THE IMPACT OF REGULATION AND SUPERVISION ON THE ACTIVITIES OF BANKS IN NIGERIA

(AN ASSESSMENT OF THE ROLE OF THE CBN AND NDIC)

BY

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CERTIFICATION

This is to certify that the research project was carried out by **AUSTIN IGWE IYADE** and has been read and approved as meeting the requirements of the St. Clements University for the award of Doctorate (Ph.D) degree in Financial Management.

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APPROVAL

This project was approved for submission in the school of Postgraduate Studies, St. Clements University.

BY

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(Supervisor) **Date**

DEDICATION

This research project is dedicated to my wife, the memory of my Dad and most especially to Almighty God for His abundant blessings and protection.

ACKNOWLEDGEMENT

I am most grateful to Almighty God who through His infinite mercy and love, guided me throughout the duration of the programme.

ABSTRACT

The study is an empirical analysis of the impact of regulation and supervision on the activities of Nigerian banks with emphasis on the role of the Central Bank of Nigeria and The Nigerian Deposit Insurance Corporation. It evaluates the roles and contributions of CBN and NDIC to the Nigerian banking sector. Extensive field survey and library research was carried out and data collected were subjected to thorough analysis.

The analysis shows that the supervisory and regulatory framework of the Central Bank of Nigeria and the Nigerian Deposit Insurance Corporation are not sufficient to guarantee effective banking practices in Nigeria.

Other findings from the study include the need to increase the maximum insurance coverage due to the effect of inflation and the persistent fall in the value of the Naira, the need to disclose transactions continuously to ensure financial prudence through regular supervision and monitoring of the financial health of local banks with the aid of the 'CAMEL' ratings and other supervisory framework.

There is need to also increase the awareness of banking activities within the general populace through a deliberate integration process aimed at demystifying certain inherent perceptions of the public with respect to distress and the role of the Nigerian deposit Insurance Corporation (NDIC). Moreover, the public, investors and depositors were not fully aware of the activities of NDIC and CBN in liquidating and revocation of banks' licenses due to the ineffectiveness of the enlightenment programmes used in carrying out the awareness.

The study focuses also on the consolidation agenda of the Central Bank of Nigeria and the processes, prospect and the challenges of consolidation.

A questionnaire and telephone based research was adopted for the study and the data collated was tested using the chi-square analysis and supported by fundamental evidence from the database of the regulatory authorities.

Finally, the study offered suggestions as to how the problems so identified could be ameliorated.

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CHAPTER ONE

INTRODUCTION

1.1.0 BACKGROUND OF THE STUDY

The banking sector in any economy serves as a catalyst for growth and development. Banks are able to perform this role through their crucial functions of financial intermediation, provision of an efficient payments system and facilitating the implementation of monetary policies. It is not surprising therefore, that governments the world over attempt to evolve an efficient banking system, not only for the promotion of efficient intermediation, but also for the protection of depositors, encouragement of efficient, competition, maintenance of public confidence in the system stability of the system and protection against systemic risk and collapse.

Worldwide, the banking business is highly regulated. This is because of the pivotal position the financial industry occupies in most economies. An efficient system, it is widely accepted, and is a sine qua non for efficient functioning of a nation’s economy. Thus, for the industry to be efficient, it must be regulated and supervised in view of the failure of the market system to recognize social rationality and the tendency for market participants to take undue risks which could impair the stability and solvency of their institutions.

Regulation and supervision of banks remain an integral part of the mechanism for ensuring safe and sound banking practice. At the apex of the regulatory and supervisory framework for the banking industry is the Central Bank of Nigeria (CBN). The Nigerian Deposit Insurance Corporation (NDIC) however, exercises shared responsibility with the Central Bank of Nigeria for the supervision of insured banks. Active co-operation exists between these two agencies on both the focus and modality for regulating and supervising insured banks. This is exemplified in the coordinated formulation of supervisory strategies and surveillance on the activities of the insured banks, elimination of supervisory over lap, establishment of a credible data management and information sharing system.

In the main, bank supervision entails on-site examination of the institutions and off-site analysis of periodically rendered prudential returns, a process called off-site surveillance. The two activities are mutually reinforcing and are designed to timely identify and diagnose emerging problems in individual banks with a view to prescribing the most efficient resolution options.

In line with prevailing international standards, these agencies (CBN and NDIC) have continued to emphasize risk-focused bank supervision in Nigeria. Similarly, they have developed twenty-five (25) core principles for effective banking supervision as enunciated by the Basle committee on banking supervision as the pivot of the framework for bank supervision.

It is worthy to note that what is currently happening in Nigeria does not differ widely from what happened in other nations. Over the years, and specifically since 1952 when the first banking ordinance was promulgated, several other statutes have also been put in place to serve as legal backbone for the actions of the monetary authorities in regulating the banking industry. Presently, the major relevant statutes, include Central Bank of Nigeria Decree No 24 of 1991, the Banks and other financial Decree No. 25 of 1991, the Company and Allied Matters Decree No 1 of 1990, the Nigeria Deposit Insurance Corporation Decree No 22 of 1988 and lately, the failed Bank (recovery of debt & Financial malpractices) Decree No 18 of 1994. These enabling laws and other relevant legislation have largely provided for sufficient and comprehensive supervisory power and operational autonomy in bank supervision, which may restore public confidence in banks.

Furthermore, as part of efforts to ensure the stability of the banking industry and in response to the lingering problem of distress in the sub-sector, the regulatory/supervision authorities have been applying various failure measures since the late 1990s. Hence depending on the severity and peculiarity of the distress, NDIC in collaboration with the CBN, has over the years, successfully adopted such measures as provision of liquidity support through accommodation bill, imposition of prompt corrective actions, assumption control and management, restructuring and sale of some distressed banks as well as liquidation of the terminally distressed banks as a last but unavoidable option.

In specific terms, the following measures have so far been adopted.

1) Accommodation facilities were granted to ten (10) banks with serious liquidity crises to the tune of N2.3 billion in 1989 following the withdrawal of public sector funds from commercial and merchant banks and the transfer to CBN during that year.
2) Holding actions were imposed on 46 banks to help stabilize their financial conditions in the mid-90's.
3) Twenty – four (24) banks were temporarily taken over by the regulators to safeguard their assets between the years 1989 – 1994.
4) Seven (7) distressed banks were acquired, restructured and sold to new investors in the late 1990's.
5) From 1994 to 1999, thirty-six (36) terminally distressed banks were closed with minimal disruption to the banking system.
6) In 2005, the number of operationally licensed banks in Nigeria numbering 89 (Eighty-Nine) was streamlined through a process of Mergers and acquisition into 25 (Twenty-Five) viable banking institutions with a capital base of not less than ₦25 billion each.

The streamlining of these banks was because of their inability to respond to all the various regulatory/supervisory initiatives employed to resolve the banks' problems, and the continued degeneration in their financial conditions.

1.2.0 AIMS/OBJECTIVES OF THE STUDY

The general aim of this research work is to determine the impact of the regulatory and supervisory functions of the Central Bank of Nigeria (CBN) and the Nigerian Deposit Insurance Corporation on the activities of Nigerian banks.

The main objective is:

1 To examine thoroughly how supervisory and regulatory functions of the regulators (CBN and NDIC) impacts on Nigerian banks.

2 To determine the relationship between the banking supervision and the incidence of bad loan portfolio in the Nigerian banking industry

3 To determine the efficiency and effectiveness of Deposit Insurance Scheme in Nigerian banks as a means to boosting depositors' confidence in the system.

4 To test the effectiveness of regulation on the pricing of banks products and services offered to their customers.

5 To determine the relationship between the CAMEL performance rating of banks and the effect of regulation in the industry

6 To determine the relationship between banks lending to the real (private) sector and regulation on the industry.

7 To underscore the efficiency of the consolidation exercise presently embarked upon by the Central Bank towards effective regulatory supervision.

1.3.0 SCOPE AND LIMITATIONS OF THE STUDY

The study will cover the operation of the regulatory authorities as it relates to the banking industry in the past twelve years prior to the consolidation era and thus, would be limited to the period of 2000-2005.

Secondly, the study assumes that the banking system has remained deregulated during the period covered in our study, as most banks practice universal banking, while the CBN/ NDIC act as the regulatory authorities and supervisor of banks in the banking sector.

In view of the technicalities involved, it would be unrealistic to assume that all necessary facts have been gathered in the process of the study. Information gathered is limited to those accesses and made available by the respondents and also those gathered with the aid of local newspapers, magazines, journals and annual reports of the Central Bank of Nigeria (CBN), Nigeria Deposit Insurance Corporation (NDIC), Chartered Institute of Bankers of Nigeria (CIBN), Agusto Industry report and basically the internet. However, the effect of this limitation will be reduced to the barest minimum.

1.4.0 SIGNIFICANCE OF STUDY

The study is significant in that it will help depositors of funds in financial institutions to fully understand the mechanism of banking supervision and the provisions of the law as it relates to the deposit insurance scheme. It also provides a platform for the regulatory authorities to appreciate the impact of their activities on the banking industry, and underscores areas for improvement.

It is also imperative to state that a study of this nature provides an independent platform via which the regulators can appraise fundamental tools of supervision in a bid to make reasonable adjustments where necessary.

The findings of this study will be of immense benefit not only to the Nigerian banking industry and its related institutions, but also to those interested in understanding the inter-relationship between the actions of the regulators on one hand and the banking institutions on the other as well as providing a platform for promoting an efficient and effective banking practice.

The significance becomes more prominent when the effect of regulation and supervision is examined against the background of the consolidation exercise of the present policies of the Central bank of Nigeria. It is worth mentioning that the present state of the nation’s financial industry precipitated out of the supervisory framework of the Central Bank, hence this study would attempt to examine what impact the present consolidation exercise would have on the regulatory framework.

1.5.0 STATEMENT OF THE RESEARCH PROBLEM

Bank regulation/supervision is implemented to ensure a sound and safe financial system in the economy. The measures are mainly concerned with the quality of risk asset in banks, compliance with key ratios such as liquidity ratio, cash reserve ratio, capital adequacy ratio amongst others, the quality of management and other corporate governance issues.

However, inadequate supervisory framework and lack of an effective risk asset database and information sharing system have contributed in no small measure in disrupting the activities of banks, thereby leading to the often distasteful incidents of banking distress and liquidation by the regulators.

In line with this problem, various banking legislation/acts have been promulgated as well as the introduction of different strategies all aimed at increasing the efficiency of banking regulatory supervision. Among them are on-site, off-site banking examination, routine examination, special examinations culled at the instance of the regulators as well as other methods of surveillance to be discussed in subsequent chapters. These measures are mutually reinforcing and are designed to timely identify and diagnose emerging problems in individual banks with a view to presenting most efficient resolution directed towards ensuring continued public confidence in the banking system.

1.6.0 STATEMENT OF RESEARCH QUESTIONS

Since the promulgation of decree No 22 of 1988, the effectiveness of the operations of NDIC and CBN has been a source of controversy and comments by key monitors in the banking industry.

The generated controversy among bankers and the general public forms an integral part of the research questions. These are:

- Why is it mandatory for banks to be overtly regulated by Central Bank of Nigeria (CBN)?
- Have the regulatory authorities helped in controlling the monetary and fiscal inefficiencies of government policies?
- How effective has NDIC guaranteed depositors' funds through its deposit insurance scheme?
- Has the Nigerian banking industry become safe, stable and command the confidence of the general public since the promulgation/implementation of the BOFIA/NDIC Act?
- Have the activities of banking supervisions brought about normal banking practice, professionalism and ethical conduct in the Nigerian banking system?
- As a liquidator, how effectively did NDIC ensure orderly and efficient closure of failed banks with minimum disruption to the banking system?
- Was proper screening of person(s) allowed to own and manage banks carried out by the regulators and if so how far has it fare in minimizing the incidence of abusive ownership and management?
- What is the performance rating of regulatory authorities in preventing financial distress in Nigeria?
- Is the CAMEL framework useful in assessing performance of financial institutions in Nigeria?
- Is Universal banking the key to Nigerian economic development and evolution of sound and healthy financial system?
- Have banks and other financial institution (BOFIA) brought about high standard of financial practice in Nigerian banks?

1.7.0 RESEARCH HYPOTHESIS

The supervisory and regulatory authorities play a significant role in the financial system of any economy through the promulgation of policies aimed at ensuring the prudent management of banks' assets and liabilities and thereby guarantee the safety of depositors' funds. They also promote compliance to safe and sound banking practices, encourage the institution of an efficient internal control system in individual money deposit banks in order to prevent the incidence of frauds, forgeries and other financial malpractices as well as ensure the stability and engendering of public confidence in the system.

This study will therefore test the following eight hypotheses.

1

Ho: The supervisory and regulatory functions of the Central Bank (CBN) and the NDIC have been effective in curtailing distress in the Nigeria banking system.

H_1: The supervisory and regulatory functions of the CBN and the NDIC have not been effective in curtailing distress in the Nigerian banking system.

2

H_O: The Regulatory and Supervisory activities of the CBN and the NDIC have boosted depositors' confidence in the Banking System.

H_1: The Regulatory and Supervisory activities of the CBN and the NDIC have not boosted depositors' confidence in the Banking System.

3

H_o: The Supervisory and Regulatory activities of the CBN and the NDIC have impacted positively on the pricing of banks' products to their external customers.

H_1: The Supervisory and Regulatory activities of the CBN and the NDIC have not impacted positively on the pricing of banks' products to their external customers.

4

H_o: The Supervisory and Regulatory functions of the Central Bank and the NDIC have been effective in improving corporate governance issues in the Banking Industry.

H_1: The Supervisory and Regulatory functions of the Central Bank and the NDIC have not been effective in improving corporate governance issues in the banking industry.

5

Ho: Effective regulations and supervisions of the CBN and the NDIC would boost the volume and the value of transactions witnessed in the Nigerian banking industry.

H_1: Effective regulations and supervisions of the CBN and the NDIC would not boost the volume and the value of transactions witnessed in the Nigerian banking industry.

6

Ho: The Regulatory and Supervisory functions of the CBN and the NDIC have stemmed the incidence of widespread bad loan portfolio in the Nigerian banking system.

H_1: The Regulatory and Supervisory functions of the CBN and the NDIC have not stemmed the incidence of widespread bad loan portfolio the in Nigerian banking system.

7

Ho: The Regulatory and Supervisory functions of the CBN and the NDIC have stemmed the distress syndrome in the Nigerian banking industry.

H_1: The Regulatory and Supervisory functions of the CBN and the NDIC have not stemmed the distress syndrome in the Nigerian banking industry.

8

Ho: The Insurance premium of N50, 000 payable by the NDIC to bank customers in the light of distress is sufficient to boost customers' confidence in the banking system.

H_1: The Insurance premium of N50, 000 payable by the NDIC to bank customers in the light of distress is not sufficient to boost customers' confidence in the banking system.

1.8.0 DEFINITION OF TERMS

Financial Intermediation: Financial Intermediation is the mobilization of funds from the surplus spending units at a cost or lending of such funds to the deficit spending units at a price both within and outside the shore of a country.

Bank regulation: a body of specific rules or agreed behaviour either imposed by some government or other external agency, or self-imposed by explicit or implicit agreement within the industry that limits the activities and business operations of financial institutions e.g. CBN/NDIC.

Bank supervision: Is the process of monitoring banks to ensure that they are carrying out their activities in accordance with laws, rules and regulations, and in a safe and sound manner.

Stable banking system: A stable banking system means that banks have the ability and capacity to meet maturing obligations as they fall due, and are making adequate profits from authorized banking business to justify their investment while at the same time keeping banking failures at a minimum within the country.

Prudential guidelines: Is a body of specific rules imposed by government through the Central bank aimed at ensuring prudent management and administration of banks' funds so that reports of financial institutions are correct and reflective of their true portfolio.

Deposit insurance scheme: Is primarily intended to promote stability of the financial system and to protect the less financially sophisticated depositor by minimizing the risk that depositors will suffer, lender of last resort, effective bank regulation and supervision and efficient payment system.

Financial stability form (FSF): This state that a deposit insurance system needs to be supported by strong prudential regulation and supervision, sound accounting and the enforcement of effective law.

CHAPTER TWO

LITERATURE REVIEW

2.0.0 INTRODUCTION

The banking system in any economy plays the important role of promoting economic growth and development through the process of financial intermediation. Development economists argue that the existence and evolution of financial institutions and markets constitute an important element in the process of economic growth. The banking system, in promoting economic growth, plays the following roles among many others:-

- Improving the efficiency of resource mobilization by pooling individual savings;

- Increasing the proportion of societal resources devoted to interest-yielding assets and long-term investments, which in turn facilitate economic growth. This relates to the savings function of banks and the pivotal role of savings is demonstrated by the fact that when it is in short supply in any nation, investment and the standard of living decline.

- Providing a more efficient allocation of savings into investment than the individual savers can accomplish on their own. This flow of savings into investment ensures that more goods and services can be produced, thus increasing productivity and the nation's standard of living.

- Reducing the risks faced by firms in their production processes by providing liquidity and capital;

- Enables investors to improve their portfolio diversification by providing insurance and project monitoring. Apart from providing insurance services as part of the practice of universal banking, banks have developed a number of products linked to specific insurance policies which are designed to offer protection against life, health, property and income risks. In addition to these, the banks have been used by businesses and private consumers to “self- insure” against risk; that is holdings of cash and other similar products are built up as protection against future losses.

- Provides a veritable platform for an effective monetary policy implementation thereby enhancing the effective management of the economy. The banking system has been one of the channels through which government carries out its policy of stabilizing the economy and controlling inflation. Through the manipulation of certain key variables such as interest rates and the quantum of credit, government is able to influence borrowing and spending within the economy. These in turn affect employment, production and prices.

- Facilitates a reliable payments system which provides support for the economy. In this regard, certain financial assets such as current accounts, deposit / savings accounts, domiciliary accounts etc, which serve as media of exchange for payments readily come to mind. Cheques, credit cards and electronic transfers are the principal means of payment today.

- Provides credit. The banking system provides credit to finance investment and consumption. This is a major function of the banking system.

2.1.0 INTRODUCTION TO BANKING SUPERVISION AND REGULATION

Regulation of banks has been defined by Llwellyn (1986) as a body of specific rules or agreed behaviour either imposed by government or other external, agency or self imposed by explicit or implicit agreement within the industry that limits the activities and business operations of banks. In a nutshell, it is the codification of public policy towards banks to achieve a defined objective and/or act prudently. Banking regulation has two major components:

(i) The rules or agreed behaviours; and

(ii) The monitoring and scrutiny to determine safety and soundness and ensure compliance.

Supervision on the other hand, is the process of monitoring banks to ensure that they are carrying out their activities in a safe and sound manner and in accordance with laws, rules and regulations. It is a means of determining the financial condition and of ensuring compliance with laid down rules and regulations at any given time. Bench (1993) asserts that effective supervision of banks leads to a healthy banking industry.

Dimitri Vitas (1990) also believes that good regulation and supervision will minimise the negative impact of moral hazard and price shocks on the banking system, thereby leading to a reduction in bank failures and banking system distress.

Traditionally, the role of banks whether in a developed or developing economy, consists of financial intermediation, provision of an efficient payments system and serving as a conduit for the implementation of monetary policies. It has been postulated that if these functions are efficiently carried out, the economy would be able to mobilize meaningful level of savings and channel these funds in an efficient and effective manner to ensure that no viable project is frustrated due to lack of funds.

In view of the importance of the banking sector in economic development and the imperfection of the market mechanism to mobilize and allocate financial resources to socially desirable economic activities of any nation, governments the world over, do regulate them more than any other sector in an economy.

This underscores the need for banking sector regulation. However, in addition, the nature of banking business (being highly geared and conducted with greater secrecy when compared with other real sector businesses) provides added reason for strict supervision. This is to constantly beam a search-light on the sector's activities with a view to ensuring that operators play by the rules of the game and imbibe sound and safe banking practices.

Furthermore, such an oversight is intended to assist supervisory authorities in timely identification of deterioration in banks' financial conditions before it degenerates to threaten the stability of the banking system or even the economy. This was the view of Donli J.G. (2003)

Radical reforms to the system of prudential regulation and supervision have been implemented since the late 1980s. These reforms are essential because the prudential system has proved ineffective in ensuring sound bank management, as the scale of financial distress among the state government and local banks indicates.

Banking regulation was first introduced in Nigeria in the early 1950s in response to the failure of local banks. The 1952 Banking Ordinance imposed minimum requirements for paid up capital and the establishment of reserve funds. This was followed by the enactment of the 1958 Central Bank Act and the Banking Ordinance of 1959. The banking legislation was further strengthened with the enactment of the Banking Decree of 1969. This consolidated previous banking legislation; raised minimum paid up capital requirements and empowered the CBN to specify a minimum capital/deposit ratio (Nwankwo 1980: 20; Ekundayo 1994: 346). It also empowered the CBN to impose liquidity ratios and placed restrictions on loan exposure and insider lending (Oloyede 1994: 283). The legislation contained in the 1969 22 Money at call from other banks accounted for 17.2 per cent and loans and advances from other banks (excluding the CBN) for 8.6 per cent of merchant banks' total liabilities at the end of 1991: these fell to 11.8 per cent and 4.8 per cent respectively at the end of 1992 (NDIC 1992: 31). The figures given in NDIC Reports for later years are not directly comparable but it is evident that Inter-bank funding from loans and call deposits fell to less than 6 per cent of merchant banks' liabilities in 1993 and 1994 (NDIC 1994: 25). As a share of merchant banks' total local currency deposits, Inter-bank funds fell from 44 per cent in 1990/91 to 11 per cent in 1994/95 (Agusto and Co 1995: 17).

The vulnerability of the merchant banks to the liquidity squeeze was exacerbated by the impact of CBN regulations which stipulated that minimum shares of their loan portfolios had to be allocated to long term loans, leading to a mismatch in the maturity structure of their assets and liabilities (Umoh 1989). Their ability to mobilise deposits was also impeded because regulations prevented them from accepting deposits below a specified minimum amount.

The CBN Decree of 1991 established the regulatory framework for the prudential control of banking for the next 22 years until it was superseded by the 1991 Banking and Other Financial Institutions Decree (BOFID). The prudential system was ineffective in preventing mismanagement and fraud from becoming widespread in the banking system for a number of reasons. First, although the CBN was responsible for supervising banks, it lacked independence from the Federal Ministry of Finance (FMOF), especially with regard to the licensing of banks (the authority for the granting of banking licenses lay with the FMOF until this was transferred to the CBN under the 1991 BOFID), and the enforcement of sanctions when infractions of legislation were discovered. Political considerations, and a lack of technical expertise in the FMOF, impeded proper bank regulation and supervision in particular because many of the public sector banks were expected to follow developmental objectives (Ologun 1994: 314).

Second, the primary regulatory concern of the CBN was with ensuring compliance with the allocative controls, such as the sectoral lending guidelines, rather than the prudential controls. The allocative controls weakened loan portfolio quality by diverting loans towards non viable borrowers (Jimoh 1994: 304).

Third, between the mid 1980s and 1991 the licensing procedures were too lax, allowing politically connected people to obtain licenses and operate banks despite having no obvious qualifications or relevant experience. The CBN suspended granting new licenses in 1991, but between 1986 and 1991, 84 new banks were established. The rapid growth in the number of banks overwhelmed the examining capacities of the CBN/NDIC. On-site inspections were infrequent and were confined mainly to checking compliance with allocative requirements.

This, combined with political constraints allowed banks to flout the banking laws. In 1989, 27 banks failed to meet the minimum capital requirements (Alawode 1992: 107-8). It is also clear that the restrictions on unsecured insider lending were flouted. The de facto liberalising of licensing policy before prudential regulations and supervisory capacities were strengthened allowed under-capitalised and poorly managed banks to be set up in large numbers, and was therefore a significant contributory factor to the financial fragility which subsequently afflicted the banking industry.

Fourth, the banking legislation failed to ensure that loans were properly classified, provisions made for loan losses, and unpaid interest suspended from income (Umoh 1994: 323). This allowed banks to conceal the true state of their balance sheets.

Despite the deficiencies of prudential regulation there were very few overt bank failures between 1960 and the early 1990s. It is unlikely that this was because all banks were soundly managed in this period. Although fragility in the banking system clearly worsened during the 1990s, the imprudent lending policies which were the major cause of the distress probably began soon after most of the distressed banks were set up. Bank failures were probably averted in this period, despite the mounting bad loans afflicting, in particular, many of the state government banks, by a number of factors.

The Federal Government appears to have had an implicit policy not to allow banks to fail, and as a result, banks facing liquidity shortages because of non performing loans probably had recourse to support from the Federal budget, CBN loans, or public sector deposits, although there is little evidence to substantiate this. The lack of competition due to regulatory restrictions on lending, interest rates, and new entry is also likely to have assisted some of the badly managed banks to survive, while insolvency was concealed by accounting practices which failed to reveal the true state of asset quality and income.

There was a change in the attitude of the authorities towards prudential regulation in 1988/89.

The Federal Government appears to have become less willing to accommodate bank distress through public subsidies, possibly because of the need to improve macroeconomic control. Instead the emphasis changed towards imposing much stricter prudential standards, providing limited deposit insurance, and putting in place a mechanism for dealing with distressed banks.

