis and Financial Reforms in Nigeria. My testimony will focus primarily on the impact of the global financial crisis on the Nigerian capital markets and the reform agenda that the NSEC has embarked upon since I assumed duty on 7th January 2010.

This testimony is both timely and relevant to the challenges facing Nigeria, the United States and the rest of the world. It is also auspicious as we at the Nigerian Securities and Exchange Commission (NSEC) seek to strengthen our partnership with the United States Securities and Exchange Commission (US SEC). We believe a strong partnership with the US SEC is critical to building a world class capital market and mutually beneficial in the fight against financial crime and in our common objective of maintaining capital markets that are of the highest integrity.

As you may know, while Nigeria is the second largest economy in Africa, the 8th largest producer of oil, has the 7th largest gas reserves, and produces 6% of the world's cocoa, it is still one of the poorest nations in the world with a GDP per capita of a little over USD 1,000. We believe that a world class capital market is key for Nigeria as it seeks to better leverage its wealth in terms of natural and human resources to realize its full potential and address its socio-economic challenges. World class capital markets are enablers of socio-economic development because they foster a meritocracy, good corporate governance, innovation and entrepreneurship which in turn create job opportunities that will harness the skills and entrepreneurial zeal of the many hard working people that Nigeria is blessed with. World class capital markets fund business expansions and new opportunities and provide governments long term funds for financing infrastructure and other important projects that transform economies. World class capital markets facilitate the diversification of an economy, enable economic agents to pool, price and exchange risks, encourage savings and create wealth.

As the apex regulator of the Nigerian capital markets whose mandate is to regulate and develop these markets, the goal of our reform agenda at the NSEC is therefore to build a world class market that will enable Nigeria diversify its economy, finance its huge infrastructure needs and enhance its business climate and environment. A world class market is one that engenders investor

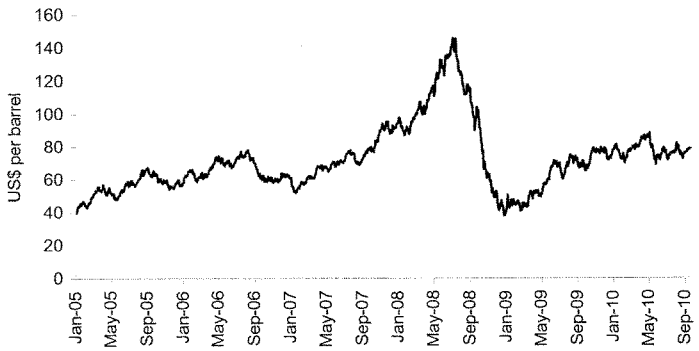
confidence, has breadth and depth in terms of product offerings, is characterized by market integrity, has a sound regulatory framework, a strong and transparent disclosure and accountability regime, fosters good corporate governance and is a fair robust and efficient market place. While the global financial crisis has been devastating, we believe that it has created an opportunity for us to build a world class capital market given the lessons that we have learnt. This testimony will outline the impact of the global financial crisis on Nigeria and key elements of the reform agenda that we have embarked upon to build a world class capital market. It will also present the nature of the partnership that we have developed and the support we have received from multilateral organizations and the United States Securities and Exchange Commission.

Impact of the Global Financial Crisis on the Nigerian Economy

The impact of the global financial crisis on the Nigerian economy was multifaceted as it led to a dwindling of government revenues, affected the Nigerian currency, weakened the banking sector and fueled an unprecedented stock market crash, undermining confidence in the financial sector. The effects of the crisis were however mitigated by the dividends of sound macroeconomic management, particularly since 2003, recent rise in oil prices, and decisive measures that have bolstered oil production and fostered confidence in the financial sector.

The global financial crisis resulted in a deceleration in gross domestic product (GDP), worldwide, as consumer spending, consumer demand and industrial output declined, while unemployment rose. Commodity prices fell sharply including oil which fell from a peak of USD 147 per barrel in July 2008 to USD 33 per barrel by December 2008. Given that the Nigerian economy is heavily dependent on the oil sector, a key channel for the impact of the crisis on Nigeria was the decline oil prices which led to a dramatic decline in government revenues as oil makes up 80% of budgeted revenues, 90% of exports and 33% of GDP.