In 1988 the NDIC was set up to insure the deposits (up to a maximum amount for a single deposit) of all licensed banks, funded by a (tax deductible) levy on the insured deposits of the banks. The NDIC was given authority to inspect banks (thus providing a second supervisory agency alongside the CBN) and also acts as the liquidator for those banks which the CBN decides to take over and close down.

The CBN introduced new capital adequacy requirements in 1990 under which the banks' minimum required capital and reserves are based on risk weighted assets, as in the Basle accords. The previous requirements, under which banks' minimum adjusted capital were computed as a percentage of loans and advances have been retained, hence banks are required to meet both ratios. The new requirements are more stringent in that they require banks to maintain higher levels of capital to support their operations (Umoh 1991). In 1991 the minimum paid-up share capital for commercial banks was raised from N20 million to N50 million while that for merchant banks was raised from N12 million to N40 million.

The prudential guidelines issued by the CBN in 1990 directed banks to classify loans according to whether they were being serviced, to make provisions for non performing loans, to suspend unpaid interest from income, and to classify and make appropriate provisions for off balance sheet commitments. The 1969 Banking Act was replaced in 1991 by the BOFID.

This strengthened the legislative powers of the CBN. It gave the CBN the sole responsibility for licensing banks and provided it with various powers to enforce the banking laws: e.g. issuing cease and desist orders, imposing penalties on bank directors and employees, and taking over the management of distressed banks. In 1994 draconian anti-fraud legislation was introduced with the promulgation of the Failed Banks (Recovery of Debts) and Financial Malpractice's Decree.

Since 1992 the CBN and NDIC have taken steps to deal with bank distress. The strategy adopted involves first imposing holding actions (preventing further lending, etc.) on the distressed banks while their owners are instructed to recapitalise them, recover debts and improve their management. If they fail to do this satisfactorily, the CBN then appoints interim management boards to the banks, following which it may liquidate the banks, with the NDIC reimbursing insured depositors, or acquire them for a nominal fee for possible resale to new owners. The take-over of many distressed banks was however delayed until well after the problems had been identified because of the need to secure presidential approval (World Bank 1994: 48). In 1994 four local banks had their licenses revoked by the CBN and are currently being liquidated by the NDIC. As of late 1995, the CBN has taken control of ten state government banks and a further 13 local private sector banks, appointing interim management boards for these banks. Six of the state government banks were acquired by the CBN for a nominal sum of ₦1 in 1995.

The reforms outlined above have addressed many of the regulatory defects prevailing in the 1980s and put mechanisms in place for improved prudential regulation and for dealing with bank distress. Nevertheless, the practical difficulties involved in both tackling the prevailing distress and in ensuring that banks are prudently managed are enormous, probably greater than anywhere else in Africa. The political and economic environment is very difficult for bankers and regulators because of the persuasiveness of corruption in both public and private sectors, excessive political interference in public administration from which the CBN and NDIC are not immune, and the severe crisis in the real sector of the economy which has created an unstable and difficult business environment for the banks' debtors.

Effective prudential supervision is likely to be impeded by the large number of banks and other financial institutions to be supervised which limits the frequency with which banks can be examined on site. Given the level of fraud in banks, the efficacy of off-site supervision in revealing potential distress may also be limited. Moreover the allocative regulations imposed on banks compromise prudent management as well as encourage bank executives to violate the spirit of CBN guidelines. The magnitude of bank distress in the banking system is especially problematic for the regulatory authorities: the net worth of the 45 distressed banks at the end of 1994 amounted to negative N19 billion (2 per cent of GDP). Restructuring and/or liquidating (and therefore reimbursing insured depositors) all the distressed banks will impose substantial financial and administrative demands on the CBN and NDIC.

2.2.0 DEVELOPMENT OF BANKING IN NIGERIA

Prior to the 17th century, rudimentary banking activities have become wide –spread in several parts of the world. Banking activities in Nigeria evolved to serve the interest of the colonial government, especially in the distribution of sterling coins. However, with the influence of European trading activities and the presence of colonial government, the Africa bartering gradually gave way to the use of currency to facilitate exchange (Odozi, 2000).

Commercial banking activities commenced in Nigeria in 1892 when African Banking Corporation (ABC) started business in Lagos. In 1894, the bank of British West Africa which later changed to Standard Bank and is now known as First Bank of Nigeria Plc replaced African Banking Corporation and monopolized the banking scene. The Barclay's Bank (D.C.O.) opened a branch in 1917. Before then, Bank of Nigeria (formerly Anglo African bank), which was established in 1905 had been sold out to Bank of British West Africa (BBWA), while the British and French Bank, now United bank for Africa (UBA) became the third expatriate bank to commence the business of banking in Nigeria in 1949.

The indigenous banks, which included the CBN (not the same as the present CBN) failed due to the peculiar features that characterized banking scene in the free banking era that extended to the period of independence. These features comprise of the following:

1. Foreign bank's domination of deposit base and credit availability;
2. Bank service tailored to the needs of the expatriates;
3. Indigenous bank boom and failures resulting from undercapitalization and poor quality management.
4. Lack of banking control and direction, as there was no regulatory framework.

This development notwithstanding real banking regulation and surveillance did not commence until the establishment of the Central Bank of Nigeria (CBN) in 1958), and its commencement of business in 1959.

Banks during the Pre-SAP era were subjected to substantial restrictions in their products and services and this severely limited the scope of competition in the industry. The restrictions were in various shades:

1. Ceiling on credit expansion and interest rate
2. Restrictions on entry into the banking industry
3. Restriction on banks' portfolio selection, as many of the banks were forced to perform developmental roles such as provision of subsidized credit to some areas designated as priority sectors and public enterprise.

In 1986, the Structural Adjustment Programme (SAP) was introduced which had as its arrowhead the "deregulation of the financial and economic systems". This brought about the liberation of banking hence the elimination of other discriminatory practices that inhibited both the free entry into the market or the scope and manner of its operation. It also brought about the privatization of a number of government-owned banks. During this period, banking became very competitive, as banks had to be innovative and aggressive in order to survive, especially with the establishment of non-bank financial institutions, mortgage institutions and the Urban Development Bank. (Okafor, 2000).

Some other fallouts of the SAP – banking era include the following:

- The deregulation of the interest rate structure
- Increase in equity requirement
- Automation in the banking industry
- High incidence of fraud
- The introduction of the prudential guidelines in 1990
- Increase in private ownership of banks.

Prior to the adoption of the concept of universal banking in the country, the merchant bank operators were complaining stridently that the playing field was skewed in favour of commercial banks. Not only were commercial banks allowed to participate in what was thought the exclusive preserve of merchant banks such as leasing and related fee-based services, commercial banks in addition enjoyed the advantages of stability, particularly when mobilized in large volumes and relatively inexpensive pool of funds.

However, following the CBN approval-in-principle of the adoption of universal banking (UB) in Nigeria, and the subsequent ratification of the report of the committee on the preparation of guidelines for same, the Governor of CBN in the exercise of the power conferred on him by the Provisions of section 61 of Banks and other Financial Institutions Decree (BOFID) 1991 as amended, has approved the issuance of guidelines for the implementation of universal banking in Nigeria.

With effect from January 1 2001, the CBN adopted universal banking in the country. Under the arrangement, banks were no longer categorized as commercial or merchant but were issued a uniform license, with each bank determining the market in which it intends to operate.

Accordingly, bank operational scope was broadened with other measures adopted to ensure improved resilience to withstand financial and operational shocks.

The universal banking policy has removed discrimination in the implementation of policies in the industry as uniform policies are now adopted and implemented across the industry.

Presently, the banking industry in the country could be described as outlined below:

- The industry has returned to profitability after a period of economic depression.
- The distress problem has been fully resolved with public confidence in the industry on the rise.
- Banks capitalization has improved, thereby increasing their capacity for their primary mandate of financial intermediation.
- There has been modest investment in information technology by banks.

2.3.0 THE OBJECTIVES FOR BANKING SUPERVISION

Banks worldwide are more regulated than other institutions because of their roles as financial intermediaries. As financial intermediaries, banks mobilise funds from the surplus spending units at a cost for on lending of such funds to the deficit spending units at a price both within and outside the shores of a country.

In discharging their financial intermediating role, it is the responsibility of banks to ensure that the funds mobilised could be accessed by the depositors as when needed.

While in their care, the mobilized funds are advanced as loans and advances at a price to be repaid along with the principal loan. The spread between the cost of funds and the price of the loans granted in this manner is the singular most important source of income for banks.

Banks also provide an efficient payment mechanism in the economy. They provide smooth and efficient system for making payment to settle both business and personal transactions, and international financial obligations on behalf of their customers.

Thus, savings are stimulated for investment in the economy by banks. The weight of evidence is that banks in the process of intermediation contribute significantly to real economic development. According to Schumpeter (1934), banks are necessary condition for economic development. This proposition has been supported by several later scholars including Goldsmith (1969) and Cameron et al (1972). Empirical evidence also suggests that there is a positive correlation between real growth of output, investment, bank assets and money supply. Growth in the banking sector when well transmitted would result in the growth of the real sector. The opposite is also possible if the banking sector is repressed and inefficient. It is in recognition of this that John B.Heimann, founding Chairman of Financial Stability Institute (FSI) in June 2001 asserted that "the prosperity and strength of any economy relies heavily upon the proper and prudent functioning of the country's system of financial intermediation. If the financial system is strong, the economy has the ability to grow and the strength to absorb shocks.

But if the financial system is weak, it acts as a magnifier of problems, rather than a shock absorber.

In performing their various functions, banks are expected to ensure prudent management of assets and guarantee the safety of depositors' funds. They are expected to adhere strictly to safe and sound banking practices, maintain adequate internal control measures to prevent incidences of fraud, forgery and other financial malpractices, to ensure stability and engender public confidence in the system. The proper management of banks is therefore a pre-requisite for economic prosperity in any country as the vehicle for the implementation of monetary policy. Indeed, the contributions of banks to the development of the economy depend on the quantity and quality of their services and the efficiency with which these services are provided.

Here lies the concern of the Regulatory Authorities and hence the “raison detre” for intensive banking regulation and supervision.

The objectives of banking regulation and supervision were advanced by Giddy (1984) as for monetary policy, i.e. the ability of banks to create money through the extension of credit; credit allocation function of banks; the need to ensure competition and innovation by the prevention of cartels; and because banks are depositories of public savings and managers of payments mechanism, they are very vulnerable to collapse.

The protection of depositors has come to be generally accepted as the most basic reason for banking regulation and supervision. This objective is hinged on the fact that bank depositors have difficulty protecting their interests when compared to other bank creditors and investors.

On his part, Sheng (1990) stated the objectives of supervision as: promotion and development of sound and wide range of financial services to meet the needs of the economy; ensuring efficiency, security and responsiveness of banks to the needs and complaints of customers; ensuring compliance with laid-down rules and regulations which are germane to ensuring high standards of banking; and to achieve important developmental and social goals through their compliance with monetary and credit allocation policies. Sinkey J. R. (1989) states the goals of regulation as:

- The protection of depositors;
- The protection of the economy from the vagaries of the banking system; and
- The protection of banks’ customers from the monopolistic power of banks.

Dale (1986) had classified prudential regulation of banks into three: preventive, protective and supportive. While preventive regulation is designed to limit the risk undertaken, the protective regulation offers protection in the event of failure. The supportive regulation is in form of a lender of last resort.

In both developed and developing economies, the banking industry determines the financial services available to the economies. Hence, regulation is necessary to break this monopolistic power and prevent abuse. Moreover, in developing economies, banks play their traditional intermediation roles as well as being used as a vehicle for achieving developmental and social goals. Banks in third world countries have to develop indigenous entrepreneurs by channeling credits for their use. As a result of this, the World Bank (1989) noted that banks in these economies have to be regulated to ensure that they play their proper role in economic development.

In a nutshell, the rationale for bank regulation and supervision can be summarised as follows:

- Efficiency,
- Diversity of choice,
- Competition,
- Stability of banking system,
- Macro economic stability, and
- Developmental and social objectives.

2.4.0 APPROACHES TO BANKING REGULATION AND SUPERVISION

The four approaches to banking regulation are standard and are applicable in all jurisdictions although with some variations here and there. A highlight of each of them is given below.

The first approach relates to information disclosure which is of two types. The disclosure to the general public through the announcement of operating results and full disclosure to bank supervisors where public disclosure may not be necessary in order to protect the clients' secrecy. Information disclosure by banks is basically designed to ensure that supervisors, depositors, investors and the general public are adequately informed of bank's performance/condition. The enforcement of adequate disclosure is paramount. The level of disclosure and timing of information to the various stakeholders should be articulated for banks to comply as a routine. This is an issue in Pillar III (Market Discipline) of the New Capital Accord.

The second approach is self regulation through the use of internal audit and controls, external audit and board audit committee. Self regulation involves the various independent checks and reviews put in place by the bank itself to ensure that its sound procedures do not deteriorate. Self regulation and self discipline are supposed to be more effective than regulation by a government agency because it is based on the conviction of self. It is also developed from industry norms; hence the stigma of non-compliance with peers and competitors are enough to encourage compliance. Basically in all banks, the primary responsibilities for safety and soundness, and prevention and detection of frauds and errors rest with the bank management. Self regulation which is yet to be imbibed in emerging markets works in developed countries where market leaders impose market discipline. Self regulation normally fails due to competition or when market leaders themselves are weak. At such periods, self regulation becomes ineffective; indecision and self interest become a determinant.

The third approach is through banking supervision which is in two forms. The on-site examination is to ascertain the financial condition of a bank. It also aims at verifying the accuracy of the periodic reports of the banks sent to the Regulatory Authorities, analysing those aspects of a bank that cannot be adequately monitored through off-site surveillance and confirming and ensuring compliance with laid down laws, rules and regulations. On-site examiners assess the quality of assets, management, earnings, capital and funds management as well as accounting and internal control systems. The second form is off-site surveillance. The returns of banks to the Regulatory Authorities are analysed by off-site supervisors for completeness, accuracy and consistency as well as compliance with prudential ratios and regulations. Regulatory Authorities, mainly in emerging markets, which do not have adequate resources rely more on off-site supervision to monitor the financial condition and performance of banks and to identify those banks that may need closer scrutiny. It is an irony of fate that where on-site examination should be emphasized due to low integrity of information from banks, resource constraints make such Regulatory Authorities to rely on off-site supervision. It is useful to add that on-site examination has been found to be more effective than off-site supervision in many jurisdictions due mainly to unreliable information that many banks do send to the Regulatory Authorities.

Finally, deposit insurance scheme is a financial guarantee scheme which seeks to protect depositors' fund against losses associated with bank failures. The scheme promotes a safe, sound and stable banking system. As a means to curtail moral hazard that deposit insurance could engender, the insured limit is always set at a low amount to ensure adequate protection of small savers for which the scheme is primarily designed. It is therefore, necessary for Regulatory Authorities to set up effective monitoring systems and increase punitive measures against the abuses in the system.

2.5.0 BANKING SUPERVISION AND REGULATORY STRUCTURES

It has been said that there is no theoretically optimal system or standard blueprint of what constitutes the best structure of banking system regulation and supervision (Bank for International Settlement, 2000). Factors like differences in political structures, general complexity and state of development of the financial systems; the nature and extent of public disclosure of banks' financial positions; level of market discipline; the availability and robustness of information technology; and the capacities of the regulator(s) dictate(s) regulatory and supervisory approaches world-wide.

The Basel Committee on Banking Supervision in 1997 came out with an implicit framework for the regulation and supervision of banks code-named, The Core Principles for Effective Banking Supervision. The framework can be interpreted as comprising four distinct yet complementary sets of arrangements:

- Legal and institutional arrangements for the formulation and implementation of public policy with respect to the financial sector, and the banking system in particular;
- Regulatory arrangements regarding the formulation of laws, policies, prescriptions, guidelines or directives applicable to banking institutions (e.g. entry requirements, capital requirements, accounting and disclosure provisions, risk management guidelines);
- Supervisory arrangements with respect to the implementation of the banking regulations and the monitoring and policing of their application; and
- Safety net arrangements providing a framework for the handling of liquidity and solvency difficulties that can affect individual banking institutions or the banking system as a whole and for the sharing of financial losses that can occur (e.g. deposit insurance scheme or winding-up procedures).

With respect to the supervisory arrangements, the Core Principles describe what could be termed a "cradle to grave" approach covering the licensing of individual banks, the process of ongoing supervision and mechanisms for taking prompt corrective actions in case institutions do not meet regulatory or supervisory requirements (the latter would also include exit arrangements for institutions facing serious losses or default and possibly resulting in the activation of safety net arrangements). The overall objective of this comprehensive process of supervision is to guarantee that banks can be established, operated and restructured in a safe, transparent and efficient manner.

Interestingly the Basel Committee has continued to facilitate collegial approach to cross border supervision through co-operation and resource input in response to the increasing globalization of the financial systems, which raised concerns for standards and competence of regulators worldwide. Such concerns have often been met by agreement on conduct, codes or principles. Consequently, regulatory standards by the Basel Committee on such thresholds like capital adequacy are often adopted at the minimum.

2.5.1 EXISTING BANKING SUPERVISORY STRUCTURE IN THE WEST AFRICAN MONETARY ZONE

The Central Bank in each member State is not only the apex financial institution, it is the sole supervisory body with the exception of Nigeria where NDIC understandably complements the efforts of the CBN in supervising banks.

It is apparent that Nigeria accounts for 71.2% and 88.7% of the total number of banks and their total assets as at 30th June, 2002 respectively. Such a disproportionate distribution can pose a problem in the composition of a sole banking supervisory body if it is desired. Such a sole banking supervisor should automatically have its headquarters in Nigeria given the need, to cut cost by being closer to supervised banks. Also, Nigeria should account for at least 70% of the management staff and the budget. This may not be feasible as the argument of sovereignty will surface in deciding on the level of management staff that should come from each country. Of course, that will not be an issue if Nigeria wants to contribute at least 70% of the budget.

The level of resources at the disposal of each country is also not relatively equal to the extent that that has impaired the effectiveness of banking supervision in some less endowed countries.

The coverage of supervision also varies from one member State to the other. For example, the Central Bank of The Gambia also supervises insurance companies whereas; insurance companies are under the purview of National Insurance Commission (NAICOM) in Nigeria. Such variations abound from one member State to the other. If there is proposal to have a unified supervisory body for all financial services, that will meet with opposition in some countries. In Nigeria for example, with the introduction of universal banking, NAICOM and SEC had voiced their opposition to CBN to becoming the sole supervisor of all financial services even when the CBN has not taken the step to do so.

2.6.0 WAYS AND METHODS BY WHICH REGULATORY AUTHORITIES CARRY OUT SUPERVISORY FUNCTIONS IN BANKS

Supervisory authorities carry out their functions through bank examinations. Bank examination may be defined as the examination of the books and records of a bank for the purpose of ascertaining that the affairs of the bank are being conducted in a safe and sound manner with respect to: adequacy of capital, asset quality, board and management, earnings, liquidity, adequacy of internal controls, adequacy of accounting system and record keeping as well as compliance with both the individual banks' internal policies and prudential regulations.

To accomplish the task of examining banks, bank examiners use both off-site and on-site supervision to carry out their supervisory functions.

2.6.1 ON-SITE SUPERVISION

On-site supervision of banks entails physical presence of regulators (CBN and NDIC) in the financial institutions to evaluate their internal controls, compliance with the laws and regulations governing their operations with a view to determining their overall risk exposure. Emphasis is placed on their capital, asset quality of management, the strength of earnings and the adequacy of liquidity. On-site supervision is carried out by the Bank Examination Department of the regulatory bodies.

2.6.2 OFF-SITE SUPERVISION

The off-site supervision of banks is carried out by the Banking Supervision Department of the CBN/NDIC and involves essentially the appraisal of banks returns. Essentially, it serves as an early warning device to detect a bank's emerging financial problem. This is accompanied by analyzing key bank financial ratios and other financial data that are generated from periodic bank financial reports that are submitted to the supervisor.

An off-site surveillance system can also contribute to a more efficient use of examiners' resources by giving priority to the examination of banks that are experiencing problems or which appear to be significantly increasing their risk exposure. The availability of off-site surveillance reports and analyses can help examiners to prepare for on-site bank examination by focusing attention on specific banks' operational areas that may require close supervision / attention.

At the aggregate level, off-site surveillance system can be employed by bank supervision to monitor the financial condition and performance of the entire banking system. Off-site surveillance system typically focuses on a variety of key bank financial ratios covering such areas as earnings, asset quality, capital and reserves and liquidity.

2.6.3 MAIDEN EXAMINATION

This is usually carried out after six months of operations by a new bank to determine if the conditions and premises for granting of banking license by the CBN and the business objective of a bank are being pursued.

2.6.4 ROUTINE EXAMINATION

This is the normal examination, currently carried out on a yearly basis to review the prudential operations, information-processing systems, foreign exchange operations and the anti-money laundering control of banks to determine the continued conduct of banking business in a safe and sound manner.

2.6.5 TARGET/SPECIAL EXAMINATION

This is usually carried out when serious issues of regulatory concern arise in bank, e.g. persistent illiquidity, lingering boardroom squabbles, deteriorating assets quality etc. In such a situation, the examination effort is concentrated primarily on the identified areas of regulatory concern.

2.6.6 INVESTIGATION/SPOT CHECKS

These arise from the discovery of abnormal banking practices, complaints and petitions by the banking public and other stakeholders of issues bordering on unprofessional and unethical conduct by a bank.

2.7.0 PROCEDURES AND AREAS OF BANKING EXAMINATION

I. PRE-EXAMINATION PLANNING

This is a very crucial stage of the examination process, which determines the overall quality of an examination. It involves perusing all correspondents, call reports, preliminary visit to the bank, in some cases, etc to ascertain the intervening event since the previous examination and hence the present condition of the bank. It also involves the determination of the resources (Human, Time and Material) that would be needed for the examination.

II. FIELD WORK

This is the examination proper and involves the review of the following issues: The level of implementation of the recommendation in the previous examination report by the bank. The non-implementation of some categories of the examiners' recommendations is sanctionable, ownership/shareholding structure to ascertain effectiveness of the board oversight; corporate government issues/structures and management function; Internal Audit and Internal Control System; accounting System and records and Information Technology/Processing System, deposit, Liquidity and Funds Management; Application of know-your-customer (KYC) principles; credit administration and risk asset; asset quality; income and expenditure; capital adequacy; foreign exchange operation and anti money laundering control. The totality of those reviews enables examiners to determine the bank's level of compliance with regulatory/prudential requirements and its own internal controls.

III. EXAMINER'S REPORT

At the conclusion of the fieldwork, which usually ends with a discussion of the examiners' salient findings with the top management staff of the bank, an Examination Report is issued to the bank as the ultimate product of the exercise following which the bank's board is expected to convey a special meeting within two weeks, to formally receive the report.

The bank's external auditors are usually invited to the presentation of the report by the examiners just as in the exit conference, to familiarize them with the banks situation, in the spirit of mutual Examiners/Auditors cooperation. Copies of Examination Report are also forwarded to the Banking Supervision Department, the other Financial Institutions Department, the Nigerian Deposit Insurance Corporation, the bank's external auditors etc.

The highlights of the report are summarized and presented to the financial sector surveillance committee of the CBN to keep its members abreast of the conditions of, opportunities and threats to the bank. It must be noted that the Examiner's Report is a highly confidential document, with restricted circulation.

IV THE FOLLOW-UP EXAMINATION

The bank's board is expected to respond to the Examiner's findings within four weeks of the presentation of the report. On the receipt of the bank's response, a follow-up examination is carried out by another team of Examiners to confirm the bank's claims and ascertain the level of compliance with the recommendations in the report. Thereafter, penalties imposed by Examiners for infractions are given effect.

Conclusively, it should be emphasized that off-site surveillance system are always employed as supplement to on-site examinations but not as substitutes.

Certain information that is crucial for the supervisory process such as quality of bank's loan portfolio or the quality of a bank's internal policies and procedures can only be effectively evaluated through on-site examinations. Simply stated off-site surveillance and on-site examination should be viewed as compliments, each of which produces useful, but different information that contribute to an effective supervisory program.

2.8.0 ORIGIN OF BANK REGULATION/SUPERVISION IN NIGERIA

The origin of regulation in the banking industry in Nigeria dates back to the early 1950s following the tragic failures suffered by the largely unregulated indigenous banks – a phenomenon which caused untold hardship for many banks.

This incidence led to the enactment of the 1952 Banking ordinance (amended in 1958 and 1962)repealed in 1969 following the birth of the 1969 Banking decree. The 1969 decree (amended several times) is now repealed following the promulgation of central Bank of Nigeria Decree No 24 and Banks and other financial institutions (BOFID) decree No 25 both of 1991. These decrees update the innovations in the financial system consequent upon the deregulation of the system; they now cover both banks and non-bank financial institutions.

2.8.1 BANKS AND OTHER FINANCIAL INSTITUTIONS ACT (BOFIA) NO. 25 OF 1991

The Act, among other things, regulates banking and other financial institutions by prohibiting the carrying on of such businesses in Nigeria except under license and by a company incorporated in Nigeria. Adequate provisions have been made regarding the proper supervision of such institutions by the Central Bank of Nigeria.