Price of Brent Crude Oil (Per Barrel)



Source: Central Bank of Nigeria

There was also a decline in oil production due to the activities of the militants in the Niger Delta, the oil producing region and ahead of the amnesty/peace agreement reached in 2009. This created enormous fiscal pressures on Nigeria turning the fiscal balance from a surplus of 5% in 2008 to a deficit of 8% in 2009. Since the aggregate credit to oil and gas was about 10% of total banking sector credit exposure, the decline in oil prices also affected the quality of bank assets as a number of oil importers had entered into long term contracts at previously high prices. Nigeria's currency, the Naira (N) depreciated from 118.50 Naira/dollar in 2008 to 150 Naira/dollar, the level it has maintained since 2009.

Mitigating Factors

Nigeria's strong macroeconomic framework resulting from efforts of successive governments helped Nigeria to reduce the devastating effects of the global financial crisis on the Nigerian economy. Notably, in 2003, a set of broad macroeconomic and policy reforms were adopted as part of a strategic package to make Nigeria competitive. A major component of the 2003 reform program was the adoption of stringent fiscal principles including the oil based rule. Under this scheme, oil revenues above a benchmark price were set aside in an excess crude account. In addition to the above there was the standard package of policies used by nations seeking support from the multilateral agencies under the Washington consensus. Also Nigeria obtained favorable terms for debt write-offs from the Paris Club of Lenders. In all Nigeria's external debt

which was $36bn was partly written off or paid down. The effect of this was a reduction in total external debt to almost nil. Its public debt to GDP ratio reduced to 5.2%. It subsequently obtained a sovereign credit rating and kept inflation under control whilst ensuring positive real rates of return. The government also passed the Nigerian Pension Reform Act of 2004. In line with that Act, the National Pension Commission (PENCOM) granted licenses to eligible pension fund administrators and custodians to begin the receipt, investment, management and administration of defined contribution pension schemes in Nigeria. This has led to an accumulation and professional management of more than USD 12 billion in pension assets which are invested conservatively in the Nigerian capital markets.

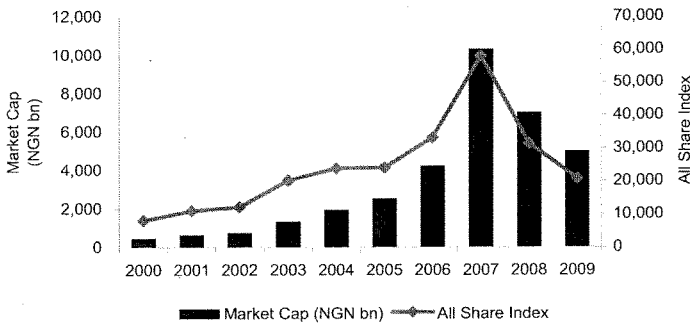
The Impact of the Global Financial Crisis on the Nigerian Capital Markets

The Nigerian capital market was established almost fifty years ago to complement the banking system in providing vehicles for mobilizing formal savings and financing government initiatives and private enterprise. While the Nigerian Securities and Exchange Commission was established in its current form, thirty years ago, its predecessor, the Capital Issues Committee was established in 1962 to regulate public issues of securities. To provide stronger institutional support, the Capital Issues Commission was created in 1973 to take over the activities of the Committee. Following a financial system review, the government decided to establish the NSEC as the apex regulator of the capital markets by an Act in 1979. The Nigerian Securities Exchange derives its mandate from the Investment and Securities of 2007 following reviews to strengthen the legal framework that governs the capital markets. Similarly, the Lagos Stock Exchange, the predecessor to the Nigerian Stock Exchange began actually trading in 1961. In 1999, the Investment and Securities Tribunal (IST), a dedicated fast track civil court for the resolution of disputes arising from investment and securities transactions in an accessible, transparent and cost effective was established. The IST awards and judgments are enforced as judgments of the Federal High Court and appeals go to the Court of Appeal. The Abuja Securities and Commodities Exchange commenced trading as a commodity exchange in 2001.

The Nigerian capital market has evolved with the growth of the Nigerian economy. It has been predominantly equities driven with the banking sector making up an important proportion of total market capitalization. At its peak in March 2008, the equity market capitalization was USD 100 billion with the

banking sector making up more than 60% of total equity market capitalization. Following the global financial crisis, market capitalization plummeted to USD 40 billion and has since recovered to about USD 60 billion.

NSE Market Capitalization and All Share Index



Source: Nigerian Stock Exchange

Prior to the correction in 2008, the market enjoyed a decade of unprecedented growth driven principally by the banking sector reform. In 2004, the CBN increased the minimum capital requirements for commercial banks by 1150%, from N2bn to N25bn. This recapitalization increased the capital base of banks from N400 billion to approximately N1.12 trillion, and reduced the number of banks from 89 to 25 by the end of 2005. This was achieved through a wave of capital raising exercises, mergers and acquisitions and listing of companies on the NSE. Banking sector consolidation attracted over USD1.5 billion in foreign investments. By the end of 2007, the capital of many banks were in excess of USD1 billion. While in 2004, there was no Nigerian bank amongst the top 1000 banks in the world, by the end of 2006, there were 12 banks in the top 1000. That period also saw a significant increase in the number of brokers, asset managers, issuing house that were established. Consolidation efforts and the ensuing capitalization opened up the Nigerian financial landscape to the international space.

The banking system which accounted for 36% of total market capitalization in 2002 had risen to over 60% of the market capitalization by 2007. This reform created capacity for Nigerian banks and prepared them to become relevant players in the global market. he blind pursuit of size between 2005 and 2008

saw industry total assets grow by a compound average growth rate of 44% while industry capital grew by a compound average growth rate of 78% from There was an aggressive expansion in delivery channels between 2005 and 2008. The number of offshore subsidiaries doubled, the number of physical branches rose from 3,357 to 4,824, installed Automatic Teller Machines (ATM) grew 500 to over 7,800, and payment cards rose from 1.5 million to 29.3 million. Offshore credit lines to Nigerian banks are estimated to have risen from USD 3 billion to USD 11 billion. There was an unprecedented level of optimism fueled rising oil prices, speculation and access to easy money and credit. Specifically, the additional capital raised by the banking sector went to speculative lending to the oil and gas sector, and unregulated margin finance to brokers, and individual investors fueling an asset bubble. There was also a regulation-driven insurance sector consolidation and some domestic entrepreneurs opened up their companies to public ownership. Between 2005 and 2007, new equity issues tripled in value. While all this buoyed investor confidence, emphasis on risk management and corporate governance did not evolve commensurately to support the fast growth. In hindsight, regulators were neither sufficiently prepared nor well-positioned to monitor and sustain the explosive growth in the capital markets.

When therefore the global financial crisis triggered large portfolio outflows as international investors exited the Nigerian capital markets to address challenges in their home countries, stock prices started to decline, prompting margin calls and local investors who were unaccustomed to huge and persistent declines started to panicked, fueling more sell orders, further depressing prices and eroding investor confidence. The situation was exacerbated by the huge borrowing and margin finance exposure of individual investors, brokers and banks. While the market recovery to date has been limited because different categories have taken advantage of any recovery to reduce their exposure, the recent establishment of the Asset Management Corporation promoted by the Ministry of Finance and the Central Bank of Nigeria is expected to bring make the sustain the recovery since AMCON will take over about USD 12 billion in non-performing assets and manage them through an orderly disposal of the assets.

Nigerian Securities and Exchange Commission Reform Agenda

The impact of the global financial crisis while devastating for the Nigerian capital markets, has given the Commission an opportunity to reposition the Nigerian Capital Market to play a pivotal role in capital formation and the development of the Nigerian economy. Our aim is to build a world class market which will effectively compete for long term capital internationally, attract and retain domestic capital and be the principal source of medium to long term capital to our industries, both large and small.

As a first step towards reforming the market, the Commission constituted a Committee of experts to undertake a diagnostic review of the Nigerian Capital Market. The recommendations made by this Committee on the vital building blocks of a world class market have been taken into account in the Commission's reform agenda. Some of the areas of focus for the Commission's reform program are outlined below.

Strengthened Enforcement and enhanced regulatory oversight

We believe that we cannot have a strong market or command investor confidence and public trust if our enforcement machineries are weak. Our greatest strength is in our ability to take enforcement actions without fear or favor and without regard for whose ox is goad. The Commission therefore has zero tolerance on market infractions and indeed any act which could undermine the integrity of the market. Recently, the Commission took various enforcement actions against operators and issuers with respect to inadequate filing of periodic returns and other market infractions.