The act gave powers to the CBN on matters of regulation and supervision of licensed banks especially in relation to granting and withdrawal of banking license, resolution of the problem of failed banks, which before now were the responsibilities of the Minister of Finance.

Other reforms brought by the Act include the empowerment of the CBN to increase the minimum paid-up capital of commercial and merchant banks as it deemed fit.

BOFIA No. 25 of 1991, 1998 and 1999 and the CBN act number 24 of 1991 (Amended in 1997, 1998 and 1999) superceded the CBN Act of 1958 and Banking Act of 1969. The amendment gave the CBN greater flexibility in regulating and supervising the banking sector and other financial institutions, which hitherto, had operated outside its regulatory authority. It also conferred instrument autonomy on the bank in the formulation and implementation of monetary policy in Nigeria.

In addition, the BOFIA conferred on the Governor of the CBN and the Board of Directors of the bank, powers to revoke the operating license of a bank granted under the principal Act. It also reviewed upwards penalties for offences and contraventions of the Act by banks and other financial institutions, and extended the powers of the CBN to remove erring directors and principal officers of banks. Banking licence was consequently liberalized such that by the time embargo was placed on the issuance of new banking licences in 1991, a total of 79 new banks had been licenced, which brought the total number of banks operating in the country to 120 with a network of 2,107 branches. Thus against the background of the economic deregulation policy of that era and the upsurge in the number of licensed banks, it became imperative to restructure and beef up the regulatory apparatus in order to prevent a reoccurrence of massive bank failures of the early 1950s which brought untold hardship to the banking public.

Another major reform that had a profound impact on regulatory practice in the country was the issuance of prudential guidelines for licensed banks in November 1990 by the CBN.CBN also adopted the Basel committee report on prudential guidelines, the harmonisation of accounting practice by banks via the issuance of SAS 10 and the directive that required public sector deposits to be transferred to the CBN, thereby exposing the precarious liquidity positions of some banks and the distress that was inherent in their operation. That document spelt out objective criteria for income recognition, asset classification and provisioning. It sought to ensure uniformity and comparability of the audited financial statements of licensed banks. As a matter of fact, it took the timely intervention of the regulatory authorities to prevent what could have been a systemic failure. Of course, banking system distress has been virtually put behind us now, having put 31 banks in liquidation while others were offered for sale to new investors.

2.8.2 NDIC DECREE 22 OF 1988

In furtherance of the government's objectives of having a virile banking sector, decree 22 of 1988 (the NDIC Decree) was set up to pave way for the establishment of an explicit deposit insurance scheme in the country. That was in consonance with the government's decision among other reasons to shift emphasis from direct support of shareholders and management of banks to the protection of depositors whose interest might be jeopardized as the banks take up risky assets in an orchestrated attempt to outwit one another in the name of competition.

2.9.0 CONDITIONS FOR EFFECIVE BANKING SUPERVISION

I. SOUND AND SUSTAINABLE MACRO ECONOMIC POLICY

Sound and sustainable macro-economic policy has been identified as a critical success factor in the application of the core principles for effective banking supervision, which set out the best practices in supervision worldwide. This is particularly so in Nigeria where inadequate coordination of monetary and fiscal policies tend to render them impotent. Also, the unwieldy public expenditure size, largely financed by deficits (which are seldom channeled into the productive sector) has negative impact on employment and general price level.

II. EFFECTIVE MARKET DISCIPLINE

Effective market discipline as a precondition requires that there exist a culture of financial transparency and the presence of good corporate governance. It is thus expected that bank lending decisions are carried out in strict commercial sense and without political pressure from the government. Banks are expected to operate credit risk thresholds that are driven strictly by the long term growth outlook and the safety and soundness of their institutions as the focus. In the case of Nigeria for example, loans to government, if performing, attract 50% provision and where such loans display any trait of delinquency, 100% provision is enforced. That proactive measure has to a large extent infused some discipline into the banking system in Nigeria.

III. PROCEDURE FOR THE EFFICIENT RESOLUTION OF PROBLEMS IN BANKS

The core principles note the need for supervisory authorities to be vested with the power and authority required for effective distress resolution. Such distress resolution thresholds are expected to be flexible and robust in order to prevent contagion. That would require framework for early warning signals (EWS) and a holistic engagement of their thrusts. H. Onno Ruding, (2002) was of the view that strictness requires the setting of high standard of prudential guidelines to reduce the risks of individual banks or the entire banking system in a country from becoming illiquid or insolvent. The CBN and NDIC (2002) had developed and issued the framework for contingency planning for banking system crisis. It was billed to become effective from 1st July 2002. The document which has been circulated to all banks has comprehensive thresholds for regulatory /supervisory intervention aimed at ensuring consistency and systematic approach to distress identification and resolution. The banks are required by the CBN and NDIC to fully disclose these thresholds to all stakeholders for the purpose of transparency. In addition, each bank is required to prepare and submit to CBN its contingency plan for managing its crisis. Such a plan should be discussed and approved by the board of each bank.

IV. MECHANISM FOR PROVIDING AN APPROPRIATE LEVEL OF SYSTEMIC PROTECTION FOR FINANCIAL SAFETY NET

The key aspects of financial safety net include prudential regulation and supervision, a lender of last resort facility and deposit insurance according to financial stability form (FSF) in 2001. An effective mechanism in all the three areas has been emphasized. A country with a well developed mechanism in only one or two of these three areas is likely to face insurmountable obstacles in finding effective solutions for preventing or resolving serious difficulties in its banking system.

The FSF (2001) stated that a deposit insurance system "needs to be supported by strong prudential regulation and supervision, sound accounting and disclosure regimes, and the enforcement of effective laws". The FSF has posited that it is vital to establish a financial safety net as in its absence, the risks of destabilization of the banking system will grow. I think we can boast that we have an effective safety net in Nigeria.

V. A WELL DEVELOPED PUBLIC INFRASTRUCTURE

This is another profound aspect of the preconditions for effective banking supervision. The requirement here includes the existence of a proper credit culture that would foster the honoring and enforcement of financial contracts. Added to this is the need to enthrone the best practice and ethical standards in financial dealings. Even though the laws appeared to be in place to deal with those issues, poor or inadequate enforcement powers and the lack of the will power to sanction erring banks by the supervisory authorities need to be addressed, for effective banking supervision.

Also, the judiciary system has not fared well to facilitate foreclosure of collaterals for loans. The process at present is tortuous, costly and frustrating. Moreso, "justice delayed is justice denied". This has led to the request for a special court in Nigeria that can ensure speedy adjudication of justice relating to the recovery of bad loans.

2.10.0 THE ROLES OF REGULATORY AUTHORITIES IN BANK SUPERVISION

In any economy, the financial system is the hub of productive activity, as it performs the vital role of financial intermediation, is the primary provider of payment services and the fulcrum of monetary policy implementation.

2.10.1 MACRO-ECONOMIC POLICY AND DATA TRANSPARENCY

The code on monetary and financial policies identifies desirable transparency practices for central bank in its conduct of monetary policy, and other financial agencies in their conduct of financial policies. It has been argued that monetary and financial policies can be made more effective if the public knows the goals and instrument of policies and if authorities make a credible commitment to meeting them.

2.10.2 INSTITUTIONAL AND MARKET INFRASTRUCTURE

The enthronement of good corporate governance in financial systems, the need to improve the payment system, particularly in emerging market economies, and implementation of necessary anti-money laundering measures, are essential for the orderly conduct of any financial system.

Good corporate governance is essential for the development of a competitive private sector that in the long-term is able to attract and retain the domestic and international capital needed for investment. The Central Bank is strongly in favour of efforts to harmonize accounting practice internationally. Emphasis is also on the accuracy, reliability and timeless of accounting information because these are considered fundamental for economic efficiency and financial stability.

The payment systems are essential mechanism supporting the effectiveness of financial markets. Disruption to a systematically important payment system could threaten the stability of markets both domestically and internationally. Thus, the core principles for a systematically important payment system aim to enhance safety and efficiency in such a payment system.

2.10.3 FINANCIAL REGULATION AND SUPERVISION

As witnessed by recent financial crisis, weaknesses in the banking system of a country can threaten financial stability both within that country and internationally. In order to strengthen the banking system, the Basle Committee, developed a set of 25 core principles for banking supervision. Compliance with the principles is considered essential for any supervisory system to be effective. The core principles methodology sets out detailed guidelines for the assessment of compliance with the core principles by the central bank.

The central bank plays a prominent role in the development and implementation of the various key standards largely because of complementarities of the objectives of these standards and those of the central bank.

The Banks and Other Financial Institutions Act (BOFIA) 1991, as amended, provides that a person shall be deemed to be receiving money as deposits if the person accepts deposits from the general public as a feature of its business or if it issues an advertisement or solicits for such deposits. Deposit-taking institutions, therefore, are those institutions that accept money from the general public as deposits and whose activities affect and influence resource allocation and the attainment of macro-economic stability.

Deposit-taking institutions in Nigeria include licensed banks, community banks, primary mortgage institutions and discount houses. The finance companies, by their guidelines, are allowed to "borrow" and not accept deposits from the general public, although this "borrowing" essentially entails funds mobilisation. The development finance institutions (DFI's) operate under varying statutory mandates which enable them to either accept deposits from the general public or channel credit to the preferred sectors of the Nigerian economy.

2.10.3.1 The Issue of Multiple Regulatory/Supervisory Authorities

Prior to January 1997, different authorities were charged with the responsibilities for the regulation and supervision of financial institutions whose activities involved funds mobilisation and allocation of resources among the various sectors of the Nigerian economy. For example, the CBN was responsible for the supervision of licensed banks, finance companies and discount houses. The Federal Ministry of Works and Housing and the Federal Mortgage Bank of Nigeria were responsible for the licensing and supervision of primary mortgage institutions (PMI's) while the National Board for Community Banks was responsible for the supervision of community banks (CBs).

Similarly, the DFI's were under the supervision of their respective supervising Ministries while the Bureau-de-changes (BDC's) were licensed by the Federal Ministry of Finance. Generally, financial services are classified into three major groups - banking, insurance and securities businesses - for the purpose of supervision. Whereas, in Nigeria, securities business is supervised by the Securities and Exchange Commission (SEC) and insurance business by the National Insurance Commission of Nigeria (NAICOM), banks and other deposit-taking institutions are under multiple regulatory authorities.

Although the BOFIA was amended in 1997 to bring all deposit-taking institutions under the supervisory purview of the CBN, the enabling laws of the other regulators, such as the National Board for Community Banks and the Federal Mortgage Bank of Nigeria, are still in force. Thus, these organisations are still exercising their supervisory powers over their respective subsectors through actions that sometimes run counter to the supervisory objectives of the CBN. This situation harbours several weaknesses, such as circumvention of regulation, weakening of the effectiveness of monetary policy measures and duplication of functions and responsibilities.

In spite of the shortcomings of the new arrangement, the CBN has since assumed the responsibility for the overall regulation and supervision of deposit-taking institutions in Nigeria. Some of the actions taken in this regard include:

- designing appropriate supervisory strategies for the various institutions under its supervisory purview;
- increasing the minimum paid-up capital of each category of financial institution;
- issuing comprehensive guidelines for the different deposit taking institutions; and
- carrying out inspection of CB's and PMI's to determine their existence, viability and suitability for licensing.

In order to achieve an effective and efficient centralised supervision, as envisaged in the afore-mentioned amendment of the BOFIA, there is need to review the existing laws of the erstwhile regulators to reflect the new supervisory arrangement.

The benefits to be derived from a centralised supervision of deposit-taking institutions in Nigeria will include the following, among others:

I. **Formulation of co-coordinated supervisory strategies.**

The centralised supervision of deposit-taking institutions will engender the formulation of workable and credible supervisory strategies for the affected institutions. This will also enhance the sustenance of coordinated surveillance on the activities of the institutions.

II. **Elimination of supervisory overlap/arbitrages.**

The circumvention of regulation by taking advantage of supervisory overlap and varied regulatory requirements will be minimised.

III. **Information sharing on a timely basis.**

At present, licensed banks, discount houses, primary mortgage institutions, community banks, finance houses, bureaux de change and development finance institutions are supervised by the Banking Supervision and Bank Examination Departments of the CBN. The joint meetings of the two departments, for example, provide a forum for sharing information and addressing pertinent supervisory issues affecting the institutions.

IV. **The establishment of a credible data management system.**

This will cover all aspects of supervision from licensing to liquidation

2.11.0 THE AGENTS OF BANKING SUPERVISION AND REGULATIONS

2.11.1 THE CENTRAL BANK OF NIGERIA

The principal role of a central bank in an economy is to nurture an efficient financial system through the application of appropriate instruments to influence the levels of the monetary and credit aggregates in the pursuit of low inflation, economic growth and balance of payments viability. In developing economies, central banks usually go beyond these traditional roles to engage in developmental activities in order to speed up the economic development process and enhance the environment for the performance of their primary role.

2.11.1a EVOLUTION OF THE CENTRAL BANK OF NIGERIA

The earliest support for the establishment of the Central Bank of Nigeria dates back to the period of the bank failures of the early 1950s, following which the power of supervision of banks was vested in the Financial Secretary. Many nationalist leaders at that time advocated for the establishment of a central bank to perform this and other traditional administration resisted on the pretext of the absence of a highly organized money market. Apparently, the desire of the colonial administration was to sustain the monetary role that the British Bank for West Africa (BBWA) was playing at that time. The spirited agitations by the nationalists led to the institution of several commissions to examine the desirability and feasibility of establishing a central bank in Nigeria as an instrument for promoting the economic development of the country. In this regard, Mr. Fisher, an adviser to the Bank of England in 1952 and the International Bank for Reconstruction and Development (IBRD) Mission in 1953 considered the establishment of a central bank in Nigeria as premature. However, Mr. Loynes, another adviser to the Bank of England, in his own report in 1957 favoured the idea of establishing a central bank in Nigeria. The report formed the basis for the draft legislation for the establishment of the Central Bank of Nigeria, which was presented to the House of Representatives in March, 1958. The Act was fully implemented on 1st July, 1959 when the CBN came into full operation with an initial capital of N17.0million.

The promulgation of the 1952 banking Ordinance and the need to implement its provisions made it imperative and inevitable for the establishment of a central bank in the country. The Central Bank of Nigeria (CBN) was established in 1958 by an Act of Parliament. The Bank which commenced operation in July 1959 was charged, among other things, with the responsibility of promoting monetary stability and a sound financial structure in the country.

Since the commencement of operations of the CBN in 1959, the Nigeria financial service industry has recorded a remarkable revolution. The CBN, in carrying out its various responsibilities, has to ensure that all institutions within the industry operate in accordance with the generally accepted practices. With the promulgation of the CBN Decree No. 24 and BOFI Decree No. 25 of 1992, the CBN now has the sole responsibility for the formulation and execution of monetary policy in Nigeria, the power it hitherto shared with the Federal Ministry of Finance. The CBN directly regulates the activities of commercial and merchant banks and delegates the supervision of community banks to the National Board for Community Banks as its agency for that purpose.

The CBN also has the power to demand any financial information from any financial institution in the country.

2.11.1b MANDATE OF THE CENTRAL BANK OF NIGERIA

The core mandate of the CBN, as spelt out in the Central Bank of Nigeria Act (1958), and subsequent amendments (1991, 1998) include:

a). Issuance of legal tender currency notes and coins in Nigeria;

b). Maintenance of Nigeria's external reserves to safeguard the international value of the legal currency;

c). Promotion and maintenance of monetary stability and a sound and efficient financial system in Nigeria;

d). Acting as banker and financial adviser to the Federal Government; and

e). Acting as lender of last resort to banks.

Consistent with this mandate, the bank is charged with the responsibility of administering the Banks and Other Financial Institutions (BOFI) Act (1991), as amended (1997 and 1998), with the sole aim of ensuring high standards of banking practice and financial stability through its surveillance activities as well as the promotion of an efficient payments and clearing system.

The CBN in addition to its core functions, like central banks in other developing economies, has over the years performed some major developmental functions, focused on all the key sectors of the Nigerian economy (financial, agricultural and industrial sectors). Overall, these mandates were carried out by the Bank through its various departments as shown in the organizational structure (Figure 1).

2.11.1C CORE FUNCTIONS OF THE CENTRAL BANK OF NIGERIA

A). Issuance of Legal Tender Currency Notes and Coins

The Central Bank of Nigeria engages in currency issue and distribution within the economy. The Bank assumed these important functions since 1959 when it replaced the WACB pound, then in circulation, with the Nigerian pound. The decimal currency denominations, Naira and Kobo, were introduced in 1973 in order to move to the metric system, which simplifies transactions. In 1976, a higher denomination note N20 joined the currency profile. In 1984, a currency exchange was carried out whereby, the colors of existing currencies were swapped in order to discourage currency hoarding and forestall counterfeiting. In 1991, a currency reform was carried out which brought about the phasing out of 2kobo and 5kobo coins, while the 1k, 10k and 25k coins were redesigned. In addition, the 50k and N1 notes were coined, while the N50 note was put in circulation. In the quest to enhance the payments system and substantially reduce the volume and cost of production of "legal tender notes", the N100, N200 and N500 notes were issued in December 1999, November 2000 and 2001 respectively.

B). Maintenance of Nigeria's External Reserves

In order to safeguard the international value of the legal tender currency, the CBN is actively involved in the management of the country's debt and foreign exchange.

C). Debt Management

In addition to its function of mobilizing funds for the Federal Government, the CBN manages its domestic debt and services external debt on the advice of the Federal Ministry of Finance. On the domestic front, the Bank advises the Federal Government as to the timing and size of new debt instruments, advertises for public subscription to new issues, redeems matured stocks, pays interest and principal as and when due, collects proceeds of issues for and on behalf of the Federal Government, and sensitizes the Government on the implications of the size of debt and budget deficit, among others. On external debt service, the CBN also cooperates with other agencies to manage the country's debt. The primary responsibility was formally transferred to the DMO in 2000.

D). Promotion and Maintenance of Monetary Stability and a Sound and Efficient Financial System.

The effectiveness of any central bank in executing its functions hinges crucially on its ability to promote monetary stability. Price stability is indispensable for money to perform its role as a medium of exchange, store of value, standard of deferred payments and unit of account. Attainment of monetary stability rests on a central bank's ability to evolve effective monetary policy and to implement it effectively. Since June 30, 1993 when the CBN adopted the market-based mechanism for the conduct of monetary policy, Open Market Operations (OMO) has constituted the primary tool of monetary management, supported by reserve requirements and discount window operations for enhanced effectiveness in liquidity management by the Central Bank of Nigeria. It involves the routine control of the level of liquidity in the system in order to maintain monetary stability. Periodically, the CBN determines target growth rates of money supply, which are compatible with overall policy goals. It also seeks to align deposit money banks' activities with the overall target. The CBN through its surveillance activities over banks and non-bank financial institutions seeks to promote a sound and efficient financial system in Nigeria.

E). Banker and Financial Adviser to the Federal Government

The CBN as banker to the Federal government undertakes most of the Federal Government's banking businesses within and outside the country. The Bank also provides banking services to the state and local governments and may act as banker to institutions, funds or corporations set up by the Federal, State and Local Governments. The CBN also finances government in periods of temporary budget shortfalls through Ways and Means Advances subject to limits imposed by law. As financial adviser to the Federal Government, the Bank advises on the nature and size of government debt instruments to be issued, while it acts as the issuing house on behalf of government for the short, medium and long-term debt instruments. The Bank coordinates the financial needs of government in collaboration with the Treasury to determine appropriately the term, timing of issue and volume of instruments to raise funds for government.

F). Banker and Lender of Last Resort to Banks

The Bank maintains current accounts for deposit money banks. It also provides clearing house facilities through which instruments from the banks are processed and settled. Similarly, it undertakes trade finance functions on behalf of bank customers. Finally, it provides temporary accommodation to banks in the performance of its functions as lender of last resort.

2.11.1d DEVELOPMENTAL FUNCTIONS OF THE CBN

Consistent with its support for growth and development in the Nigerian economy, the Central Bank of Nigeria has been involved in developmental activities since its inception to date in all the sectors of the economy. Some of these activities are:-

A). Promotion of the Growth of Financial Markets.

A major function of the Bank is the promotion of the growth of the financial markets, which comprise the money, capital and foreign exchange markets. In order to develop the money market, which is the market for mobilizing short-term funds, the CBN initiated money instruments such as Treasury Bills (TB's), Treasury Certificates (TC's), and Eligible Development Stocks (EDS). To deepen the activities of the money market, particularly the secondary segment, the CBN granted licenses to five discount houses to participate in trading in government securities. In 2001, approval was given to some stockbrokers to also trade in Treasury Bills.

The CBN also fosters the growth of the capital market, which deals in long-term funds. Although, the first development stock was issued in 1946 before the establishment of the CBN, the Bank issued subsequent Federal Government Development Stocks to stimulate the market for enhanced patronage and accommodate government's longer term financial requirements. Initially, the Bank provided a secondary market in the development stocks, where potential buyers and sellers could strike bargains. With the establishment of the Lagos Stock Exchange in 1961 in which the CBN played a significant role, secondary market transactions in government stocks were transferred to the Exchange.

The deregulation of the exchange rate of the Naira since 1986 has fostered the development of an active foreign exchange market in Nigeria in which the Central Bank of Nigeria is a major player.

Furthermore, the CBN has greatly influenced the development of the Nigerian financial system through the promotion of and continued assistance to development financial institutions. These include the Nigerian Agricultural Cooperative and Rural Development Bank (NACRDB), the Bank of Industry (BOI), the Nigerian Agricultural Insurance Company (NAIC), Federal Mortgage Bank of Nigeria (FMBN), the Nigerian Deposit Insurance Corporation (NDIC), the Nigerian Export-Import Bank (NEXIM) and the Securities and Exchange Commission (SEC).

B). Other Promotional Activities of the Bank

Through its regulatory activities, the CBN has promoted growth in various sectors of the economy since the early 1970s to date. These include the promotion of wholly owned Nigerian enterprises, introduction of the rural banking scheme and the promotion of agricultural and manufacturing activities nationwide through its monetary policy.

C). Establishment of Special Schemes and Funds

The Bank has been very active in the promotion of special schemes and funds to enhance economic development. These are in the areas of agricultural finance, export promotion, small and medium scale enterprises, and collaborative research/Services to third parties.

i). The Agricultural Credit Guarantee Scheme Fund (ACGSF):

The Agricultural Credit Guarantee Scheme Fund (ACGSF) was established by Act 20 of 1977 to encourage banks to increase lending to the agricultural sector. It took off in April 1978 under the management of the CBN, with a Board of Directors constituted for policy making. The guarantee instrument itself is a pledge by the Fund to the banks that it would repay 75 per cent of any net default, which could arise in their agricultural loans. The Federal Government and the CBN own the Fund in the ratio of 3:2. In pursuit of its developmental function and increased effort to ensure the sustenance of the ACGSF and flow of credit to the agricultural sector, the authorized share capital of the scheme was reviewed upward from N100.0 million to N1.0 billion in 1999. Following the increase, the load limits under the scheme were raised from N5000.00 to

N20,000.00 for unsecured loans, and from N100,000.00 to N500,000.00 for secured loans to individuals as well as from N1.0 million to N5.0 million for corporate borrowers. In 2000, the capital base of the fund was further increased from N1.0 billion to N3.0 billion. In demonstration of CBN's commitment to its development function, it remitted its share of the paid-up capital to the Fund in full by 20th March, 2001.

ii). The Refinancing and Rediscounting Facility (RRF) and the Foreign Input Facility (FIF)

The CBN introduced the Refinancing and Rediscounting Facility (RRF) in April 1987 to encourage banks to undertake export finance. The scheme involved rediscounting and refinancing of pre- and post-shipment activities at preferential rates. Increased awareness about the advantages of the RRF has led to greater participation by both exporters and banks in the scheme. The Foreign Input Facility (FIF) was introduced by the CBN in May 1989 to facilitate the import of raw materials and capital goods needed to produce for exports. The programme was supported by a loan from the African Development Bank (ADB). The loan, which amounted to about US$245 million was disbursed in three tranches to stimulate non-oil exports. The RRF and FIF facilities were, however, transferred in NEXIM in 1991. In its efforts to strengthen the operations of the NEXIM, the CBN increased its contribution to the paid-up capital by N450 million to N1.4 billion.

iii). The Small and Medium-Scale Enterprises (SME) Apex Unit Loan Scheme.

In order to increase access to credit by the SME's, the CBN and the Federal Ministry of Finance, on behalf of the Federal Government, obtained a World Bank Loan for SME's. The total project cost was US$451.8 million of which the World Bank provided US$270 million or 64 per cent. The CBN established an SME Apex Unit in the Bank in 1990 to administer the credit components and other related activities of the World Bank loan in order to facilitate project implementation. Loans disbursement under this Scheme ceased in 1996.

iv). Small and Medium Industries Equity Investment Scheme(SMIEIS).