Following the audits of banks in 2009, led by the Central Bank, the Commission launched investigations into possible cases of market abuse that were associated with the capital raising exercises of banks. This has resulted in the Commission instituting legal proceedings against some 260 individuals and entities at the Investments and Securities Tribunal (IST). The Commission is alleging that these individuals and entities were involved in market abuse including insider dealing and share price manipulation. The Commission is seeking the disgorgement of any illegally gained profits and restitution to investors. With the various enforcement actions and stance of the Commission on inappropriate behavior, we have observed improved compliance with the securities law and our rules. We do realize that the cooperation of the law enforcement agencies is very vital to the overall success of our enforcement

actions. We have therefore strengthened our relationship with these agencies to the point that, the Commission now has a resident Nigerian Police desk to deal with matters which involves criminal violations of the securities laws. In addition, the Attorney General and Minister for Justice recently seconded some prosecutors to the Commission. These developments will no doubt aid in the swift dispensation of cases before the Commission.

We are also overhauling the complaint management system in the market for better efficiency and alignment with international best practice. It is hoped that the new system will become effective by the beginning of 2011 and strengthen investor confidence as complaints are more speedily resolved. Currently, the bulk of complaints are handled by the Commission which puts a lot of strain on its resources. As part of the reform of the market, the self regulatory organizations (SRO) are expected to assume a frontline role in the resolution of investor complaints in the market. Our inspection and monitoring activities are being intensified, including undertaking more frequent onsite inspections.

In line with the principles of 40 + 9 recommendations of the Financial Action Task Force (FATF) and money laundering Prohibition Act of 2004, the Commission drew up framework and guidelines which capital market operators are required to adopt to minimize or indeed eliminate anti-money laundering risks in the securities market.

Recent changes to the Commission's rules and regulations

Mr. Chairman and Honorable members will agree with me that market rules are meant to shape behavior, set standards and create a level playing field for participants. They are also meant to promote orderly trading, transparency and market efficiency. Our assessment of the crisis revealed that the absence or inadequate rules in some respect contributed to the scale of the crisis in Nigeria. A good example is the heavy margin trading exposures of banks and brokerage firms which was fueled by the absence of adequate margin trading regulation. New rules have been introduced, while some existing rules were amended and others completely expunged to ensure alignment with international best practice. Some of the new rules were introduced to encourage the emergence of new products, strengthen the protection of customer assets in the market and improve financial reporting and governance of public companies. Some of the rules have emerged from the collaborative efforts of financial sector regulators. An example is the margin trading rules

which were developed and have been jointly issued to banks and market operators by the Central Bank and the Commission.

Reforming the Nigerian Stock Exchange

You will agree with me that a Stock Exchange is a visible symbol of the capital market and must not only exhibit but be perceived by the public to exhibit the highest level of good governance, transparency, fairness and accountability. Investors obviously will not want to participate in a market which lacks these attributes and nor would issuers. The Commission, in early August 2010 intervened in the Nigerian Stock Exchange, replacing the leadership with an interim administration. This was necessitated by certain developments in the Exchange which was significantly eroding investor confidence and undermining the integrity of the market. The Interim Administration whose principal mandate is to conclude a credible and transparent selection process for the Chief Executive and Executive Directors of the Exchange has with the approval of the council of the exchange undertaken some measures to reposition the exchange and bolster confidence. It is hoped that by the beginning of 2011, the new executives would have assumed duties. We are pleased that with the exit of the previous management progress is being made with the process. Steps are also being taken to replace the trading platform with a more efficient and robust system that will ensure that the Exchange is in good stead to respond to future growth in the Nigerian capital markets. The Commission believes that the Nigerian Stock Exchange should be ultimately demutualised and is examining the best model for Nigeria with the various initiative to reform the exchange a more focused, transparent and efficient exchange would emerge.