Bothered by the persistent decline in the performance of the industrial sector and with the realization of the fact that the small and medium scale industries hold the key to the revival of the manufacturing sector and the economy, the Bankers' Committee in 1999, initiated the Small and Medium Industries Equity Investment Scheme (SMIEIS) aimed at ensuring assistance to small-scale industries. Under this new scheme, banks are required to set aside 10.0 per cent of their profit before tax for investment in small-scale industries in the country. A bank's investment in the scheme is conceived to be in the form of equity participation, project packaging/monitoring, advisory services and nurturing of specific industries to maturity. As at December 2004, a good number of banks had set aside 10 per cent of the profit before tax (PBT) for the scheme.

v). Refinancing Scheme for Medium and Long Gestation Agricultural Projects:

The Refinancing Scheme for Medium and Long Gestation Agricultural projects is an initiative of the Central Bank of Nigeria aimed at providing funds for extending credit for the establishment and sustenance of medium and long gestation agricultural projects whose moratorium and financing requirements have hitherto been unattractive to banks. Under the scheme, a fund from which the banks will draw for fending for these agricultural projects will be set-up. Some of the enterprises covered by the scheme include cocoa, rubber, oil palm, coffee, gum arabic, cashew, tea, fish capture, traveling etc. The modalities for the operations of the scheme were prepared with inputs from stakeholders through series of workshops held all over the country by the Bank in 2000. The main outstanding issue is the sourcing of the seed fund for the scheme. The refinancing scheme would be operated as a profit-making venture and as such there would be returns on investment, which will be shared as dividends to all stakeholders.

D). The Monetary Policy Forum

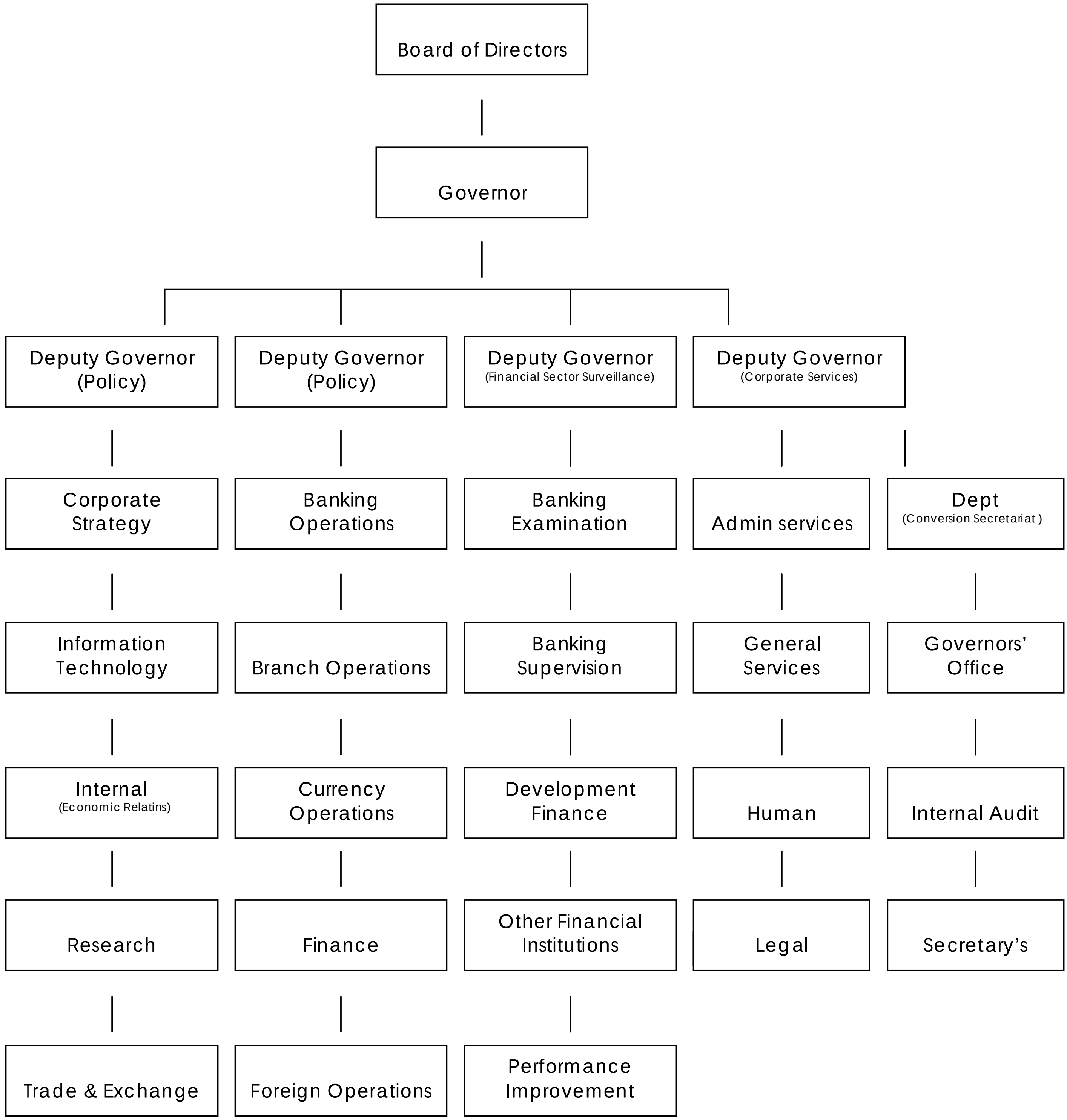
In 2000, the CBN established the Monetary Policy Forum in order to create a channel for public enlightenment and cross fertilization of ideas between the monetary authorities and other stakeholders. The forum was created in recognition of the fact that monetary policy works best in an environment in which the views of the key stakeholders are taken into consideration in both its formulation and implementation. This initiative is consistent with the general move towards greater transparency and openness in monetary policy making by central banks worldwide. The Forum also serves as a medium for educating the public on the statutory functions of the bank, which is necessary for the sustenance of its autonomy and credibility.

E). Collaborative Research/Services to Third Parties

The Bank's services to third parties are largely routine, interspersed with ad-hoc/special studies directed at addressing specific and contemporary economic problems. The routine services include organizing/participating at seminars, data gathering through surveys and releases of the banks' publications comprising weekly, monthly, quarterly, half-yearly and annual reports. Papers are presented by the Governors and other top officials of the bank on topical economic issues to enlighten the public. The outcome of the studies and collaborative research work with other institutions also inform the design and implementation of economic policies in the country.

TABLE 1

ORGANISATIONAL STRUCTURE OF THE CBN



Source: CBN Annual Report & Statement of Account

In 2004, the number of departments was reduced from 23 to 17

2.11.2 THE ROLE OF THE CBN IN ENSURING PUBLIC CONFIDENCE

Banking business being a highly leveraged one, practically every aspect of it could be said to have implications for depositors' safety and by extension, the whole financial system. Worldwide, the approach of regulators to enhance banking confidence through ensuring depositor safety is by restricting bank risks to a level that is acceptable to depositors or to the regulatory authorities assigned to protect depositors' interests, the insurance of deposits with a premium levied to cover depositors' claims and the government's assumption of overall responsibility for monetary stability and depositors' protection. The role which the bank regulators assume in protecting and insuring depositors is similar to the position any creditor or insurer takes in protecting his interest. A bank regulator has much of the same step. It is pertinent at this juncture, to consider these regulations as contained in the central bank of Nigeria (CBN) Decree No 24 of 1991,

Banks and other financial Institutions (BOFI) Decree No 25 of 1991, the Companies and Allied Matters (CAM) Decree No 1 of 1990 and the Nigerian Deposit Insurance Corporation (NDIC) Decree No 22 of 1988.

(i) LICENSING REGULATIONS

Since the establishment of the CBN in 1959, all Commercial and Merchant banks have been required to obtain a licence to conduct business. Bank chartering is adopted primarily to prevent "over-banking" and to keep dishonest or inexperienced people from operating banks, either of which would lead to bank failure and possible depositor losses and hence endanger public confidence in the entire banking system. Going by BOFI Decree section 2(1) of 1991, no person is permitted to carry on banking business in Nigeria except it is a company duly incorporated in Nigeria under the CAM Decree No 1 of 1990 and in possession of a valid banking license issued under the BOFI Decree. To further protect the interest of depositor, section 40 of BOFI Decree 1991 disallows any person(s) or body corporate to solicit for any type of deposit from the public except it is duly licensed bank. This last provision is necessary to prevent exploitation of the public by just any person(s) and / or corporate body thus causing banking instability in the economy.

(ii) MAINTENANCE OF ADEQUATE CAPITAL

A bank must have enough capital to provide a cushion for absorbing possible loan loses, fund its internal needs and for expansion. In this wise, adequate capital provides added security for depositors and the deposit insurance system. Bank regulators view capital as an important element in holding banking risks to an acceptable level. World wide, the determination of adequate capital for bank has been a very knotty problem.

Until recently, when the Basel committee came up with the concept of risk-weighted assets in measuring capital adequacy, capital adequacy was determined through setting capital guidelines by bank size. Regulators tried to promulgate laws covering this issue, though somewhat in a vague form.

At the beginning, a minimum paid-up share capital would be specified for all licenced banks. According to section 9 of BOFI Decree, such amount can vary over time and between different types of banks. Failure to comply with this provision can result in the revocation of a bank's license.

Secondly, section 13(1) expressly states that "a bank shall maintain, at times, capital funds unimpaired by losses, in such ratio to all or any assets or to all or any liabilities of the bank. In other words, what constitutes the minimum capital ratio is left for the CBN to determine. Again failure to comply with the provisions of section 13 may constitute a ground for the revocation of the license of a bank.

Thirdly, as a capital maintenance/improvement measure, BOFI Decree section 16 of 1991 also specifies that all licensed banks should out of their net profit for each year, maintain in reserve fund between 15% and 30% if such reserve fund is equal to or in excess of the paid-up capital or less than the paid-up share capital, respectively. It is expected that such transfer would be made only after all identifiable losses have been made good and before any dividend is declared.

(iii) **GENERAL LENDING AND INVESTMENT RESTRICTION**

a) **General Loan Restrictions**

As a general rule, the central bank of Nigeria is empowered to fix a ceiling on the volume of loans, advances and discounts that may be granted and/or outstanding at anytime. By section 39(5) of the CBN decree, the bank is empowered: "to require that all applications for loan to any bank shall be submitted by the bank to the Central Bank for approval and no such loans shall be made without such approval". The rationale behind these rules is to guide against over-lending in general as well as curtail those that affect specified sectors of the economy.

b) Limits on Loans to a single borrower

Bank lending decisions are affected not only by general credit limitation statutes alone but also by several specific credit regulations. One of such regulation limits the loans and advances that can be made to a single borrower. For any licensed commercial bank the limit is pegged at 20% of the shareholders fund unimpaired by losses and in the case of a merchant bank not more than 50% of its shareholders' fund and also unimpaired by losses. According to section 20 (a) of the BOFI Decree, these limits include: aggregates of all advances, loans or credit facilities extended to any person or subsidiaries or associates of a corporate body.

c) Loan to Insider

This is another credit restriction, which applies to banks' shareholders, directors, executives, officers and their relations. Hence regulators try to put up legislation that severely limits easy and improper access to depositors' funds by bank owners and employees or their relations. Section

20(2) of BOFI Decree 1991 limits the amount of unsecured loans and advances any licensed bank can grant to its director(s) jointly or severally to N50,000 only. Section 20 (2) (b) of the same decree states that no officer or employee is permitted to have outstanding loans or unsecured credit facilities which in the aggregate exceed one year's emolument of such an officer or employee. But these sections can only be violated with the approval from the Central Bank of Nigeria.

d) Restriction on Certain Banking Activities

In order to guide against diversion of depositor's funds to other non-banking areas, however profitable, regulators promulgate laws specifying "no-go" areas for licenced banks. Section 20 (2) © of BOFI Decree 1991 forbids all licensed banks from engaging in any form of wholesale or retail trade for profit either on its account or on commission basis without prior approval from CBN. Section 20 (2) (e) of the same decree also forbids banks from the purchase/sale acquisition/disposal or lease of real estate for profit except where such real estate are used as collateral for loans which have become due for repayment. Again, these regulations are aimed at protecting depositors' funds from being employed for speculative or other risk ventures.

(iv) Disclosure Of Interest By Directors, Managers And Officers

Provisions concerning the disclosure of interest are included in bank legislations in order to guide against undue influence by bank directors, managers and officers over depositors' funds and bank activities in general. The belief is that a declaration of interests in any particular advance/loan by these set of persons would forewarn the supervisors. Section 18 (1)a prevents such persons from having interest in any loan/advance without declaring the nature of their interest. In addition, such director(s)/manager(s)/officer(s) are not expected to benefit materially from the granting of such loans/advances, neither could they grant such loans or any credit facility for that matter without due regard to the rules and regulations of the bank. Section 18(1) b and ensure this.

(v) Prohibition Of Employment Of Certain Persons, Inter-Directorship And Disqualification And Exclusion Of Certain Individuals From Management Of Banks

Management constitutes the key factor that determines the success of any bank. The other factor such as capital adequacy, assets quality, earning growth and liquidity all hang on good management.

Consequently bank regulators critically monitor and approve those they want to own and manage banks. According to decree section 19 (1) a, no bank is permitted "to employ or continue the employment of any person who is or at any time has been adjudged bankrupt or has suspended payment to or has connived with his creditors, who is or has been convicted by a court for an offence involving fraud or dishonesty, or professional misconduct".

Persons who have been dismissed from the employment of any bank due to fraud, misconduct or dishonesty are also not expected to be employed in any bank. Again, no director of any liquidated bank is permitted to be directly connected with the management of any other bank without the express permission of the Central Bank governor.

(vi) Information Disclosure

Information disclosure by banks is basically designed to ensure that depositors, investors and the general public are adequately informed of a bank's performance/condition. As regards the publication of annual accounts of banks, section 27(1) of the BOFI decree provides that "subject to the prior approval in writing of the Bank (CBN), a bank shall, not later than 4 months after the end of its financial year. Have cause to publish in a daily newspaper printed in and circulating in Nigeria and approved by the CBN; Exhibit in a conspicuous position in each of its offices and branches in Nigeria.

Forward to the CBN, "copies of the bank's balance sheet and profit and loss account duly signed and containing the full and correct names of the directors of the bank".

(vii) Supervisory Compliance Procedure

The principal supervisory procedures used to check compliance with the above regulators and protect depositors.

(a) Bank Examination: These are used to collect on-the-spot information that will indicate the current financial condition of a bank and its compliance with applicable laws and regulations Section 30 of BOFI decree and section 16 of NDIC decree specify the functions of the examiners to include:

- Having a right of access at all times to the book, accounts and vouchers of the bank.
- Being entitled to require and obtain information and explanation from the officers and directors of a licensed bank as may be deemed necessary.
- Having access to any accounts, returns and information with respect to any licenced and insured bank.

(B) Reporting Requirement: This is the second supervisory compliance procedure employed by regulatory authorities. In various forms, banks are required to file information as may be required by the regulatory bodies for effective monitoring of their conditions and the utmost objective of maintenance of banking confidence and enhancing financial stability. The legal backing for this provision is contained in section 28(1), 39(2)(b) and (c) of the CBN Decrees. The periodic information supplied by banks is used by the supervisors for off-site surveillance of the banks. Such surveillance gives early warning signals of impending problems and may be one of the reasons for on-site examination of the banks.

(viii) Management Of Failing/Failed Banks

This constitutes the final regulatory action in ensuring depositors' confidence in banks. Actions that are taken by regulatory bodies regarding failing or failed banks may have significant positive or negative effect on bank depositors and the entire financial system. In a system where there is an absence of deposit insurance either in the implicit form, or explicit form, the run that may be experienced when a bank fails can ruin the whole system. In most economies the impact of liquidated banks is minimized through strict and careful management of bank failure coupled with some extraordinary legal provisions.

In Nigeria, specific provisions in the statute books have ensured no significant negative impact on bank failures. The Central Bank of Nigeria is empowered by section 33, 34 and 35 of BOFI Decree to take over any bank perceived to be failing or to have failed, and subsequently apply appropriate failure resolution options. Such take-over, it is envisaged, would precipitate a situation where a bank would wind itself up just like any other company. Whatever necessary failure resolution option is applied, the CBN is further empowered to appoint a receiver or liquidator as the case may be and in this regard the NDIC is given priority over any other person(s) as official receiver or provisional liquidator, section 38(3) of the BOFI Decree and section 28 of the NDIC Decree ensure this.

Finally, section 36 and 53(2) of the BOFI Decree ensures that only the Governor of CBN has the power to revoke a banking license, without prejudice to the provision of the CAM Decree. Where a bank is finally liquidated, the provision of section 27 of the NDIC Decree ensures that all depositors receive whole or part of their deposit, depending on the amount, to the maximum amount of N50, 000. In these circumstance depositors' funds are given priority over other creditors' funds.

The only deposits that are not insured according to section 20 of NDIC Decree are:

- Insider deposits

- Counter-claims from a person who maintains a deposit and loan account, the former serving a collateral for the loan:
- Such other deposits as may be specified from time to time by the board.

2.11.2.1 CENTRAL BANK OF NIGERIA TRADITIONAL INSTRUMENTS FOR CONTROLLING BANKS IN NIGERIA

The instruments of monetary policy are those devices which are used by monetary authorities to influence the supply, allocation and cost of credit to the economy. These instruments are used to influence the behavior of commercial banks so as to induce particular patterns of behaviour which will generate the desired results with respect to policy objectives.

The traditional instruments are as follows:

1. **Open Market Operation**: This involves the buying and selling of securities from and to commercial banks in order to increase and reduce the volume of money in circulation. If the central bank determines that the money in circulation in the country is too small and wants to increase it, it will buy securities from commercial banks. By buying securities, it will increase the volume of money in the possession of commercial banks and increase their ability to give more loans to members of the public, which will help to add more money in circulation. On the other hand, if the central bank feels that the amount of money in circulation is too much and wants to curtail it, it will sell securities to commercial banks. This will attract more money from commercial banks and at the same time reduce their lending powers, thereby decreasing the amount of money in circulation in the country.
2. **Special Deposit**: This is an instruction from the Central Bank asking the commercial banks to keep with it special deposits over and above their statutory requirements. This is a mechanism used by the Central Bank to curtail credit facilities of the

commercial banks. By obeying this instruction, the amount of money with the commercial banks will be drastically reduced and their lending abilities also reduced to the barest minimum. The Central Bank uses this method to restructure the economy when it is in bad shape.

3. **Bank Rate:** This is also called discount rate. It is the rate of interest the Central Bank charges commercial banks and other financial institutions for discounting their bills. If the Central Bank feels like curtailing the lending powers of commercial banks and other financial institutions, it will raise its discount rate, which will force other rates to rise. If the rate of interest charged by commercial banks and other financial institutions is high because that of the Central Bank is also high, it will make borrowing very exorbitant and will scare people away, and the rate of lending will reduce. This will make borrowing cheaper and people will be attracted to borrowing.

4 **Special Directives:** These are special instructions, which the central bank gives to commercial banks and other financial institutions as to which directions their lending policies should follow. The central bank will tell them the sector of the economy they should direct their lending policies. In this case, if for instance, the nation is pursuing agricultural and industrialization policies, the central bank will direct them to give more loans to farmers and industrialists.

5. **Cash Reserve/Liquidity Reserve Ratio:** This specifies the required ratio of certain selected assets and securities to the deposit liabilities of commercial banks. The assets which are usually used are short-term government securities e.g. treasury bills and treasury certificates. The commercial banks are required by law to keep a certain percentage of their total cash or liquid assets in the form of cash either in their vaults or with the central bank. In Nigeria for example, the liquidity ratio is 25% and the commercial banks can give out the remaining 75% in form of loans, thereby creating deposits or money. The Central Bank uses this cash ratio which it fixes, to increase or

decrease the volume of money in circulation in the country. If the central bank wants to increase the amount of money supplied to the public especially in a period of deflation and thereby expand credits, it will lower the cash ratio of the commercial banks. On the other hand, if it (the Central Bank) wants to decrease the amount of money supplied especially in a period of inflation and thereby contract credit, it will raise the cash ratio of the commercial banks. Therefore, the higher the cash ratio, the lesser the power of commercial banks to grant credit, hence; limiting wealth creation and vice versa.

6. **Moral Suasion:** This is persuasion based on moral grounds not with the use of the force of law by the central bank. It takes the form of gentle appeal by the central bank to commercial banks as to the kind of lending policy they should adopt regarding the expansion or contraction of money supply. Non adherence to this appeal by commercial banks can then force the central banks to apply the force of law.

7. **Credit Guidelines of Selection Credit Control:** This is an important instrument of monetary policy in Nigeria. Infact, it is the instrument of monetary policy used specifically to direct credit to the so-called favoured or preferred sectors.

   It is used as the monetary policy part of the overall development strategy and the distribution of credit according to the guidelines. It is usually an indication of what the Government considers to be the necessary direction.

   In conclusion, all the instruments of monetary policy must be properly coordinated to ensure that the total effect of all the instruments employed work towards achieving the desired objective.

2.11.3 CAMEL AS CBN TOOL FOR DETERMINING FINANCIAL CONDITIONS OF BANKS

The objective of supervision is to promote the safety and soundness of financial institution through on-going evaluation and monitoring, including the assessment of risk management systems, financial conditions and compliance with laws and regulations. The supervising agencies cannot effectively deal with systemic banking crises without an in-depth knowledge of the condition of the bank they supervise.

The main focuses in determining the conditions of banks prior to a crises situation are to enable supervisors promptly distinguish between banks which have good chances of emerging from crises and those that are terminally distressed. An analysis of individual rating elements is given below:

2.11.4a CAPITAL ADEQUACY REQUIREMENT

The capital adequacy of banks was monitored on a continuous basis throughout the year. Eleven (11) banks failed to meet the minimum statutory capital adequacy requirement of 8% as at December 31 2002.

Accordingly, various amounts of additional capital injection were recommended. Furthermore, existing banks were required to raise up their paid up capital to N1 billion. By December 31 2002 when the deadline expired, 42 banks were yet to comply with the directive, although many of them had capitalisable reserves while arrangements were at an advanced stage to meet the N1 billion mark.

The CAR indicator is derived by comparing the ratio of an entity's equity to its assets at – risk.

Capital adequacy ratio (%) =

$$\frac{\text{(Paid in capital + Reserve funds + Net Profit) X 100}}{\text{Total Assets – loan provision – Risk free Assets}}$$

Note: Risk free assets should include:

- Cash on hand
- Due from Banks

- Inter bank loans
- Government guaranteed loans
- Investment in government securities, etc.

TABLE 2:

CAPITAL ADEQUACY OF LARGEST 10 BANKS AS AT 31ST DECEMBER 2002

S/NO	BANK	CAPITAL'N BILLION	MARKET SHARE
1	Union Bank of Nigeria Plc	29	13.8
2.	First Bank of Nigeria Plc	20	9.5
3.	Zenith International Bank	9	4.3
4.	Guaranty Trust Bank	8	3.8
5.	United Bank for Africa Plc	6	2.8
6.	Citibank Nigeria Limited	6	2.8
7.	Diamond Bank Limited	5	2.4
8.	Bank of the North	4	1.9
9.	Wema Bank Plc	4	1.9
10.	Afribank Nigeria Plc	3	1.4
	TOTAL INDUSTRY	**210**	**100**

Source: Banking Analysis System, CBN (Unaudited figures) Banking Supervision Annual Report 2002

2.11.4b ASSET QUALITY

The asset quality of the banking industry deteriorated in 2002. The non-performing credits increased from N126 billion in 2001 to N187 billion in 2002, while the ratio of non-performing credits to total credits (gross) which fell from 24% in 1999 to 16% in 2001, rose to 20.2% in 2002. However, the overall non-performing credit to total credits is below the 35% specified in the contingency plans as the threshold for systemic distress as at 31st December, 2002.

The value of loan assets would depend on the realizable value of the collateral while investment would depend on the market value.

Loan loss provision ratio (%) =

$$\frac{\text{Loan loss provision}}{\text{Average Performance Assets}}$$

This indicates provision requirements on loans portfolio for the current period. The loan provision is the current period allocation to the loan loss reserve. The performing assets currently pay interests which are not more than 60 days past due.

TABLE 3:

Asset Quality of Largest 10 Banks as At 31st December 2002

S/NO	BANK	N BILLION	MARKET SHARE
1	First Bank of Nigeria Plc	337	13.6
2.	Union Bank Nigeria Plc	258	10.4
3.	United Bank for Africa Plc	176	7.1
4.	Zenith International Bank	99	4.0
5.	Bank of the North	96	3.9
6.	Afribank Nigeria Plc	82	3.3
7.	Citibank Nigeria Plc	75	3.0
8.	Guaranty Trust Bank Plc	73	2.9
9.	Diamond Bank Plc	56	2.2
10.	Wema Bank Plc	55	2.2
	TOTAL (LARGEST 10)	1,305	52.8
	TOTAL INDUSTRY	**2,476**	**100**

Source: Banking Analysis System, CBN (Unaudited figures) Banking Supervision Annual Report 2002

2.11.4c LIQUIDITY RATIO REQUIREMENT

A bank must always be liquid to meet depositors' and creditors' demands in order to maintain public confidence.

During the year, banks were required to continue to maintain a prescribed minimum percentage of their deposit liabilities in liquid assets. Compliance with the minimum liquidity ratio requirement, which remained at 40% throughout the year, was assessed on a monthly basis. The assessments were carried out through spot checks and the analysis of banks' monthly returns. Some banks however failed to meet the minimum requirement during the year.

Although the average industry liquidity ratio as at December 31 2002 was 71.1%, 10 banks did not meet the required minimum. While the supervisory efforts were directed at monetary disbursement in four critical illiquid banks, which had overdrawn balances with the CBN, eleven of such banks were given liquidity support during the year.

Consequently, financial analysts (investment officers) should carefully analyse the banks' portfolio quality on the bases of collectability and loan loss provisioning.

Loan to Deposit ratio (Medium and long term) % =

$$\frac{\text{Long and medium term loans X 100}}{\text{Long and medium term deposit}}$$

Table 4

LIQUIDITY ASSESSMENT OF 10 BANKS AS AT 31st DECEMBER

S/NO	BANK	N BILLION
1	First Bank of Nigeria Plc	83.5
2.	Zenith International Bank	80.3
3.	Citibank Nigeria Plc	65.4
4.	United Bank for Africa Plc	59.9
5.	Union Bank Nigeria Plc	56.6
6.	Afribank Nigeria Plc	52.8
7.	Diamond Bank Plc	47.4
8.	Wema Bank Plc	46.5
9.	Guaranty Trust Bank Plc	46.5
10.	Bank of the North	(6.83)

*Source: Banking Analysis System, CBN (Un-audited figure); Banking Supervision Annual Report 2002**(TABLE 4**)*

2.11.4c (i) LIQUIDITY MANAGEMENT ISSUES IN NIGERIA

Liquidity management involves the routine control of the level of liquidity in the economy in order to maintain monetary stability. This is necessary because an excess supply of money will result in an excess demand for goods and services, which could lead to rising prices, exchange rate depreciation and / or deterioration of the balance of payments position. The major problems confronting monetary policy management by central banks in developing countries are excess liquidity and death of appropriate intervention securities. To overcome these problems, central banks in some of these economies have introduced various intervention instruments side by side with existing government treasury securities. For several years, the problem of excess liquidity has persisted in the Nigerian economy, while the Central Bank of Nigeria (CBN) intervention securities for managing liquidity continued to be overburdened. Consequently, the CBN has introduced a number of other measures, including the issuance of its own intervention instrument (CBN Certificate) in 2001 to complement the traditional instruments, to help manage liquidity in a more effective manner.

As in other central banks, there are two main reasons why the CBN issued its intervention securities. First, partly due to cost considerations, the Federal Government since 1988 has consistently reduced the issuance of debt securities, thereby contributing to the scarcity of intervention securities. For instance, the issuance of development loan stocks was phased out in 1998, while treasury certificates were phased out in 1997. Since 1992, no new treasury bills have been issued except conversion of Ways and Means Advances to treasury bills, as well as the conversion of treasury bunds to bills to increase OMO intervention securities.

The issuance of the National Savings Certificate (NSC), which is expected to take effect in 2005, would assist in managing excess liquidity on a more permanent basis. Secondly, the Federal Government enjoys significant inflow from oil exports to the extent that with prudent budgeting and implementation, government could maintain a balanced budget, which would eliminate the need for debt financing. In addition, the Federal Government has recently curtailed borrowings from the CBN through the Ways and Means Advances, to finance its budget deficits. This development is attributable largely to the Federal Government's resolve to operate a single consolidated account with the CBN whereby its borrowings are netted out from its deposits. Thus, the level of liquidity in the economy was significantly reduced in 2004.

This section aims at enlightening the reader on the framework that guides the design of an appropriate mix of instruments for liquidity management by the CBN as well as highlights the objectives, strategies and challenges of effective and efficient liquidity management in Nigeria.

I. SOURCES AND SIZE OF LIQUIDITY

The source and size of liquidity would suggest the type of securities the central bank would need to introduce. In Nigeria, the main sources of liquidity include, the federal government fiscal operation; earnings from oil, especially the monetization and sharing of the oil windfall; and the excess creation of credit by deposit money banks. Resulting from the expansionary fiscal operations of the three tiers of government in the last few years, which were financed mainly through the CBN Ways and Means Advances to the government, excess liquidity has persisted in the economy. For instance, the fiscal operations of the Federal Government resulted in deficits of N202.7 billion or 2.9 and 1.7 percent of GDP in 2003 and 2004, respectively. The deficit in 2003 was financed from domestic sources, mainly through the conversion of outstanding Ways and Means Advances to either treasury bills or treasury bonds. However, in 2004 it was financed from the non-bank public and other funds, including Nigeria Liquefied Natural Gas (NLNG) dividend and loans from the 3.0 per cent Development of Natural Resources Fund. With these levels of deficit in the fiscal operations of the government, excess liquidity in the near future would remain. There is therefore the need for the CBN to design more durable instruments to manage the anticipated liquidity.

II. OBJECTIVES AND STRATEGIES OF INTERVENTION INSTRUMENTS

The goal of a central bank's intervention instruments is to facilitate efficient operations as well as foster overall development of the money market. Given the size of the excess liquidity in the economy, a number of options as well as strategies would be required in designing the appropriate intervention instruments. The system of seeking to manage excess liquidity puts the CBN on the defensive, as the Bank is sometimes compelled to find ways and means to mop-up excess liquidity, for which there are no ready-made instruments. Central banks that have made relative success in the application of indirect monetary tools manage shortages and not excess liquidity. The main advantage of managing liquidity shortages is that banks in most cases begin each day with shortages, which compels them to seek for facilities from the central bank, thereby affording the central bank the opportunity to use the instruments of monetary policy effectively. On the contrary, these conditions do not exist in an environment of excess liquidity. A number of central banks manage liquidity shortages. To be able to do this, an enabling environment is consciously created over time by adopting appropriate policy actions. For instance, through an act of parliament, the German Government is precluded from borrowing from the Bundesbank. The government therefore, sources all borrowing requirement from the capital market. This has the effect of draining excess liquidity in the system on a continuous basis, thereby making credit institutions to begin each day with shortages. Also, when the Bank of England introduced indirect tools of monetary management in the early 1980s, it was faced with the problem of excess liquidity. To resolve the problem, the Bank adopted the policy of over-funding the borrowing requirement of government through treasury issues for a period of five years. The excess over government borrowing needs was sterilized, ostensibly to remove the liquidity overhang. Since then liquidity has remained at levels that facilitate effective monetary operations. Against this background, the introduction of medium to long term instruments by the CBN was designed to reduce excess liquidity in the economy to the level that would enable the bank to adopt the strategy of managing liquidity shortages and thereby ensure effective implementation of monetary and foreign exchange operations.

A central bank would consider introducing its own instruments when there are insufficient treasury securities. For example, government in Indonesia has been required to maintain a ‘Balanced Budget’ and also prohibited from issuing any domestic debt instruments. Consequently, Bank Indonesia was compelled to introduce two intervention instruments, one each for absorbing and injecting liquidity since the country adopted OMO in 1983. In some other countries, government has become increasingly unwilling to continue their support for the central bank’s use of treasury securities for open market-type operations. In Mauritius for example, government discontinued the issuance of treasury bills for liquidity sterilization purposes because the cost was deemed too high. Thus, since July 1991, the Bank of Mauritius has issued its own intervention securities.

Also, at certain periods, government may not have need for issuing debt securities, owing to a favourable fiscal situation. This happened in Chile in the early 1980s and in Ghana during 1988-89. Central banks in these countries therefore had to issue their own intervention instruments for purposes of liquidity management. In other situations as in New Zealand for example, both the government and the central bank wanted a clear separation between monetary and debt management in order that the central bank might pursue its mandate effectively. The Reserve Bank of New Zealand therefore introduced its own bills in 1988 for controlling liquidity.

In theory, the origin of financial instrument for market development and policy intervention seems irrelevant; what matters is the characteristics of the instruments. It is expected that any set of instruments should foster the development of a free, well-functioning money market and market-based monetary policy operations. The literature identifies the following as desired characteristics of such instruments.

The use of new instruments should foster freely determined market interest rates;

- The holders of the instrument should be defined as broadly as possible to encourage competition thereby improving the process of interest rate setting and facilitating the transmission of monetary policy impulses;
- The maturity of the instruments should be such that they encourage trading;
- Transfer of ownership of the instrument should be easy;
- Any tax on the instrument should be simple and transparent to facilitate trading and holding; and
- Proper rules for rediscounting the financial instrument should be established.

Against this background and faced with the problem of persistent excessive liquidity in the Nigerian economy, the CBN has introduced other measures, including the introduction of its own (CBN Certificate) in 2001 to complement its traditional instruments, to help manage liquidity more effectively in the country. The main advantage of the use of CBN certificate for monetary operations and development of the money market was that the Bank's monetary management was separated from debt management to some extent, thereby strengthening the bank's operational independence. This however, has the disadvantage of exposing the CBN to the risk of incurring large losses in its profit and loss account, especially if the size of excess liquidity is large and if it has to service the instruments alone. It also has negative effects on monetary policy as substantial payments made in respect of interest costs could be a source of liquidity injection.

III. CBN'S STRATEGY AND INSTRUMENTS OF LIQUIDITY MANAGEMENT

CBN's liquidity management strategy over the years is geared towards maintaining an optimum level of liquidity that is consistent with non-inflationary growth, through the use of market-based techniques. Since 1993, Open Market Operation (OMO) conducted mainly in Nigerian Treasury Bills (NTB's) has remained the primary instrument of monetary management in Nigeria. However, the paucity of Nigerian Treasury Bills necessitated the use of the Nigerian Treasury Bonds in the secondary market for the conduct of Open Market Operations in 2004. These are complemented by Cash Reserve Requirement (CRR), discount window operations and the withdrawal of public sector funds from deposit money banks to the CBN. A specified uniform rate 9.5 per cent CRR is currently fixed for all the banks based on each bank's total deposit liabilities (i.e. demand, saving and time deposits), certificates of deposit (CDs), and promissory notes held by the non-bank public, and other deposit items. The Minimum Liquidity Ratio was, however, maintained at 40.0 per cent, while discount window operations including repurchase agreements (repo's) allowed banks and discount houses to access the CBN window for short-term financial accommodation. Also, the CBN certificate which was first issued in 2001 was expected to provide more flexibility in terms of competitive pricing and tenor as a complementary measure for liquidity management. The certificates were issued in two tranches of 180 and 360 days tenors. The yield on certificates of 180 day maturity was raised from 19.0 per cent in February to 19.5 per cent in August and 20.5 per cent in November that year, while that on the 360 day tenor was adjusted upward from 20.0 per cent in February to 21.5 per cent in April the same year, in line with the prevailing market conditions.

Furthermore, the withdrawal of public sector funds from deposit money banks to the CBN was initiated in 2004 to further address the problem of excess liquidity in the banking system, and to encourage the banks to mobilize savings from traditional sources other than the public sector. Its implementation in 2004 had proved very effective in liquidity management. Depending on the liquidity condition in the banking system, the CBN would resort to this instrument for liquidity management from time to time.

In addition, the Bank collaborated with the Federal Government towards the issuance of the national savings certificate (NSC), which is a medium to long-term security, designed to promote financial savings and to address the problem of excess liquidity in the banking system on a more permanent basis. Specifically, the introduction of the NSC is intended to broaden the financial market, and hence, establish the appropriate environment that will facilitate the effectiveness of the open market operations as a monetary and financial policy tool that will help stem the growth of excess liquidity in the banking system by trapping part of the liquidity to financial assets. As a direct obligation of the Federal Government of Nigeria, it is backed by the full faith and credit of the Federal Government. The coupon rate of the certificate is envisaged to be attractive and higher than the rates that banks pay on savings deposits. The National Savings Certificate will be issued in four tranches of 3, 6, 9 and 12 years and in units of N1, 000.00 and multiple thereof, and thus, would encourage investment by low-income savers. The NSC shall be marketable and subsequent to original issuance, may be bought or sold in the secondary market at prevailing market prices. The certificate is expected to be launched in the fiscal year 2005.

IV. CHALLENGES OF LIQUIDITY MANAGEMENT IN NIGERIA.

In spite of the significant efforts to address the problem of excess liquidity in the Nigerian economy, the CBN still faces a number of challenges in trying to achieve an effective and efficient mechanism for liquidity management.

First, fiscal expansion and the concomitant large fiscal deficits have militated against the efficiency of liquidity management Nigeria. In particular, the monetary financing of large fiscal deficits and the monetization of excess crude oil receipts have continued to pose serious challenges to liquidity management in the country. This has also remained a challenge towards promoting effective monetary policy implementation in the country. In this regard, it is necessary to ensure that the Fiscal Responsibility Bill is passed by the National Assembly and fully implemented. This would go a long way in ensuring fiscal prudence and adherence to budgeting provisions by the government.

Another challenge is the subsisting pockets of distress in the financial sector, which erode public confidence in the system and thus, lead people to withhold large cash outside the banking system. In 1998 for instance, 26 banks had their licenses revoked due to distress conditions. Most of the distressed banks had inadequate capital base. However, it is expected that the requirement of the new capital base of N25.0 billion for banks would strengthen the banks and enhance their competitiveness. It is also expected to integrate the financial system to the global financial architecture as well as strengthen banks' ability to use IT technologies including ATMs and other computer-based instruments that will enhance the effectiveness of the payments system and hence liquidity management in the economy.

Furthermore, there is the challenge of the country having a limited number of bank branches and the absence of banking facilities, especially in the rural areas where access to banking services is practically impossible for a large section of the population. This has led to a great number of financial transactions still being carried out outside the banking system. The recent reforms in the banking industry which are expected to engender competition in the industry and subsequent opening of new bank branches in the long-run would impact positively on liquidity management in the country. The reforms of the community banks could also provide the impetus for integrating rural financial markets to the urban financial centers, effectively channeling financial transactions through the payment system channels for efficient liquidity management.

Another major challenge is the problem of inefficient payments system in the country. Until recently, up-country cheques used to take about 21 working days to get cleared, while intra instruments take 12 days. It should be noted that an efficient payments system provides the basis for the Central Bank's liquidity forecasting and management process, the features of which affect the demand and supply of bank reserves, credit delivery and support economic growth. It requires a clear and conscious strategy on the approach and the ability to measure and control excess liquidity. Specifically, an efficient payments system minimizes float, liquidity risks, as well as settlement, systemic, credit and operational risks which are inherent in financial transactions. If the payments system is underdeveloped and inefficient, the banking system will hold large amounts of excess reserves which often lead to highly volatile and unstable reserve floats. On the other hand, an efficient payments system promotes timely clearing and settlement, as well as payment finalities at least cost to customers. It is amenable to various types of inter and intra financial transactions and is available to all segments of the economy. The impact of such a system is to facilitate high inflow of liquidity into the banking system, enhance effective management of liquidity as well as improve the ability to implement monetary policy. In this regard, it will be necessary to ensure that the development of the Real

Time Gross Settlement (RTGS) systems embarked upon by the CBN is fully implemented. This would facilitate individual payments across the settlement accounts of deposit money banks at the Central Bank as they progress from the sending bank to the receiving bank. The full implementation of RTGS for high-value, time-critical payments is an important element for establishing safe and effective settlement arrangements which will translate to efficient and effective liquidity management in the country.

Finally, the poor data quality from banks and other sources poses a great challenge for liquidity management in the country. The indirect approach which the CBN currently employs to manage liquidity in the banking system requires up-to-date information and monitoring. The lack of high frequency and reliable data renders economic analysis difficult. Thus, the unrealistic data returns by banks and other sources undermine the setting of accurate targets. In this regard, the urgent implementation of the wide area network (WAN) in the banking system by the bank is highly recommended as the CBN will be in a position to access information on the financial sector on timely basis through the WAN.

2.11.4d EARNINGS/PROFITABILITY

Banks' profitability earning declined in 2002 due to increased in provision for loan losses resulting from the deteriorating quality of the credit portfolio and high operating costs. The profit before tax (PBT) of the banking industry which increased from N24 billion in 1999 to N44 billion in 2000 dropped to N23 billion in 2001 and further to N19 billion in 2002. Twenty (20) out of the 90 banks recorded net losses in 2002 as against 14 banks in the previous year. The assessments were carried out through spot checks and the analysis of banks' monthly returns.

For the purpose of this study, the researcher used Return on Asset as a determinant factor to assess the ten largest banks. Return on Asset % =

$$\frac{\text{Net Income after Tax X 100}}{\text{Average Total Assets}}$$

Table 5

TOTAL EARNINGS OF THE 10 LARGEST BANK AS AT 31ST DEC. 2002

S/NO	BANK	PAT (N' BILLION)	AVERAGE TOTAL ASSET NBILLION	PROFITABILITY RATIO
1.	Citibank Nigeria Ltd	3,396,697	72,906,403	4.65
2.	Zenith Int. Bank	3,504,013	92,562,897	3.78
3.	Guaranty Trust Bank	2,140,355	59,292,395	3.60
4.	Wema Bank Plc	1,481,667	44,101,146	3.35
5.	Diamond Bank Ltd	1,478,175	53,003,546	2.78
6.	Afribank Nigeria Ltd	1,674,562	73,008,433	2.29
7.	Union Bank of Nig. Plc	4,726,000	275,194,000	1.72
8.	First Bank of Nigeria Plc	3,979,000	266,356,000	1.499.
9.	Bank of the North	15 months 524,979,000	62,594,945	0.83
10.	United Bank for Africa Plc	1,361,000	198,680,000	0.68
	TOTAL (LARGEST 10)			25.17

Source: 10 Banks Financial Annual Report for 2002 ***(TABLE 5)***

2.11.4e MANAGEMENT QUALITY

A good management should have a robust and perfect information system. Again, the management of banks should comprise of highly qualified personnel with banking experience and academic qualifications, as sound management is crucial for the success of any institution. Management quality is generally accorded greater weight in the assessment of the overall CAMEL composite rating. For the purpose of this study, the researcher used the earning/profitability ratio to assess the management.

Return on Asset (%) =

$$\frac{\text{Net income after tax X 100}}{\text{Average total Assets}}$$

Table 6

MANAGEMENT QUALITY OF 10 LARGEST BANK'S AS AT 31ST DECEMBER 2002

S/NO	Bank
1.	Citibank Nigeria Plc
2.	Zenith International Bank
3.	Guaranty Trust Bank
4.	Wema Bank
5.	Diamond Bank Nigeria Plc
6.	Afribank Nigeria Plc
7.	Union Bank of Nigeria
8.	First Bank of Nigeria Plc
9.	Bank of the North
10.	United Bank of Africa Plc

Source: 10 banks Financial Annual Report for 2002

2.11.4e (i). MARKET SHARE OF TEN LARGEST BANKS

First Bank of Nigeria Plc (FBN) had the largest net asset base while Union Bank of Nigeria Plc had the largest market share of capital and deposit.

The 10 largest banks ranked by their net asset, held 52.8 percent of the banking system's total assets as at December 31, 2002.They controlled 49.1 percent of the deposit liabilities as against

53.1 percent in the previous year, while their share of total credits increased from 46.0 percent in 2001 to 47.4 percent in 2002.

In terms of capitalization, they provided 44.8 percent of the banking system's adjusted capital as against 40.2 percent in the previous years.

(TABLE 7)

MARKET SHARES OF 10 LARGEST BANKS

S/NO	BANK	TOTAL ASSET		TOTAL CAPITAL		TOTAL DEPOSITOR		TOTAL CREDIT		LIQUIDITY RATIO
1.	First Bank of Nigeria Plc	337	13.6	20	9.5	97	8.6	121	13.0	83.5
2.	Union Bank of Nigeria	258	10.4	29	13.8	128	11.4	73	7.9	56.6
3.	United Bank of Africa Plc	176	7.1	6	2.8	76	6.7	34	3.7	59.9
4.	Zenith International Bank	99	4.0	9	4.3	50	4.4	25	2.7	80.3
5.	Bank of the North	96	3.9	4	1.9	44	3.9	52	5.6	6.83
6.	Afribank Nigeria Plc	82	3.3	3	1.4	53	4.7	30	3.2	52.8
7.	Citibank Nigeria Plc	75	3.0	6	2.8	24	2.1	24	2.6	65.4
8.	Guaranty Trust Bank	73	2.9	8	3.8	27	2.4	31	3.3	46.5
9.	Diamond Bank Nigeria Plc	56	2.3	5	2.4	33	2.9	23	2.5	47.4
10.	Wema Bank	55	2.2	4	1.9	20	1.8	2.7	2.9	
	Total Largest 10	1,307	52.8	94	448	552	49.1	440	47.4	
	Total Industry	2,476	100	210	100	1,125	100	928	100	71.1

Source: Banking Analysis System, (Un-audited Figures) Banking Supervision Annual Report 2002

2.12.0 CHALLENGES OF SUPERVISION – THE DISTRESS SYNDROME

A bank that is illiquid or insolvent or both is distressed and therefore in crisis. If many banks in a country are distressed to the extent that it becomes systemic, the country can be said to be having banking crisis and ditto for a region/continent as witnessed in the South East Asia. It therefore implies that banking crisis can be in a bank or a country or a region. As a matter of fact, if many banks are in crisis in all the regions of the world at the same time, global banking crisis can ensue even though the situation has not degenerated to that extent.

It thus follows that a typology of banking crisis is easily discernable: **illiquid but solvent; insolvent but liquid and illiquid and insolvent**. Also, degrees of banking crisis are a continuum from mild to severe. Banking crises become severe when a bank reveals most or all of the following conditions:

(i) Gross under-capitalization in relation to the level and character of business;

(ii) High level of non-performing loans to total loans;

(iii) Illiquidity reflected in the inability to meet customers' cash withdrawals and/or persistent overdrawn position with the CBN.

(iv) Low earnings resulting in huge operational losses; and

(v) Weak management as reflected by poor asset quality, insider abuse, inadequate internal controls, frauds including unethical and unprofessional conduct, squabbles, high staff turnover, etc.

According to Reinhart (1999), banking crisis is marked, by an event that indicates either (i) bank runs that lead to the closure, merger or takeover by the public sector of one or more financial institutions; and (ii) if there are no runs, the closure, merger, takeover or large-scale government assistance of an important financial institution (or group of institutions) that marks the start of a string of similar outcomes for other financial institutions. When many banks are in crisis in a country, then it becomes systematic. The Toronto Leadership Forum has defined systemic banking crisis as "those situations where the solvency and/or illiquidity of many or most banks have suffered shocks that have shaken public confidence." The CBN and NDIC (2002) have adopted this definition and specify that a systemic banking crisis would be said to have occurred in Nigeria when least one of the following situations arise:

- The bank(s) that are critically distressed control 20% of the total assets in the industry.
- 15% or more of deposits are threatened; and
- 35% of the banking system's total loans are not performing.

There is need to also emphasize that banking crisis is not synonymous with banking instability. Of course, banking crisis if not adequately managed and curtailed could result in banking instability. Instability in the banking industry means that the banks are not making adequate profits to justify their investment and at the same time bank failures are many. Many bank failures mean that the number is large to the extent that the cost of their resolutions exceeds what regulatory Authorities could consider tolerable. Any dramatic decline in bank profitability and a sharp increase in the costs of their resolutions will normally raise public concern (Schwartz, 1988). It thus follows that when a banking crisis becomes systemic it can easily precipitate banking instability and the dire consequences could be the collapse of an economy especially if the instability is not immediately triggered by economic depression.

2.12.1 CAUSES OF BANKING CRISIS

There is need to establish the causes of banking crisis as that will enable us to appreciate resolution options being adopted to address the problem. In view of the importance of this need, a CBN/NDIC Collaborative Study (1995) undertook an empirical method to verify the causes of bank distress in Nigeria. The empirical study employed the analysis of primary data obtained from a survey and the analysis of secondary data on a wide range of performance indicators including Capital Adequacy, Assets' Quarterly, Management, Earnings and Liquidity (CAMEL) parameters. The findings of the study have corroborated the earlier held view that distress among Nigerian banks is a visible expression of a complex set of interrelated problems emanating from a number of factors, including poor corporate governance/management, capital inadequacy, policy/regulatory environment, widespread incidence of non-performing loans arising mainly from economic downturn, poor lending and borrowing culture, asymmetric information, and aftermath of competition. Some of these factors examined here are endogenous while the others are exogenous to the banking system.

1. Policy and Regulatory Environment

Prior to the adoption of a comprehensive economic reform programme under the Structural Adjustment Programme (SAP), the Nigerian banking system could simply be described as highly regulated. Some of these regulations had sometimes been counter-productive and had contributed to the strains in our banking system. Banks were subjected to substantial restriction on their products and activities. These restrictions had, to a reasonable extent, limited some banks' ability to adapt to changing market conditions. The government had generally in the past made the control over banks an important tool of the country's economic development strategies. These policies were put in place in the belief that without such intervention, the banking system might not cooperate in the development effort because of divergence between public and private goals. Some of the policies manifested in the form of direct control and the establishment of interest rate ceiling as well as restriction on entry into the banking industry.