Developing the Nigerian Fixed Income Market

Given the importance of the fixed income market to both infrastructural and industrial development, and also as a key asset class for institutional investors such as pension funds and insurance companies, the Commission is working assiduously with various stakeholders to develop a strong and virile bond market. To this end, the Commission is enhancing the framework for bond issuance and has introduced rules on book building and shelf registration and simplified disclosure rules for fixed income which are sold to institutional investors and high net worth individuals. These rules have shortened the average issuance time line in the market and improved the price discovery process for securities. These and other measures have increased appetite for

bonds and will complement the first class sovereign bond market that the Federal Government has nurtured over the last seven years. We expect more fixed income activities in view of a recent revision of the tax regime to eliminate tax discrimination which previously existed between sovereign bonds on the one hand, and corporate and sub-national bonds on the other hand.

Promoting Collective Investment Schemes

The experience of the recent past clearly revealed that most retail investors do not have the capacity for direct investing in the capital market. The Commission is therefore encouraging a more institutional market with retail participation principally through Collective Investment Scheme (CIS). Currently, there are over 40 CIS schemes many of which are specialized to cater for the various appetites of investors. Existing funds include bonds, equity, balanced, guaranteed, money market, Islamic and Real Estate Investment Trusts (REITs). There are presently applications before the Commission for the establishment of Exchange Traded Funds (ETFs). In view of increased interest in mutual funds, the Commission has intensified it examination and monitoring of fund managers and trustees of such schemes and recently encouraged the establishment of an industry trade group for mutual fund managers.

Disclosure Issues

Any meaningful reform of the capital market and indeed the financial market must of necessity include the reform of the governance of entities and players in the market. Such governance reform must not only be beamed at public companies but should also focus on regulated entities. For the Commission, the capital market reform agenda includes a review of our 2003 Corporate Governance Code in order to address weaknesses in current practices and strengthen governance and disclosure by public companies. The draft of the new Corporate Governance Codes which is comparable to internationally acclaimed codes has already been exposed to the public and will soon be released in the near future. The Central Bank and the Commission has also been sponsoring sensitization and awareness programs for company directors.

The importance of transparency and disclosure cannot be over-emphasized in enthroning good corporate governance. The public want to believe the numbers they see and information they are given by companies. As is well known, financial information is a key barometer of the state of health of a business entity and should be timely, accurate and reliable to be meaningful to others. Information that is outdated would not serve investors much purpose

in taking timely investment decisions. The Commission has therefore continued to strengthen its disclosure rules and to penalize issuers who violate the rules. Additionally, the auditor of a public company is now expected to issue a statement in his audit report to the company of the existence, adequacy and effectiveness or otherwise of the internal control system. This is borne out of the fact that a strong internal control system is important in promoting good governance of entities.

The adoption of International Financial Reporting Standards (IFRS) by listed companies and regulated entities should improve the quality of financial reporting in the country. Through the efforts of the Commission and other stakeholders, the Federal Government has approved that Nigeria should adopt IFRS, and publicly listed companies and significant interest entities such as banks are required to comply by January 2012.

Greater emphasis Capacity Building and Investor Education

In addition to enhancing the rigor with which it evaluates capital market operators, the Commission is reviewing ways to enhance the programs offered by its training institute, the Nigerian Capital Markets Institute to ensure that the capacity of the industry continues to evolve in line with the growth in the size and complexity of the capital market product offerings. It is supporting trade groups and associations and encouraging them to develop and enhance their continuing education programs, and develop accreditation schemes

A well informed investing public will be better placed to protect itself, forming the first layer in investor protection. For instance, an investor who understands his right is most likely to assert his right and seek redress when such rights are violated. Similarly, an investor who understands the workings of the market is less likely to be taken advantage of by unscrupulous market participants than one who has a low knowledge of the market. When investors are knowledgeable about the workings of the capital markets, they are also better able to assess the risks and rewards of investment opportunities and participate in the market.

In this respect, the Commission has developed various investor education initiatives including providing educational materials for various investor types, sponsoring seminars, town hall meetings, quiz competitions, and capital market studies in universities. It also has capacity building programs for financial journalists and judges.

Support from American Regulators and Multilateral Organizations

Given the breadth and depth of the relationship between Nigeria and the United States, we appreciate very much the partnership that we have developed with the US SEC. The recommendations made by the US SEC carried in their peer review of our capital markets are very useful for us in our bid to build a world class market. We have participated actively in their training programs both in Washington DC and in Africa and expect to jointly host a regional program next year. Also important is the sharing of information and partnership that we have developing in the fight against financial crime.