Through the direct credit controls, banks were made to perform developmental roles for which some of them were ill-equipped. Consequently, their participation led them to serious financial problems arising especially, from mismatching of assets and liabilities. The direct credit controls often included the requirement that banks should provide subsidized credit to priority sectors and public enterprise. There were instances of defaults in the repayment of loans and advances to agriculture and small and medium scale enterprises even when they were given at below market rates. Compulsory participation of banks in the Rural Banking Programme in the past had also forced some banks to expand faster than their capabilities. That was in addition to the non-viability of some of such branches which some banks have dubbed as "loss centers." The control of interest rates in the past tended to reduce banks' profitability and contributed to the poor financial condition of some of them. An effect of these regulatory policies was the large number of weak banks, particularly, among the first generation distressed banks. Also, the need to sanitise the operations of banks, in a deregulated environment prompted the introduction of some measures which adversely affected some of them. Among such policies are the prudential guidelines, Statement of Accounting Standards, the sudden withdrawal of public sector deposits to CBN in 1989, and the use of stabilization securities by the CBN to mop up excess liquidity in the system.

The adoption of these measures, though sometimes imperative, exposed many weak banks and threatened them with illiquidity and insolvency. Some banks which had earlier posted huge profits while under providing for loan losses, started to post heavy losses resulting in insolvency. The use of stabilization securities to mop up excess liquidity also pushed some marginal banks to illiquidity. In extreme cases of illiquidity, there was near-panic as some banks were unable to meet depositors' demands. Loss of depositors' confidence increased flight to safety and aggravated runs on some banks. Consequently, the adversely affected banks resulted to distress borrowing particularly in the inter-bank market at exorbitant interest rates.

2. Capital Inadequacy

A function of capital in a bank is to serve as a means by which losses can be absolved. Capital provides a cushion to withstand abnormal losses not covered by current earnings, enabling banks to regain equilibrium and to re-establish a normal earnings pattern. The need for adequate capital largely informed the decision of the Regulatory Authorities to raise the minimum equity share capital of banks over the years. At present the minimum paid-up equity share capital is ₦2 billion for a new bank to be licensed and the existing universal banks have the deadline of 31st December, 2002 to beef up their paid-up equity share capital to N1 billion. This problem of inadequate capital has been further accentuated by the huge amount of non-performing loans which has eroded some banks' capital base. It has even been discovered that many of the closed banks in Nigeria started with fictitious capital through the use of commercial papers (CP's). Such CP's were paid back soon after commencement of business with deposits. Many of such so-called bank owners contributed nothing to own a bank, yet they used the means to amass wealth and ruin the bank at the end of the day.

3. Economic Downturn

The adverse economic condition in Nigeria since mid-1981 had been characterized by high inflation, depreciating value of the Naira, large fiscal deficits, heavy external and internal debt overhang and slow growth. Arising from this stress in the economy, many borrowers, corporate bodies and individuals as well as government at all levels were unable to service their loans, thereby making many banks to come under severe crisis. The macroeconomic reforms introduced in 1986 also had its toll on the external value of the Naira which was then believed to be overvalued. A massive depreciation that followed shot up foreign manufacturing input prices leading to greater domestic capacity under utilization and reduced ability of business borrowers to repay their loans and advances.

4. Borrowing and Lending Culture

This problem of economic downturn has been exacerbated by the attitude of some borrowers who are unwilling to repay even when they are known to have the means to service their debts. Such borrowers seek refuge under the inadequate legal framework and cumbersome loan recovery processes which make it difficult for the lending bank to foreclose collaterals. Obtaining judgment when a loan defaulter is sued is often lengthy, thereby increasing the cost of doing banking business in Nigeria. Yet justice delayed is justice denied. In the case of some small borrowers, particularly in priority sectors of agriculture and small and medium scale enterprises, they willfully default on the wrong notion that the bank loans are part of their share of the "national cake". There are also "professional" borrowers who through connivance with some banks' staff take bank loans with no intention to repay such loans. These problems greatly impair the quality of banks' assets as non-performing loans and advances become unbearable and turn out to be a high burden on many of them.

Insider abuse by bank owners, directors and management staff is another factor which exacerbated loans defaults in some weak banks. Insiders in those banks obtained loans and advances without collateral in contravention of banking regulations. State Government banks were no exception. The banks were used as extension of the owing states' treasuries. Management staffs in the weak banks have also been found to collude with customers to defraud the banks by granting loans and advances without adequate collaterals. Sometimes, the loan applications are poorly appraised with inadequate documentation. Poor lending and borrowing culture was contributory to distress in the system.

TABLE 8

Asset Quality of Banks

	Loans & Advances (N'BILLION)		**Non-Performing Loans & Advances (N'Billion)**		**Proportion of Non-Performing Loans to Total Loans & Advances (%)**	
Year	Industry	Distressed	Industry	Distressed	Industry	Distressed
1989	23.1	4.3	9.4	2.9	40.8	67.1
1990	27.0	6.4	11.9	4.7	44.1	72.8
1991	23.9	5.4	12.8	4.1	39.0	76.5
1992	41.4	15.7	18.8	6.8	45.5	43.0
1993	80.4	25.3	32.9	14.7	41.0	58.0
1994	109.0	45.6	46.9	29.5	43.0	64.6
1995	175.9	48.9	57.8	29.5	32.9	68.9
1996	213.6	51.7	72.4	33.9	33.9	75.5
1997	290.4	490.	74.9	40.7	25.81	81.92
1998	327.2	24.2	63.3	18.7	19.3	77.3
1999	370.2	29.1	24.8	21.0	25.6	72.2
2000	519.0	26.4	111.6	20.0	21.5	75.8
2001	803.0	123.1	135.7	35.4	16.9	28.9

Source: NDIC Report (Various Years)

5. Asymmetric Information

Closely related to negative borrowing culture is asymmetric information which has been known to cause banking crisis, particularly in emerging markets. Asymmetric information is described as a situation whereby a borrower taking out a loan has superior information about the potential returns and risk associated with the investment project than the bank lending the money

(Mishkin, 1996). This problem of asymmetric information is often rampant in an unstable economy as loans are likely to be extended for risky projects and the borrower may have incentives to misallocate borrowed funds for personal use or invest them in unprofitable projects. With the benefit of hindsight, it is clear that many NERFUN, NEXIM and many agricultural loans were diverted for personal use and for projects different from which they were extended. Also, some borrowers have been known to contract loans with the intention of not repaying form the onset. Such loans had become bad form the moment of extension.

6. Poor Corporate Governance/Management

It has become a worldwide dictum that the quality of corporate governance for management makes an important difference between sound and unsound banks. The US Comptroller of the Currency ascribed over 90% of bank failures since deregulation in the US as being due to poor management. Just as it is in other parts of the world, so is it established in Nigeria that mismanagement is the main culprit causing banking crisis. A very significant characteristic of mismanagement is in the negative attitude and behaviour of bank managers, which is difficult to reverse by the application of external policies and measures.

The four common types of mismanagement, namely: technical mismanagement, cosmetic mismanagement, desperate management, and fraud are identified to be common in banks (World Bank, 1989), are prominent in our banking industry and they often undermine the health of our banks. Technical mismanagement involving inadequate policies, lack of standard practices, prevalence of over-extension, poor lending, mismatching of assets and liabilities, weak and ineffective internal control systems, and poor and lack of strategic planning have been prevalent in the Nigeria banking industry. This often leads to insider abuse as depicted in Table 9.

(TABLE 9)

Extent of Insider Loans in Selected Banks in Liquidation as at the Date of Closure

S/N	Closed Bank	Ratio of Insider Loans to Total Loans %	Ratio of Non-Performing Loans to Total Loans
1	Financial Merchant Bank	66.9	99.5
2	Kapital Merchant Bank	50.0	96.2
3	Alpha Merchant Bank	55.0	90.0
4	United Commercial Bank	81.0	90.0
5	Republic Bank	64.9	98.0
6	Commercial Trust Bank	55.9	100.0
7	Commerce Bank	52.0	86.9
8	Credite Bank	76.0	98.3
9	Prime Merchant Bank	80.7	100.0
10	Group Merchant Bank	77.6	64.5
11	Nigeria Merchant Bank	99.9	95.5
12	Royal Merchant Bank	69.0	98.0

Source: NDIC Annual Report (various years)

Cosmetic mismanagement (usually a derivative of technical mismanagement) consists of hiding past and current losses to buy time and stay afloat, looking, hoping and waiting for a miracle to happen. This depicts the typical practice of some bank managers in Nigeria which includes systematic roll-over of matured fixed deposits, under-capitalisation, accruing interest income on delinquent facilities, keeping dividends constant on spurious earnings, fictitious collaterisation, etc, particularly before the introduction of prudential guidelines. A typical example of cosmetic mismanagement happened in a bank as it used fictitious BA to manage non-performing loans at month-end in an attempt to hide from Examiners the bad status of the loans just recently. The bank in question credited a loan account related to the ex-Chairman with ₦500 Million on the

28th May for an alleged BA discounted only to be reversed and debited with the same ₦500 million on 7th June of the following month. The cut-off date of examination was 31st May of that year. The same bank employed "SWAP" or "back-to-back" transaction to manage its liquidity. It purportedly placed N1 billion as placement in the balance sheet but failed to show the corresponding N1 billion taking as liability thereby using that ploy to boost its liquidity as at 31st May of that year.

Desperate management is a condition where bankers see themselves in danger to declare, among others, capital reduction, operation loss, and no dividends. The main unwholesome practices in desperate management by Nigerian bankers include speculation, particularly by the distressed banks which used to pay above the market interest rates for deposits, and charge higher interest to borrowers. A bank that was known to be illiquid continued to rollover inter-bank takings at 50% to 52% interest rates. Meanwhile, it was grossly under-capitalized as over 76% of its loans were not performing.

Fraud is part of the delinquent features that turn good bank managers into bad ones. When there are too many of them, the affected bank might have lost its capital several times before it knows. The management and staff of many banks extend loans under suspicious circumstances and wanton violations of their credit policies, thus making it extremely difficult or impossible to recover all or a substantial part of such loans. No doubt, the situation described here is reminiscent of what obtained in our banking system which had been riddled with some fraudulent staff as some of the closed banks had become distressed as a result of fraud. The amount involved/lost through fraud and staff indiscipline as a result is given in Table 10.

TABLE 10

EXTENT OF FRAUDS AND FORGERIES IN BANKS

YEAR	AMOUNT INVOLVED (N'M)	ACTUAL/EXPECTED LOSS (N'M)	NO.OF STAFF TERRMINATED/RETIRED/DISMISSED FOR FRAUDS
1989	105.0	15.3	313
1990	804.2	55.8	417
1991	388.6	26.7	514
1992	411.8	73.1	436
1993	1,419.1	246.4	516
1994	3,399.4	950.7	737
1995	1,011.4	229.1	625
1996	1,600.7	375.3	552
1997	3,777.9	226.5	566
1998	3,196.5	692.3	311
1999	7,386.3	2,730.1	596
2000	2,851.1	1,080.6	493
2001	11,243.9	9.6.3	152

Sources: NDIC Annual Report (various years)

7. Aftermath of Competition

The deregulation of the economy has brought about increased competition and innovation in the market place. The increasing competition and innovation have equally brought about visible traces of strains into the banking system. In a competitive environment allocative and operational efficiency require that inefficient and marginal firms be crowded out and allowed to go under. In accordance with the principle of market economy, there is free entry and there should be free exit. Some banks that have previously been protected from competition do not have the management expertise to survive in an increasingly complex, volatile and competitive market which has resulted from banking deregulation. In a way, therefore, it is a paradox that while competition enhanced the menu of bank products available to customers, such competition has indirectly caused the insolvency and failure of some banks in Nigeria through increased cost schedules (K.S. Adeyemi, 1993).

8. Ownership Structure/Political Interference

Ownership structure is one of the major variables that could be used to explain financial distress in Nigerian banks. Owners' direct intervention, most especially in government-controlled banks, in the internal operation of the banks has contributed to distress in some of them. In private banks, the prevalence of boardroom quarrels and insider abuse are precarious cankerworms, causing distress in some of them. In fact, boardroom has changed to bedroom in some banks to heighten the extent of meddlesome interference of some privately owned banks.

Besides, most of the government-owned banks are often treated as political banks. Some of these banks are characterized by inept management whose tenure of office is occasionally very unstable. In most cases, as the owner government changes frequently, so also do board and key management staff of the banks. One result is inconsistent policies due to the fact that what one board did, the succeeding one (for political reasons) would overturn with reckless abandon. Even though the number of banks in this category has reduced considerably, the remaining ones still exhibit the situation described here.

2.12.2 EARLY WARNINGS SIGNALS

There is need to emphasize that the central pillar of a virile banking system is in the ability and capacity of the Regulatory Authorities to distill the problem banks for timely application of remedial measure. Just like any other ailment, early detection and application of appropriate remedial strategies are crucial for effective management of banking crisis. Such distress resolution thresholds are expected to be robust in order to prevent contagion. That would require a framework for early warning signals (EWS) and a holistic engagement of their thrust. According to Ruding (2002), Regulatory Authorities should adopt proactive and strict policies to resolve the problems at an early stage. Strictness requires the setting and enforcing of high standards of prudential guidelines to reduce the risks of individual banks or the entire banking system in a jurisdiction from becoming illiquid or insolvent. The need for being proactive is because delay in taking action can cause a lot of damage even if the action is appropriate – a case of medicine after death.

The CBN and NDIC (2002) have developed and issued The Framework for Contingency Planning for Banking Systemic Crises. It becomes effective from 1st July 2002. The document which has been circulated to all banks has comprehensive threshold for regulatory/supervisory intervention aimed at ensuring consistency and systematic approach to distress identification and resolution. Please refer to the document for details. The banks are required by the Regulatory Authorities to fully disclose these thresholds to all stakeholders for the purpose of transparency. In addition, each bank is required to prepare and submit its contingency plan to manage its crisis. Such a plan should be discussed and approved by the Board of each bank.

It is important to indicate that there are early warning system (EWS) models for predicting banking crisis. Nyong (1994) identified four potential advantages of using EWS models. First an EWS model can assist Regulators and Supervisory Authorities in the achievement of their mandate of timely identification of problem banks so that taking appropriate intervention might result in fewer bank failures, fewer losses to depositors and less disruption to the payment mechanism. Second, use of EWS models can lead to more efficient allocation of resources of Regulatory and Supervisory Agencies among problem and non-problem banks. Third, it provides a more objective approach to classifying banks into problem /non-problem categories than most ad-hoc or heuristic methods. Finally, an EWS model provides a basis for critical self-assessment by banks so that they can take remedial action in good time to arrest any ensuing problem. For Sahajwala and Ban de Bergh (2000), EWS models assist in (i) systematic assessment of banking institutions within a formalized framework both at the time of on-site examination or in-between examination through of-site monitoring; (ii) identification of institutions and areas within institutions where problems exist or are likely to emerge; (iii) prioritization of bank examination for optimal allocation of supervisory resources and pre-examination planning; and (iv) initiation of warranted and timely action by the supervisor.

Some developed economies are known to have an EWS model for predicting bank failures. The Financial Services Authority of UK has put into use Risk Assessment Tool of Supervision and Evaluation (RATE) from 1998 and all Supervisory Authorities in the USA use CAMEL since 1980. The FDIC in the USA introduced Statistical CAMELS Off-site Rating (SCOR) in 1995 as an EWS to predict bank failures. These EWS models in developed economies are fairly effective because they combine bank returns with on-site assessments.

In Nigeria, CAMEL model is being used to rate banks. However, due to some weaknesses, it is not effective. One most serious weakness of the CAMEL model is the low integrity of information usually supplied by some banks. The reports of on-site examination have clearly indicated that banks have not been accurately reporting irregularities and losses. Also, the current CAMEL model solely relies on accounting-based information leaving out market-based date to complement it.

The CBN and NDIC are however in the process of enhancing the Banking Analysis System (BAS) to overcome most of these shortcomings. With an enhanced BAS, on-site assessment will easily be combined with bank returns for a more effective EWS model to rate banks in Nigeria.

2.12.3 EXTENT OF BANKING CRISIS IN NIGERIA

The wave of banking crisis has inflicted many countries of the world in the last two or three decades. Banking crisis has been protracted and systemic in such countries as Argentina, Chile and Uruguay while Bolivia, Brazil, Euador, Peru and Venezuela have managed to defer or contain the problem (Thomas Glaesnner and Ignacia Mas, 1995). Even the almighty USA, which had a banking crisis in the 1930s, is not spared of the ravaging plague of bank distress as the American tax payers had to part with about $160 billion to resolve savings and loans debacle from 1988 to the mid-1990s. Some countries in Europe, Japan and some of the Asian Tigers and many other developing countries are having the bitter dose of banking crisis.

The extent and depth of banking crisis in Nigeria has been well documented in the literature (see various editions of the NDIC Annual Report and Statement of Accounts and CBN/NDIC Collaborative Study, 1995). I shall therefore not go into the details here. However, a glimpse of the situation before Nigeria made history by closing 26 banks at one fell swoop would be reviewed to enable us appreciate the gargantuan nature of the problems (see Table 11).

TABLE 11:

Selected Indices of Banks in Crisis in Nigeria

S/N	Description	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
1	Number of Banks	107	119	120	120	116	115	115	115	89	90	89	90
2	Number of Distressed Bank	9	8	16	33	55	60	50	47	15	13	12	9
3	Ratio of Deposits of Distressed Banks to Total Deposit (%)	14.6	4.4	18.1	19.2	29.4	14.1	14.7	9.0	3.5	1.6	2.5	2.0
4	Ratio of Distressed Banks to Total Assets of all Banks (%)2.0	23.7	16.4	20.9	16.1	18.6	19.8	11.0	7.6	3.9	1.5	20.0	3.0
5	Amount Required for Recapitalisation of Distressed Banks (N'billion)	2.0	2.4	55	13.6	23.4	30.5	43.9	42.8	15.5	15.3	10.3	12.1

Source: NDIC – Annual Report (various years) and CBN Banking Supervision Annual Report, 2001

As shown in the Table 11, the number of distressed banks fluctuated from 9 in 1990 and peaked at 60 in 1995 before it dropped to 50 and 47 in 1996 and 1997, respectively. The ratio of deposits of banks in crisis to total deposits of the banking system peaked at 29.4% in 1994 from where it fluctuated to 2.0% in 2001. Also, the ratio of total assets of distressed banks to total assets of all banks at a high of 23.7 in 1990 fluctuated to 3.0% in 2001. These indices point to the fact that banking crisis in Nigeria in recent years have not been systematic and the industry is unstable as the Regulatory Authorities may not have the resources to resolve the crisis.

An indication of the depth of bank distress in Nigeria is the amount required to make them adequately capitalized for their volume of business and that would enable them to operate in a safe and sound manner. From an additional capital requirement of N2.0 billion in 1990 for 9 distressed banks, the amount multiplied by a factor of about 22 to a staggering N43.9 billion for 50 distressed banks at the end of 1996 before it marginally dropped to N42.8 billion for 47 distressed banks in 1997. No wonder the erstwhile shareholders could not muster the human and financial resources to resuscitate these banks.

2.12.4 IMPLICATIONS OF BANKING CRISIS

Banking crisis where it occurs could result in serious economic disequilibrium and distortion which if not well managed could portend doom and even lead to economic depression. The economic distress fostered by the collapse of the payments system, at some time in history, on the big economies like USA, Britain and Japan were instructive. Those economies witnessed recession consequent upon the failure of their payments system. The resolution options adopted however minimized the impact of the crisis in those jurisdictions. Bank failures are therefore made relatively painless while public confidence in the system has continued to be engendered and sustained in these economies.

In the specific instance of Nigeria, the country had witnessed two painful eras of bank failures. The pre-1950s when 21 out of the 25 indigenous banks folded up. The distressed syndrome also resurfaced in the late 80s such that by December 1995, 60 out of 115 banks in operation were known to be distressed. It is now common knowledge that many of those that could not be salvaged were later closed down by the CBN. Between 1994 and 2002 a total of 33 banks were closed down. This excludes Rims and Savannah as the action of the Regulatory Authorities in respect of them is being challenged in the courts.

Analysts of the going-on in the financial sector will agree that the experience of the last era has been largely unsavory. The means of livelihood of thousands were suddenly cut off, contractual obligations running into hundreds of million of Naira between the banks and their creditors were frustrated, not to mention the thousands of jobs that were directly or indirectly lost. Such was the painful experience of bank failures. In fact, it took the systematic and pragmatic disposal of the failed banks by the Regulatory Authorities to forestall the contagion effect it could have had on the healthy institutions.

While any legal entity could fail, bank failure on the contrary is an issue because of the financial intermediation role of banks which makes failure in the sector something of great concern both to the depositors, investing public, operators, Regulatory Authorities and government. Apart from the yield offered by banks to depositors, another important reason why funds are kept with banks is safety consideration for which distress or bank failure is an aberration to such depositors. Bank distress leads to loss of confidence which could jeopardize the intermediating roles of banks. The consequential dearth of investible funds could truncate economic growth and development. It is therefore expedient to adopt a resolution strategy that will help to ensure a stable banking system and engender public confidence in the industry. Let us review some of the adverse effects of banking crisis on the economy.

1. Erosion of Public Confidence

About the greatest havoc of bank distress is the erosion of public confidence in the system especially if the distress is not well managed. Banking is built on trust and confidence. Once the trust and confidence are misplaced, banks would no longer be efficient in playing their role of financial intermediation. The loss of public confidence would automatically have many adverse effects. It can easily lead to panic and bank runs which would threaten the survival of other healthy banks through systemic risk, particularly in the absence of a deposit insurance scheme or other forms of safety net.

A situation where there is loss of public confidence and bank runs, demonetisation would be a logical problem. There would be a massive portfolio shift to safer assets such as foreign currencies, government securities and non-monetary assets as well as capital flight. The preponderance of the banking public that would not be able to participate in portfolio shift would not have a safe place to invest part of their wealth. As this is supposed to be government's responsibility, there will be political pressure for government to abate the crisis.

Equally related to demonetisation is the negative implication for banking culture. Already, the banking culture in Nigeria is poor and low and bank distress would only exacerbate the situation. As an evidence of this ugly development in Nigeria, currency outside banks as a proportion of narrow money supply rose sharply from 42.3% in 1987 before government started to officially identify the number of distressed banks to 57.4% in 1995 (a year when 60 out of the 115 banks were declared distressed by the Authorities) before it declined to about 50% in 1997. It stood at 41.5 as at 31st December, 2001.

Hitherto, investment in the banking sector had been considered lucrative. Bank distress would make investors lose their investments in the banking industry and could lead to divestment from it. This problem would be compounded by low profitability for the remaining banks as loss of public confidence in them would jeopardize their patronage and earnings.

2. Economic Effects

Banks are central to an efficient and effective payments system in any country. With banking crisis, the payments system would be perilous and at great risk as the link between the real sector and the financial sector including international settlement would be greatly impaired. This would inhibit the intermediation role of banks.

In circumstances where the capacity of the banks to perform their main role of financial intermediation is impaired, the real sector of the economy would be adversely affected. Banks are the main means by which monetary policy is implemented in an economy. With banking crisis this would be hampered and development would be elusive.

Failed banks would be incapacitated from extending new credit. The healthy banks would equally be constrained from granting credit for fear of such facilities becoming delinquent. If credits are extended at all, they are likely to be for the short-term and mainly to finance commerce and purchase foreign exchange. A country where banks become highly speculative and reckless such as depicted here is dubbed by Onimode (1996) as a "casino" economy. The effect of these would be to further crowd out the productive sectors of manufacturing and agriculture from the credit market. Yet the productive sector must be galvanized for macroeconomic stability to materialize.

The failure of a large bank or any bank can lead to a sudden contraction of the money supply as well. This would have very serious adverse implications for macroeconomic stability as economists, whether monetarists or fiscalists, are in accord that the level of money supply has a positive correlation with the volume of activities in any economy.

Banking crisis can hinder effective competition and an efficient financial intermediation. A competitive banking system will force banks to operate efficiently if they are to make profit, keep their customers and remain in business. For this to obtain will depend on, among others, the number of banks operating in a market, and whether the existing banks are of an appropriate size and strength for the needs of their customers. Bank failures can lead to undue concentration and inefficiency in delivery of banking services as failed banks are closed and new banks are not given free entry.

3. Global Effect

The primary counterparts of foreign creditors are the banks, as they are the financial gateway to a country. With bank distress, the international perception of the banking system would be that of suspicion as it would be feared that funds could be locked up and/or lost in the banking system. In most cases, the international community, except those among them involved in criminal practices such as advances fee frauds popularly known as “419” in Nigeria, and other types of frauds would not extend credit to a country in which its banking system is distressed. This would undoubtedly compromise foreign investment and lead to escalation of capital flight out of the country.

2.12.5 BANK FAILURE RESOLUTON OPTIONS

A failure resolution measure could be described as the systematic programmes of action designed to resolve the distress state of an insured institution. Though distress resolution options could be aggregated under a broad spectrum, their application would usually be driven by the financial state and peculiarity of each institution and the banking system in the county experiencing a banking failure. The focus of a good failure resolution option would be to maintain public confidence and stability in the banking system; ensure fairness, equity, transparency and accountability; instill market discipline while discouraging moral hazards; achieve minimum disruption of banking services (both in the problem bank and the system at large); and be cost-effective.

The resolution threshold adopted should also be such that would minimize the likelihood of having to ‘bail out’ uninsured depositors and creditors. This is because such bail-outs tend to undermine market discipline and encourage undesirable risk-taking. It is therefore important to balance the conflicts inherent in those factors in order to adopt the most optimal strategy in the particular circumstance. For example, the desire to consider the least costly method might be outweighed by the need to maintain public confidence in the banking system. It is also important to add that a cardinal issue in restructuring an insolvent bank, by a government agency, is for the erstwhile shareholders to lose their investments, and managers to lose their jobs. This is to prevent a situation whereby you throw good money after bad money or allow monkey to watch over bananas especially where the resolution strategy is aimed at rehabilitating the distressed bank.

Emphasis must be made that those considerations, have hitherto influenced the strategies adopted in dealing with banking crisis experienced in the country in the recent past. Before considering the resolution options, there is need to high light some of the conditionalities for effectiveness, given the experiences of various countries. They should all be substantially met if resolution efforts are to achieve modest benefits.

These conditions include:

I A strong political will on the part of government;

Ii A stable macro-economic environment with few relative price distortions;

iii An enabling environment that favours growth and competition of enterprises;

iv Effective bank supervision and enforcement of regulations;

v. An effective receiving agency with adequate powers and backed by the central bank;

vi Appropriate legal framework that favours financial discipline in the country;

vii Transparent accounting standards that must be used by all financial institutions; and

viii Availability of a cadre of truly professional bankers of integrity.

1. Pay-Off

This involves the payment of insured deposit up to the insurable limit to the depositors of the liquidated bank. As earlier mentioned, the insurable limit is currently set at N50,000 in Nigeria. While it was acknowledged that the limit was due for review in light of the prevailing economic realities (in fact a review is already proposed for enactment by the National Assembly), it is imperative to add that the experience in liquidating 33 banks should persuade kin observers, of the system, that the sum insured was the minimum amount depositors could collect in the event of liquidation. The net income generated from the assets of banks in liquidation is subsequently shared to uninsured deposits on pro-rata basis. For the avoidance of doubt, depositors of five of the 33 banks currently in liquidation have been paid all the monies they had in those banks. As a matter of fact, in the case of Nigeria Merchant Bank in liquidation, the NDIC had made full payment to uninsured creditors and paid N240 million and N160 million to Ministry of Finance Incorporated and UBA PLC respectively in proportion of their shareholding in the bank.

2. Insured Deposit Transfer

This involves the transfer of insured deposit of the failed bank to another bank or other banks, preferably within the same locality. The acquiring bank(s) will be given enough cash and/or riskless assets to cover the insured deposits transferred from the failed bank. Like in the pay-off, only insured deposits are fully covered and therefore it is generally viewed as a variation of the pay off option. The deposits insurance institution takes over the assets of the failed bank which it then markets or manages. The acquiring bank(s) may also purchase some or all the bad assets of the failed bank.

3. Bridge Bank

Under this option the assets and liabilities of the failed bank are assumed by a new bank specifically set up for that purpose. The bridge bank would be operated for about 2 years after which it would be sold to fresh investors. The shareholders of the failed bank would be given little or no monetary consideration since they would have lost their investments in the failed bank. The major advantage of this option is that it would permit continuity of banking services to all customers and fully protect all the depositors and creditors of the failed bank.

4. Purchase and Assumption (P&A)

This is akin to a merger by which a healthy institution offers to purchase the assets and assume the liabilities of a distressed bank. A failed bank could be split to make it attractive to banks that wish to enhance market penetration or establish new branches where the failed bank had branches.

The major advantage of P&A is that it would ensure that all depositors are protected thereby giving credibility to the deposit insurance scheme. It would also ensure continuity in rendering banking services, thereby engendering confidence in the banking system, and also help to promote market discipline as other creditors of the failed bank might not be paid.

5. Open Bank Assistance

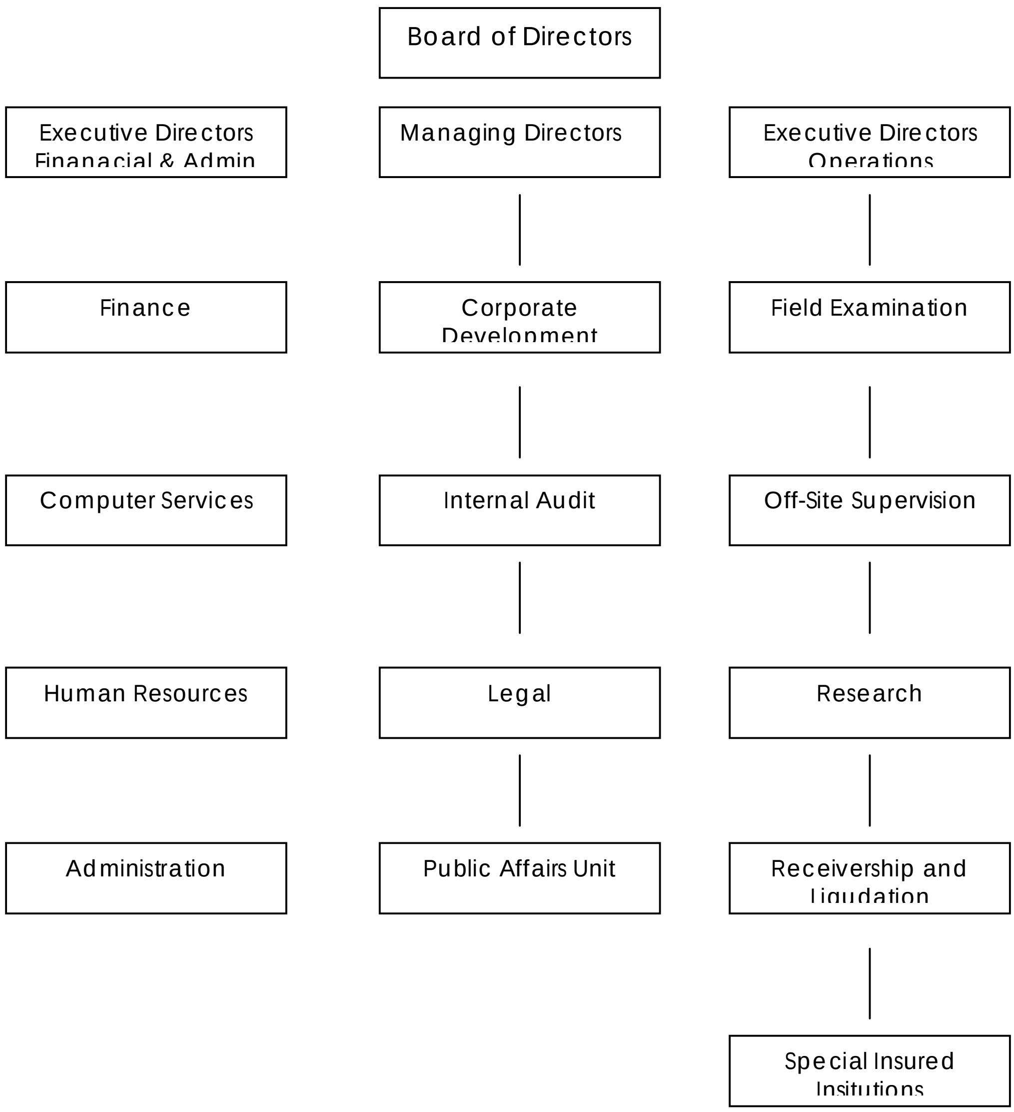
Allowing a failed bank to continue to operate in the same name as a going concern is called open bank assistance. It would involve change in ownership and management of the bank, injection of fresh funds in the form of equity and/or loan capital; and reorganization and overhauling of the bank including rationalization of staff and branches. The Regulatory Authorities in Nigeria have had to employ a combination of strategies available under this option to resolve many distressed banks in Nigeria Especially where pay-off option appeared to threaten the erosion of public confidence in the banking system.

2.13.0 THE NIGERIA DEPOSIT INSURANCE CORPORATION (NDIC)

The Nigeria Deposit Insurance Corporation (NDIC) was established by Decree No. 22 of 1988 and commenced operation in March, 1989. The NDIC is an autonomous body (i.e. an independent agent of Government) which acts as an additional supervisory authority over licensed banks and other deposit-taking financial institutions. For now, NDIC insures only all banks licensed as universal banks and therefore limits its supervisory activities to them. The NDIC not only provides financial guarantee to depositors in case of failure but also ensures that banks comply with regulations and practices which foster safety and soundness in the market place.

TABLE 12

ORGANISATIONAL STRUCTURE OF THE NDIC



Source: NDIC Annual Report

TABLE 13

CURRENT REGULATORY/SUPERVISORY FRAMEWORK FOR NIGERIAN BANKS

TYPES OF INSTITUTION	LEGAL FRAMEWORK	LICENSED BY	SUPERVISED BY	EXAMINED BY	INSURED BY
Banks	CBN Act 1991, BOFIA Act 1991, NDIC Act 1988. CAMA 1990	CBN	CBN/NDIC	CBN/NDIC	NDIC

2.13.1 PROBLEMS AND PROSPECTS OF THE NIGERIAN DEPOSIT INSURANCE SCHEME

A Bank Deposit Insurance Scheme (DIS) is a financial guarantee to depositors, particularly the small ones, in the event of a bank failure. Bank deposit insurance schemes developed out of the need to protect depositor, especially the uninformed, from the risk of loss and to also protect the banking system from instability occasioned by runs and loss of confidence. The banking system has been singled out for the special protection because of the vital role banks play in an economy, whether developed or developing. For a DIS to be effective in achieving the above objectives, it must be properly designed, well implemented by the agency established to execute the scheme and well understood by members of the public, Financial Stability Forum (FSF, 2001). A well designed DIS contributes to the stability of a country's financial system by reducing the incentives for depositors to withdraw their insured deposits from banks following rumors about their financial conditions.

The establishment of the Nigeria Deposit Insurance Corporation (NDIC) in 1988 heralded the introduction of an explicit Deposit Insurance Scheme in Nigeria. The NDIC is responsible for insuring the deposit of all banks and other deposit-taking financial institutions and offers technical assistance, in the interest of depositors, to banks in difficulties and in case a bank fails, it guarantees the payment of insured deposits.

Finally, the Corporation assists the CBN in the formulation and implementation of banking policies with a view to ensuring sound banking practices among others.

The scheme was meant to augment the existing safety-net by protecting depositors, thereby boosting confidence of the banking public. It was also considered as an additional framework to serve as a substitute to the government support policy (implicit insurance) hitherto in place. Prior to the establishment of the Corporation, government was unwilling to let any bank fail no matter its financial condition due to fear of the potential adverse effects. Consequently, inefficient banks were given government support over the years. However, such direct supports (implicit insurance) could not be sustained under the Structural Adjustment Programme introduction in 1986 which, among other factors, deregulated the economy towards market orientations. With the establishment of the NDIC the pains of bank failure inevitable in a market environment, were reduced to a minimum while moral hazard associated with direct government support was eliminated.

2.13.2 REASONS FOR ESTABLISHING THE DEPOSIT INSURANCE SCHEME IN NIGERIA

The decision by the Federal Government of Nigeria to establish the Nigeria Deposit Insurance Corporation in 1988 was informed by a number of factors. These included the country's past bitter experience of bank failures, the lessons of other countries' experiences with deposit insurance schemes, increased competition in the industry, the need for effective supervision/prudential regulation and change in government bank support policy. We shall discuss these very briefly.

1. Lesson of History: Bank Failure in Nigeria

The period between 1947 and 1952 witnessed a rapid growth of indigenous banks in Nigeria. This was before the establishment of the Central Bank of Nigeria in 1958 (though it commenced operations in 1959). The increase in the number of indigenous banks was followed also by a high rate of failure of such banks. By 1954, twenty-one (21) out of twenty-five (25) indigenous banks operating in Nigeria had collapsed. The failures were attributed largely to mismanagement of assets, lack of adequate capital and inexperienced personnel on the one hand and the lack of regulation on the other hand. Since the country had no central bank at the time to regulate the operations of the banks, market participants set their own differing standards until the enactment of the Banking Ordinance in 1952 which came into force in 1954. Since the mid-60's, the Federal Government had ensured through direct support of banks, that the Nigerian banking public was no longer exposed to the hazards of bank failures. In this respect, the Central Bank of Nigeria had deliberately pursued certain measures to prevent bank failures. These included the requirement for every licensed bank to create and maintain a statutory non-distributable reserve fund from yearly profits before dividend payments; stipulation of minimum liquidity ratio and capital requirements as well as the rendition of statutory returns. In spite of these measures, experience showed that the capitals of some licensed banks were seriously eroded by bad and doubtful debts due mainly to poor management. Since the Federal Government of Nigeria did not want Nigerians to relive those experiences, it was considered that the establishment of a Deposit Insurance Scheme was urgently needed.

2. Lesson from Other Countries

The success stories of some countries especially the United States of America (USA) in addressing the problems associated with bank failure through explicit DIS also informed the establishment of the scheme in Nigeria. In fact the Federal Deposit Insurance Corporation (FDIC) has since provided the abiding lesson and model for most countries which subsequently introduced explicit deposit insurance schemes in response to anticipated changes in economic and banking conditions. Since Nigeria was at the threshold of fundamental changes in the economy and the banking sub-sector, the authorities reckoned that the country might benefit from the experience of the FDIC.

Sequel to the deregulation of the Nigerian economy, the banking system witnessed a rapid growth in view of the pivotal role it was expected to play in the economy. Market forces were allowed to play prominent role in the determination of the prices of bank services and interest rates. Banking competition increased as is evident in the growth of the number of licensed banks. (See table 14) plus the growth in the range of banking services offered.

TABLE 14

Growth in Number of Banks in Nigeria (1989-1990)

Year	Number of Banks	Annual Growth Rate %
1980	26	0.0
1981	26	0.0
1982	30	15.4
1983	35	16.7
1984	35	8.6
1985	40	5.3
1986	41	2.5
1987	50	21.9
1988	66	32.0
1989	81	22.7
1990	107	32.1

Source: CBN Bulletin

Table 14 shows that the number of licensed banks in the immediate years following the introduction of SAP (1987-1990) witnessed double digit annual growth rates. This can be taken as evidence of increasing competition in the banking industry. The increasing bank competition manifested in higher risk appetite, hence banks and consequently bank depositors were exposed to greater risks.

3. Changes in Government Bank Support Policies

Prior to the establishment of NDIC, government had been unwilling to let any bank fail, no matter the bank's financial condition and/or quality of management. Government feared the potential adverse effects on confidence in the banking system and in the economy following a bank failure. Consequently, government deliberately propped up a number of technically-insolvent state-owned banks over the years.

In the new economic policy of government dictated by the imperative of SAP, it was felt that there was the need to shift emphasis from direct support of banks, to prevent failure, to one of protecting the deposits of customers especially the small depositors. It was considered that the establishment of an explicit DIS would facilitate the change in policy.

2.13.3 OWNERSHIP, MEMBERSHIP, COVERAGE AND FUNDING OF DEPOSIT INSURANCE SCHEME IN NIGERIA

The different characteristics of DIS from country to country are usually measured in terms of the coverage, ownership, funding and membership. The practice in Nigeria in these areas is reviewed thus:

1. Ownership

There are three types of ownership structures identified among the countries that have established the scheme. There is the one where ownership is jointly held by the private and public sectors. The second type is the private ownership whilst the third variant is one where ownership is held purely by the public. The practice in Nigeria falls into the third category. The DIS in Nigeria is owned 100% by the Federal Government of Nigeria through the Central Bank of Nigeria and the Federal Ministry of finance, which hold 60% and 40% equity capital of the Nigeria Deposit Insurance Corporation, respectively.

2 Membership

The major issues associated with membership are the types of institutions that should be included in the scheme, and whether or not participation by eligible member should be compulsory or voluntary. In Nigeria, membership of the scheme is compulsory for all licensed banks and deposit-taking institutions to be members of the scheme. Presently, only banks licensed by the CBN are covered by the scheme.

3. Funding

Adequate financial resources are required to meet the scheme's obligations and operational costs. In Nigeria, the act establishing the NDIC recognizes four sources of funding the activities of the scheme. These are insurance premium contribution by participating institutions, capital contributions and periodic recapitalisation provided by the owners of the scheme, borrowing facility from the CBN, and special contributions or levies imposed on healthy member institutions and when necessary. In specific terms, Section 21(1) of the NDIC Act 22 of 1988 states the assessment rate for premium by all insured institutions as 15/16 of 1% per annum which is about 0.94 per cent with the possibility of reduction in premium rate when the General Reserve Fund is more than 10 times the paid-up capital as provided for in Section 10(2) of decree. Section 20(a-c) specifies the assessment base as the total deposits of the insured institution except the following deposits.

- insider deposits, that is deposits of staff including directors of the insured institution;
- counter claims from person who maintains both deposit and loan accounts, with the former serving as collateral for the loan; and
- such other deposits as may be specified from time to time by the Board of the NDIC.

Also Section 9(1) of the act indicates the amount of initial capitalization by government as N100 million with provision for periodic recapitalisation in Section 9(3). Under this provision, the initial paid-up capital had been reviewed upward to N500 million in 1995 and N2.0 billion in 1998 and subsequently increased to N25 Billion in July 2004. Lastly, where the Deposit Insurance Fund (DIF) of the Corporation is not sufficient for its insurance obligations, Section 21 (3) of the Corporation's enabling act provides that all participating institutions shall be obliged to pay to the Corporation, a special contribution up to the amount of an annual premium. Finally, Section 36(1) of the act gives the NDIC the power to borrow from the Central Bank of Nigeria such money as it may deem fit for the discharge of its statutory functions.

Emphasis however should be made of the fact that the day-to-day administration of NDIC is being funded from the income earned on the investment of the Deposit Insurance Fund (DIF) in accordance with Section 11(3) of NDIC Act, 1988 as amended. The DIF can only be used to pay depositors in banks under liquidation and to resolve the problems of a distressed bank as provided for in Section 12 of NDIC Act, 1988 (as amended).

4. Coverage

Coverage is of great significance in a DIS because it determines not only the potential liabilities of the scheme but also depositors' level of confidence in the banking system. The key factors that are central to the issue of coverage are the deposits to be insured and the insurance limit. Coverage may be limited or unlimited. Unlimited insurance coverage has been widely criticized due to the fact that it leads to moral hazard. The argument is that when deposits are 100 percent insured, bankers tend to engage in highly risky business activities with a view to maintain high returns. The question of coverage also crops up in terms of types of accounts to be covered. In some countries only accounts denominated in the domestic currency are covered whereas in others, coverage is extended to accounts denominated in foreign currencies. It should also be noted that in some cases, large deposits are left uninsured as a way of retaining some measure of market discipline.

All depositors in Nigerian banks are covered as provided for in Section 20 of NDIC Act, 1988 (as amended) with the exception of insider deposits, counter-claims from a person who maintains both a deposit and loan account and such other deposits as may be specified from time to time by the Board.

At the commencement of the Corporation in 1988 the maximum insurance coverage per depositor was set at N50, 000.00 and is still in use. However based on its perceived inadequacy, in the light of Naira depreciation and inflation among other reasons, the Board of Directors of the Corporation approved an upward review of the limit to N100, 000.00 during the last quarter of year 2000. The review would become operational once the necessary amendment is made to the NDIC Act by the National Assembly.

2.13.4 Others

(a) Investment Policy of Deposit Insurance Fund

A policy regarding how the deposit insurance fund is to be invested is usually contained in the enabling legal instrument establishing a DIS. Major points of emphasis are usually liquidity and safety of the fund. The availability of instruments for meeting these criteria depends on the depth and breath of the financial system and its exchange rate regime. By the provision of Section 11(1) of the NDIC Act, 1988 (as amended) the Corporation is required to invest its fund in government securities and any other securities that may be approved by its Board of Directors.

(b) Power to Supervise Insured Institutions

Under a DIS, the supervision of insured institutions is a major burden that falls squarely on the insurer. This arises from the fact that it is of paramount importance that the administrator of the scheme knows the extent of risk it is assuming and to monitor the changes in the composition and extent of such risks through close supervision of the insured institutions.

For effectiveness therefore, the legal instrument establishing the scheme in countries where it exists normally provides power for close supervision. Such is the case in Nigeria. The NDIC Act 1988 (as amended) empowered the Corporation to supervise insured institutions. The Corporation carries out its supervisory responsibility through the on-site examination and off-site surveillance of insured banks.

2.13.5 OPERATIONAL ACHIEVEMENTS OF THE NDIC

The operational achievements of the NDIC are brought into sharper focus when examined within the context of its activities in the discharge of its primary mandate of deposit insurance. These activities are broadly classified into four, namely: deposit guarantee, depositor protection through supervision (off-site surveillance and on-site bank examination), distress resolution and other activities undertaken by the Corporation with the aim of insulating the industry from destructive runs and instability.

As a deposit insurer, the Corporation guarantees payment to insured banks' depositors in the event of bank failure. At the commencement of the scheme in Nigeria, the maximum insurance limit was set at N50,000.00 per depositor and that was applied to insured depositors of all the 33 closed banks up to year 2000. However, after one decade of operation, the maximum limits are being reviewed upwards to align more closely with prevailing economic conditions.

The corporation had paid about N3.3 billion to depositors, representing 63% of total insured claims to the depositors of 33 banks in liquidation as at March 22, 2002. This has gone some way in engendering depositors' confidence in nation's banking system. A large number of depositors who are aware of these previous payments or affected in the previous exercise no longer panic at the first signs of financial distress in insured banks. Thus, the absence of panic and runs has ensured stability in the banking system.

1. Depositor Protection through Supervision

Banks are supervised to protect depositors, ensure financial stability, evolve an efficient and competitive system, and protect customers. In addition to these reasons, the corporation supervises insured banks to gauge the health of the banks, as no deposit insurer would wait to be told by another party that its insured institutions have failed. Supervision of insured banks therefore, remains an integral part of the mechanism for ensuring safe and sound banking practices and the Corporation continues to regard this as a major responsibility. Operationally, this entails on-site examination and off-site surveillance, both of which are mutually reinforcing. The off-site supervision provides early warning signals which are useful in prioritizing on-site examination and assessing potential problem areas.

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

2. Distress Resolutions in the Banking Industry

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

Depending on the severity and peculiarity of the distress, the NDIC in collaboration with the CBN, has over the years, successfully adopted such measures as provision of financial assistance, imposition of prompt corrective actions, assumption of control and management, restructuring and sale of some distressed banks as well as liquidation of the terminally distressed banks as a last but unavoidable option. The achievements recorded in this area include, but are not limited to the following:

- Accommodation facilities were granted to eight (8) banks with serious liquidity crisis to the tune of N2.3 billion in 1989 following the withdrawal of public sector funds from commercial and merchant banks to CBN during that year.
- Holding Actions were imposed on 46 banks to help stabilize their financial conditions.
- Twenty-four (24) banks were temporarily taken over to safeguard their assets.
- Seven (7) distressed banks were acquired, restructured and sold to new investors.
- Between 1994 to date, thirty-five (35) terminally distressed banks were closed down with minimal disruption to the banking system. The closure of these banks was because of their inability to respond to all the various regularity/supervisory initiatives put in place to resolve their problems, and the continued deterioration in their financial conditions. Thereafter, the NDIC was appointed Provisional Liquidator of the closed banks. The corporation's dual roles of insurer and liquidator ensured that the losses suffered by the banking public as well as the economy at large due to bank failure had been minimized.

The cumulative effect of the above measures was a drastic reduction in the level of distress in the nation's banking system. The number of distressed and potentially distressed banks was drastically reduced.

As part of failure resolution measures, the NDIC continues to serve as liquidator to all the closed banks. The achievements of the Corporation as liquidator of the failed banks include the following:

a. Payment of Liquidation Dividend to Depositors

In addition to the payment of insured depositors of the closed banks, depositors with credit balances in excess of the guaranteed amount were paid liquidation dividends based on the volume of proceeds of the closed banks' assets realized by the Corporation. As at December 31, 2001, the Corporation had declared an aggregate dividend of N5.67 billion for 27 out of 33 banks in liquidation. Out of this amount, about N2.9 billion representing 51% of the total amount declared had been paid.

Of the 27 banks, 5 banks had declared final dividend of 100 per cent while the remaining banks declared dividends ranging from 10 to 82 per cent. In other words, all the depositors in the 5 banks had fully recovered their deposits, both insured and uninsured.

b. Payment of Liquidation Dividend to General Creditors

Similarly, liquidation dividend had also been paid to some general creditors of some of the banks. For example, the general creditors of Pan African Bank (in liquidation), a state-owned bank, had been paid a total of about N163 million. The amount represented about 90% of the total amount of N180.54 million declared as liquidation dividend in favour of the creditors of the bank as at the end of December, 2001. Likewise, the shareholders of another bank, Nigerian Merchant Bank (in liquidation), had received liquidation dividend of N450 million which was far in excess of their equity interest of N50 million.

c. Recovery of Loans & Advancement

The total book value of the loan portfolio of the 33 banks in liquidation stood at N35.37 billion as at January 16, 1998. Recoveries made since commencement of liquidation up to December 31, 2000 amounted to N3.79 billion.