The Commission has been a member of the International Organization of Securities Commissions (IOSCO) for several years. In June this year, I was elected the Chairperson of the African Middle-East Regional Committee (AMERC) of IOSCO. We feel that membership of IOSCO is extremely important in the global fight against financial crime and are pleased to be one of the ten AMERC members that are 'A' signatories to the IOSCO memorandum of understanding. Membership of IOSCO enables us to share knowledge and benchmark our capital markets with other markets.

Nigeria continues to participate actively in multilateral organizations and continues to benefit from their programs. The USD 500 million Financial Sector and Public Management Development Policy Credit Nigeria received from the International Development Association (IDA) helped provide fiscal space at a time when government revenues were under pressure due to effects of the global financial crisis and attendant dramatic decline in oil prices. We have also found useful, the support the World Bank Group on the Financial System Strategy 2020 as well as through technical assistance programs such as the the provision of an experienced resident expert to assist the Commission with developing the fixed income market in Nigeria.

Conclusion

I hope my submission has contributed to an understanding of the impact of the global financial crisis on the Nigerian capital markets. As I have indicated, while the impact of the financial crisis has been devastating, the silver lining is the opportunity that it gives us to build a world class capital market as this is critical to Nigeria's economic and social progress.

Once again, I wish to sincerely thank this honorable body for the opportunity to give this testimonial and look forward to your continued support.

CENTRAL BANK OF NIGERIA

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

Sanusi Lamido Sanusi
Governor
Central Bank of Nigeria

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

November 16, 2010

GLOBAL FINANCIAL CRISIS IMPACT IN NIGERIA, NIGERIAN FINANCIAL REFORMS AND THE ROLES OF MULTILATERAL DEVELOPMENT BANKS AND IMF[1]

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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.

Nov 16th 2010 Subcommittee Congressional Hearing on International Monetary Policy and Trade

Appendix to the submission by the Governor of the Central Bank of Nigeria, Mallam Sanusi Lamido Sanusi.

This document is prepared as an appendix to the submission of the Governor, Central Bank of Nigeria on the impact of the Global Financial Crisis on the Nigerian Economy, to shed light on some areas not covered in sufficient detail in the main paper.

1. The Support of Multilateral Organizations

The IMF has been a constant source of support along with the World Bank throughout this period. The IMF in particular played a critical role in designing the AMCON and drafting the legislation, arriving at valuation models and learning from the experience of other jurisdictions. In addition to the technical support for monetary policy implementation, the IMF has provided us with a special adviser on AMCON, a Nigerian with strong background in asset management and liquidation.

Nigerian banks have also benefited from credit lines and investments from a number of Multilaterals that have shown us support during the crisis. These include the IFC, US EXIM bank, EIB and FMO.

2. Court cases with Bank CEOs

In early October the former CEO of Oceanic Bank Plc Mrs Cecilia Ibru entered into a plea bargain arrangement in which she pled guilty to some counts and received 3 jail sentences for six months running concurrently. She also forfeited assets including shares in over 100 companies and about 200 pieces of real estate located in various cities in Nigeria, the UAE and the USA, totaling about USD1.2b.

The former CEO of Intercontinental Bank plc, who was on the run and in hiding in the UK, returned to face trial after we secured a freezing order on his assets worldwide from a UK court and applied for his extradition.

There is a very good chance of getting convictions and custodial sentences on other CEOs

3. Banking sector funding for bailout

It is clear that AMCON will not be able to recover the costs of the bailout from disposal of assets and loan recovery. Considering that the funding for AMCON takes the form of a Bond guaranteed by the Finance Ministry the implications are a potential increase in the fiscal deficit as a result of the bailout.

To mitigate this risk we have secured an agreement with the banks to pay an amount equal to 0.3percent of their total balance sheets as at December 31 for ten years beginning 2011 into a sinking fund. This will be complemented with a N50b contribution annually from CBN surplus. Together the sinking fund and the proceeds of AMCON assets will cover bail out cost and avert the need for fiscal costs of the bailout.

The agreement for the sinking fund is now being processed to be passed as law by the National Assembly.

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