3. Other Activities of the NDIC Which Have Facilitated The Achievement Of Stability In The Banking Industry.

a. The Promulgation of the Failed Bank Act

The promulgation and implementation of the Failed Banks (Recovery of Debts) and Financial Malpractices Act No. 18 of 1994 was in response to the inadequacies of the existing laws, court processes and procedures with respect to debt recovery and prosecution of perpetrators of financial crimes in the banking industry. Thus the main thrust of the law was to facilitate the recovery of debts owed to failed banks and to subject individuals involved in the monumental incidence of financial malpractices in the distressed banks to due process. The highly acclaimed successful implementation of the Failed Banks Act which was facilitated by the NDIC was indeed a major plank in the battle to contain distress and promote the soundness of the Nigerian banking system. A total of 3,714 cases were filed before the Tribunals; N8.99 billion was recovered, while judgment in respect of N2.3 billion, $67.04 million, and 5.021 million pounds had been delivered. With the advent of democratic rule in 1999, the special-purpose vehicle for debt recovery (that is Failed Banks Tribunal) was abolished and all the undecided cases were transferred to the Federal High Court. Since then, the recovery of debts owed to failed banks remained an intractable problem.

b. Bank Customers' Enlightenment

The corporation has, since its establishment, been providing financial information on insured banks to the general public. Such information had enabled the public to have a better understanding of the banking system. The dissemination of financial information is done through the corporation's Annual Reports and the NDIC Quarterly. Other publications which have aided public enlightenment include a pamphlet, 'Facts about NDIC' and two books written on Deposit Insurance by the staff of the Research Department. All these publications are now being regarded by operators and the academia as veritable sources of information on the banking industry.

In addition, top quality courses, seminars, workshops and endowment of Chairs to chosen departments in Nigerian Universities are widely acclaimed as successful capacity building initiatives by the NDIC.

2.13.6 CHALLENGES FACED BY DEPOSIT INSURANCE SCHEME IN NIGERIA

Despite the modest achievements highlighted in the preceding paragraphs, this corporation faces a number of challenges in implementing the DIS in Nigeria. These are discussed below.

1. Public Perception and Public Awareness of the DIS

On the one hand, the concept and operational activities of DIS are still being confused with those of conventional insurance business for protection against incidents such as fire tornado, automobile accidents and so on, by those who are supposed to know. It is this confusion that is responsible for the lack of understanding with respect to areas related to coverage, membership and even premium rate. For instance, the agitation for 100% coverage has been heightened under the current democratic governance as some of our lawmakers and members of the public are clamoring for complete coverage. This is largely due to the wrong perception of the scheme.

On the other hand, there is inadequate awareness of the existence of the scheme and the role of the NDIC, particularly by the banking public and especially amongst small depositors. Arguably this is one of the reasons that have contributed to the low response by depositors to file their claims. The Corporation had to extend, twice, the 18-month period for filing claims for payments of insured deposits. Such misunderstanding, confusion and lack of awareness could erode public confidence and undermine market discipline.

2. Clamour for Increased Coverage

There has been a great clamour for increase in the deposit insurance coverage. Even the proposed increase of insurance cover from N50, 000.00 to N100,000.00 has been criticized as inadequate. The Corporation has consistently argued that an unduly high coverage will create a perverse incentive and expose the DIS to moral hazard. A survey conducted by the Corporation revealed that up to 90% of depositors are covered by the proposed coverage.

3. Clamour for Risk-Based Premium Assessment

Some operators have advocated the introduction of Risk-Based Premium Assessment as against the present flat-rate assessment method. While the Corporation appreciates the concerns of the advocates of risk-based premium assessment, it is of the firm view that caution should be exercised in adopting it. The parameters for risk-based assessment have to be clearly defined. The integrity of prudential returns should not be in doubt. Public perception of "riskier banks" which could trigger flight to safety by depositors could be counter-productive. The Corporation would prefer a gradual transition from flat-rate assessment to risk-based premium assessment.

4. Reduction of Premium Rate

The premium rate of 15/16th of 1% has been criticized while operators had clamoured for a reduction. The Corporation had explained that the rate was informed by the need to rapidly build up the DIF against the background of pervasive distress in the banking system at the time the rate was fixed. The Corporation has proposed the necessary amendment to the law to give it the discretion to vary the rate from time to time. The present provision of the law did not allow any discretion.

5. Determination of Bank Distress

The issue of determination of bank distress has emerged as a challenge in recent times. This resulted from the tendency to equate ability to meet obligation irrespective of the cost of borrowing to meet such obligations. Thus, a bank that is illiquid may be perceived as liquid. Also, supervisory sanctions imposed on some banks are interpreted to portend distress, thus leading to a run on such banks despite the fact that they are solvent and liquid. For example, banks penalized for violation of the Foreign Exchange Market rules and regulations were being perceived as distressed by the banking public.

6. Banking Supervision

The major challenges in this area have to do with the adequacy of enforcement power. Examiners' recommendations are not promptly implemented. The latest development is the resort to litigation by Principal shareholders and directors of banks to contest regulatory sanctions imposed on them.

Furthermore, it is the CBN that has the power to impose sanctions for the violations of the Banks and Other Financial Institutions Act (BOFIA). Consequently, the corporation has to refer infractions of BOFIA to the CBN for appropriate actions. The point being made here is that the corporation has very limited enforcement powers. However, proposals to review the corporation's enabling law have been made to the legislature.

7. Legal Framework

Rules and regulations guiding distress resolution in Nigeria flow directly from the provisions of the Banks and other Financial Institutions Act No. 25 of 1991 (as amended). With the series of amendments that gave operational independence to the CBN as regards withdrawal of banking license, the issue of enforcement powers in this regard is still a challenge to the Supervisory Authorities. The recent case of a commercial bank whose license was revoked but could not be closed because of court injunction is a test case. More importantly, the Corporation does not have the enforcement power to close any bank deemed to be in distress however bad the financial condition might be.

8. Prompt Reimbursement of Guaranteed Deposits When Banks Fails

One of the factors that often enforce public confidence in the DIS is the ability of a deposit insurer to promptly reimburse insured depositors of their insured deposits when their insured institution fails. Whereas the corporation had achieved a lot of success in its liquidation efforts, prompt payment of insured deposits to depositors had been very elusive. A significant number of depositors have not filed their claims. This problem is partly attributable to the low level of awareness of the DIS and apathy on the part of depositors with small credit balances. The corporation had to issue press releases to invite depositors to file their claims.

9. Corporate Governance

In Nigeria, one of the recurring challenges facing the corporation has been the need to ensure the transparency and accountability of management of banking institutions and the curtailment of their risk appetite. Some of the operators engage in unethical practices, including rendition of inaccurate or misleading prudential returns which undermine early detection of problems or weaknesses that require urgent supervisory action. Furthermore, the rapid growth in the number of banks over-stretched the available managerial capacity.

10. Advent of Universal Banking

The adoption of Universal Banking poses many challenges to the NDIC. There is the issue of market perception whereby the public believes that a bank is not insulated from the problem of its non-bank affiliates or subsidiaries. Such negative perception can precipitate a run on a bank with contagion effect which could in turn threaten the DIF. These concerns make it imperative for other regulatory agencies (mainly the securities and insurance regulators) to have in place an adequate and efficient investors protection scheme.

Furthermore, it is imperative to have regulatory restrictions on risk-taking by universal banks. In pursuance of this, the NDIC had presented the under-listed issues to financial market regulators for discussion:

- Banks should not guarantee or enhance the marketability of securities or debt instruments underwritten by their own affiliates for subsidiaries.
- Banks should not grant loans to clients for the purpose of repaying obligations relating to securities underwritten by their affiliates or subsidiaries.
- Affiliates/subsidiaries of banks should not be permitted to serve as issuing houses for stocks affecting their parent or affiliate banks.
- Banks' affiliates should publicly disclose that their liabilities are not insured by NDIC.
- The existing Prudential Guidelines for banks which place greater emphasis on credit risk, asset classification, income and loss recognition require a comprehensive review to accommodate other risks to which universal banks will be exposed.
- There is need for clear guidelines for banking intra-group transactions such as sale and lease-back, swaps, back-to-back transactions.
- There is the need for the adoption of risk-based supervision by all the regulators of the financial services industry.
- Disclosure requirements by financial institutions should be reviewed and enhanced to facilitate market discipline.

The above list is by no means exhaustive.

2.13.7 PROSPECT OF THE SCHEME IN NIGERIA

In spite of the challenges indicated above, there appears to be prospect for the long-term goal of the deposit insurance scheme in Nigeria. The optimism is based on following:

1. The continued efforts at improving the Corporate Governance of banks especially the continued encouragement of banks by the regulatory supervisory authorities on the need to always adopt employment policy which will guarantee that staff recruited satisfy the "fitness and properness" criteria. This effort has taken two broad forms, namely:

   - The specification of minimum qualification and experience required of board membership and top management positions by the CBN in 2001. This will go a long way in addressing the problem of inexperienced top management staff and will also help to address the observed problem of inadequate corporate governance prevailing in the system.
   - The regulators facilitated the newly adopted code of ethics and professionalism for bank employees which is also aimed at evolving responsive corporate governance in the nation's banking system.

2. The recently released Contingency Planning Frame-Work for handling systematic crisis has made the determination if distress and handling if distress situation more transparent and more objective than hitherto.
3. The automation of rendition of prudential returns by licensed banks through a computerized Banking Analysis System (BAS). BAS was designed to enhance data capture and analysis by the bank regulators.

4. The proposed amendments of the enabling laws for conducting banking business are expected to address the challenges posed by the advent of universal banking as well as inadequate enforcement powers with respect to bank closure and liquidation.
5. The continued efforts of the CBN and the NDIC to enhance the scope of their supervisory activities through consolidated supervision, risk-focused supervision and capacity building are likely to impact positively on the safety, soundness and stability of the banking system.
6. The establishment of the Financial Services Regulation Coordinating Committee (FSRCC) which encompasses all regulators/supervisors of the financial system would go a long way to improving the supervision of financial conglomerates as well as minimize regulatory arbitrage opportunities being exploited by market operators. The key responsibilities of the committee are to coordinate and harmonize the supervision of all market participants in the system and to ensure effective information sharing amongst regulators/supervisors.
7. The hope for the emergency of a stable macro-economic environment with few relative price distortions would enable business enterprises, both individual and corporate, to generate stable income to repay bank loans.
8. An increase in public awareness about the existence of deposit insurance scheme through closer relationship with the Nigerian press will go a long way in boosting public confidence in the scheme and by implication, the nation's banking system.

   The disposition to implement the policy of "free entry and free exit" has compelled banks to operate in a safe and sound manner.

2.14.0 THE IMPACT OF PUBLIC POLICY ON THE BANKING SYSTEM IN NIGERIA

This section explores the impact of government policies on the development of banking in Nigeria in the period since independence. It examines how banks were affected by public ownership and policies of financial repression, the reasons behind the growth of local private sector banks, the policy-related causes of the financial distress in the banking industry and the efficacy of the financial reforms undertaken since 1987 with a view to determining the impact of regulation.

The banking system in Nigeria has undergone radical changes during the 35 years since independence. Banking developed from an industry which in 1960 was dominated by a small number of foreign owned banks into one in which public sector ownership predominated in the 1970s and 1980s and in which Nigerian private investors have played an increasingly important role since the mid 1980s. Government policies had a major influence on developments in the banking industry. Extensive government intervention characterised financial sector policies, beginning in the 1960s and intensifying in the 1970s, the objective of which was to influence resource allocation and promote indigenisation. Since 1987 financial sector reforms have been implemented, encompassing elements of liberalisation and measures to enhance prudential regulation and tackle bank distress.

The three largest banks currently operating in Nigeria (sometimes referred to as first generation banks) have their origins in the colonial period. The British Bank for West Africa (now called First Bank) was incorporated in 1894, the Colonial Bank, later acquired by Barclays and now known as Union Bank, began operations in 1917, and the British and French Bank, the precursor of the United Bank for Africa, started in 1949. All three were originally wholly foreign owned but the Federal Government purchased majority share holdings in the mid 1970s. These banks encountered little serious competition during the colonial period. Although a number of banks were set up by Nigerian investors during the so-called free banking era prior to the enactment of the first banking legislation in 1952, most failed within a few years of opening.

Beginning around the time of independence, a second generation of banks was set up in Nigeria. The first group of second generation banks were also mainly foreign owned. They included the Banque Internationale Pour L'Afrique Occidental (BIAO), now called Afribank. This was followed in the 1970s by the establishment of commercial banks by the state governments in Nigeria and by the entry of a number of merchant banks, mostly as joint ventures between foreign investors and the Federal Government and/or private investors. The Federal Government took controlling shares in all of the foreign owned banks in the mid 1970s, and enacted an indigenisation decree in 1977 which limited foreign participation in banks to a maximum 40 per cent of equity. By 1980 there were 20 commercial banks and six merchant banks in operation, in all but a few of which the Federal Government or state governments were the majority shareholders.

A third generation of banks emerged during the 1980s. Some of these banks were set up by state governments but the majority was started by Nigerian private investors. The growth of the local private banks was very rapid after 1986, particularly in the merchant banking sector.

By 1992 there were 66 commercial banks and 54 merchant banks in operation in Nigeria.

Despite the growth of new entrants however, the three largest banks have retained their dominance of banking markets, accounting for 48 per cent of the total deposits of the commercial banks in 1994, while Afribank accounts for a further 7 per cent.

Since the late 1980s the banking industry has been afflicted by widespread financial fragility: 57 banks, almost half the total number of banks in operation, were regarded as distressed or potentially distressed by the regulatory authorities in 1995. Most of the distressed banks were owned by state governments or the local private sector.

2.15.0 BANKING SECTOR POLICIES IN NIGERIA

The banking sector has been subject to extensive regulation by the CBN as well as direct participation by the Federal Government and state governments during the post-independence period. Economic nationalism and developmental aspirations were important motivations for interventionist policies. The character of these policies was that of financial repression, in that controls depressed interest rates and channeled resources away from areas where private rates of return would have been maximised. The allocative controls have been liberalised to some extent since 1986, although controls over key areas remain in force.

The domination of banking by expatriate banks during the colonial period provoked considerable resentment among Nigerians, including businessmen and politicians. The expatriate banks were perceived as acting solely in the interests of their foreign owners rather than of Nigerians and of the Nigerian economy. In particular they were accused of discriminating against indigenous businesses in the allocation of loans, and failing to finance the developmental needs of the country, instead concentrating on the provision of short-term trade related finance to foreign companies. Consequently government objectives following independence included securing greater local control over the banking system, and ensuring improved access to credit for indigenous businesses and priority sectors (Nwankwo 1980).

During the 1960s the CBN was given extensive powers to regulate the quantity, cost and direction of bank credit. These powers were used to further monetary control (a priority throughout most of the post independence period because of inflationary pressures in the economy) and the objectives of influencing resource allocation and indigenisation. The main instruments of monetary policy were aggregate ceilings on the expansion of banks' credit, while sectoral credit guidelines and interest rate controls were used to influence the direction and cost of credit. From 1969 onwards the controls over the banking system were set out in annual monetary policy circulars issued by the CBN.

The 1969 Banking Decree empowered the CBN to set the structure of bank interest rates, specifically minimum deposit rates and minimum and maximum lending rates, with priority sectors (e.g. manufacturing, agriculture, etc.) subject to preferential lending rates. The controls held nominal deposit and lending rates below the rate of inflation in most years during the 1970s and 1980s.

The direction of bank credit was influenced through guidelines issued by the CBN stipulating the minimum and maximum percentage shares of a bank's total loans to be allocated to particular sectors and to indigenous businesses. Additional guidelines prescribed minimum levels for lending to small-scale enterprises and loans extended in rural areas. The merchant banks were also subject to guidelines stipulating the term structure of their loan portfolio: these were designed to ensure that they undertook medium and long-term lending (Soyibo and Adekanye 1992). Banks which failed to comply with the prescribed limits were subject to penalties or had to transfer to the DFIs or CBN any shortfall in lending to priority sectors, a course of action which banks often preferred rather than extending loans to borrowers perceived as uncreditworthy or too costly to service (Ndekwu 1994: 150). The effectiveness of the guidelines in channeling credit to the priority sectors was limited: Bank lending frequently fell short of the minimum prescribed for the preferred sectors, particularly to agriculture (Oyewole 1994: 97-99). Moreover the sectoral definitions were not always clear, which together with the fungibility of credit, further reduced the impact of the guidelines in directing credit towards the priority sectors.

A rural banking programme was initiated in 1977 under which the commercial banks were provided with targets to establish specified numbers of branches in the rural areas over the following decade. The objectives were to attract cash held in the rural areas into the banking system so as to increase the effectiveness of monetary policy, extend rural credit facilities and spread the banking habit (Adegbite 1994: 41). The banks were expected to set up over 750 rural branches under the programme.

Oyewole (1994: 98) presents data showing that during the 11 years from 1975 to 1985, the aggregate lending of the commercial banks to agriculture met the prescribed sectoral target in only one year, as did that of the merchant banks. The average share of loans to agriculture in total commercial bank lending was 6.7 per cent in this period, compared with an average for the minimum prescribed share of 7.8 per cent, the comparable figures for merchant banks were 3.6 per cent and 5.1 per cent respectively.

The sharp fall in Nigeria’s oil revenues in the first half of the 1980s precipitated a severe economic crisis which exposed the adverse consequences of the wide ranging regime of controls imposed on the economy, including controls on the financial sector. In response, the Federal Government embarked on a major shift in economic strategy in 1986 with the adoption of a structural adjustment programme (SAP). As part of the switch towards more market oriented policies, some of the allocative controls over financial markets, such as those over interest rates, have been liberalised, albeit in an inconsistent manner.

2.16.0 THE PERFORMANCE OF PUBLIC SECTOR BANKS IN NIGERIA

2.16.1 BANKS WITH FEDERAL GOVERNMENT OWNERSHIP

Public sector ownership has been a dominant feature of the banking system in Nigeria since the mid 1970s, although its importance has diminished with the growth of the local private sector since the mid 1980s and the sale of Federal Government equity to the private sector in 1992/93. During the 1970s the Federal Government acquired controlling equity stakes in the first and second generation foreign banks in Nigeria. Most of these were subsequently operated as joint ventures with the foreign shareholders which retained minority stakes, which included Standard Chartered, Barclays (which subsequently disinvested), Banque Nationale de Paris, BIAO, Bank of America and Bank of India. The Federal Government had major share holdings in eight commercial and five merchant banks, nine of which were joint ventures with foreign investors: it also had a minor stake in one other merchant bank. The banks in which the Federal Government had a share holding included the four largest commercial banks and three of the five largest merchant banks ranked according to total assets in Nigeria. As part of the privatisation programme, the Federal Government sold most of its equity holdings in seven commercial banks and two merchant banks to Nigerian private investors in 1992/93, although it threatened to re-establish controlling stakes in the four largest commercial banks in 1995.

The motivation for Federal Government equity participation in banking was the desire to control strategic industries and to further the policy of indigenisation. The Federal Government's explicit policy towards the banks in which it held equity was to appoint board members, including the chairman, and to set out the broad outlines of policy while leaving day-to-day operational decisions to the banks' management, which initially was largely controlled by the foreign shareholders (Nwankwo 1980: 74-77). Federal Government ownership of banks therefore reinforced the controls employed by the CBN to influence resource allocation by the banking industry, most notably in three different aspects of banking policy.

First, the management of the Federal Government banks was almost entirely indigenised by the end of the 1980s: only a few specialised posts were still filled by expatriates. Second, these banks were in the forefront of the programme to establish branches in the rural areas. Third, credit policies were influenced by 'policy lending', i.e. extending credit to the public sector, to locally owned businesses and to the priority 'productive sectors' as set out in the credit guidelines. The second and third of these developments adversely affected the banks' financial performance. Most of the rural branches established under the rural banking programme have not been profitable mainly because the volume of business generated in the rural areas has been insufficient to cover overheads. The banks accumulated substantial volumes of non performing debts as a result of lending to the public sector or as a result of lending in line with credit guidelines. The accumulated non performing loans of the four largest commercial banks amounted to an average of 40 per cent of each bank's total loan portfolio in 1994 (Agusto and Co, Appendix 1, P 24).

The financial performance of the Federal Government banks during the 1970s and 1980s does not appear to have been very good while the quality and efficiency of their services were poor. The four largest commercial banks all recorded profits during this period, although their returns on assets were low and returns to equity not especially impressive when inflation is taken into account. However, assessment of their financial performance is impeded because, until 1990 when the CBN issued new prudential guidelines, they were not required to classify loans according to quality and make provisions for non performing loans, or to suspend the accrual of income from unpaid interest. Hence published accounts are likely to have overstated earnings. When the new prudential guidelines were introduced in 1990, First Bank recorded large losses as a result of having to make provisions for bad debts, while the profits of the other three major banks were sharply reduced. Their financial position would have been less secured had they not been allowed to spread the necessary provisions over a period of four years.

Nevertheless the four major Federal Government banks remained solvent and avoided the distress which afflicted many of the state government and private sector banks in Nigeria, as well as public sector banks in some other African countries. These banks have avoided serious trouble for a number of reasons.

First they have employed experienced and conservative management, in part because of the influence of their foreign shareholders, but also because the Federal Government ensured that its appointees to executive positions were experienced professional bankers. Second, their portfolio management has generally been cautious: they have remained very liquid, restricting loans as a share of total assets to below 40 per cent in most years, which has reduced the adverse impact of non performing loans on their balance sheets. Their size has also ensured that their loan portfolio has been well diversified.

Third, given their international links and their historical position as the dominant banks in Nigeria, the Federal Government banks have had a base of 'prime' borrowers among the multinational companies operating in Nigeria. Fourth, competition among the large banks has been limited by the regulatory controls over, inter alia, interest rates, and, prior to 1986, by barriers to new entry into the industry. They have also had access to public sector deposits, which together with the interest rate controls, has ensured that their average cost of funds was low, which helped to offset their high overheads.

2.16.2 BANKS WITH STATE GOVERNMENT OWNERSHIP

The involvement of the regional and state governments in banking dates back to the 1950s. Two of the earliest indigenous banks, National Bank and African Continental Bank, had close links with politicians in the Western and Eastern Regional Governments. The regional governments acquired equity in these banks when they got into financial difficulties in the mid 1950s and eventually became the majority shareholders. In 1959 the Bank of the North was established by the Northern Regional Government in partnership with Lebanese investors. Another indigenous bank (Agbonmagbe Bank, since renamed Wema Bank) was taken over in 1969. During the 1970s the state governments, which had replaced the regional governments in the late 1960s, began setting up their own banks; by 1980 there were ten banks in which state governments held equity and this number had risen to 25 by 1989. The primary motivation of the state governments in setting up these banks was to access funds for development projects in the states and to expand lending to indigenous businesses (Nwankwo 1980: 74).

Most of the state government banks are joint ventures with local private investors; state governments hold majority share holdings in 11 of these banks and minority share holdings in the other 14. The state government banks accounted for 20.5 per cent of total commercial bank assets in 1994. Most of these banks are relatively small; only two (Wema Bank and Bank of the North) are among the largest ten banks in terms of lending.

The financial performance of most of the state government banks has been very poor. Ten distressed state government banks were taken over by the CBN during 1992-95, and it is very likely that several more state government banks are among the more than 50 banks regarded as distressed by the regulatory authorities (with the exception of those taken over by the CBN the distressed banks have not been officially named). In addition to the banks taken over by the CBN, a further three state government banks have not published annual reports for at least two years. The banks which appear to have remained solvent are mainly those in which state government participation has been limited to minority share holdings.

The scale of the financial difficulties facing the state government banks is evident from data published by the Nigeria Deposit Insurance Corporation (NDIC). The state government banks as a whole made losses amounting to N0.7 billion and N1.2 billion in 1993 and 1994 respectively (the latter figure was equivalent to 75 per cent of their total paid-up capital). Twelve state government banks recorded a liquidity ratio, averaged throughout 1994, which was less than the statutory minimum of 30 per cent of their deposits. Sixty per cent of the total loans and advances of the state government banks were classified (i.e. non performing) in 1994. As a consequence of their non performing loans, the capital and reserves of the state government banks had been eroded to an aggregate of negative N8.4 billion (approximately $100 million) in 1994. A total of N10.2 billion was required to restore capital adequacy to the statutory minimum levels (NDIC 1994: 8-16).

The poor financial performance of the state government banks is not just a recent development, although it has become more evident during the 1990s because of the imposition of the stricter prudential regulations in relation to loan classification and capital adequacy, and the tightening liquidity position. Ibe (1992) assessed the performance of banks in Nigeria during the first half of the 1980s in terms of their ownership. The 14 state government banks were only marginally profitable: rates of return (after tax profits) to shareholders' funds averaged only 3 per cent compared to 24 per cent for the non state government banks. The 1985 Annual Report of the CBN noted that management and accounting systems were unsatisfactory in state government banks and that bad debts had depleted capital (CBN 1985: 118).

The financial problems afflicting the state government banks are attributable to a number of factors. The quality of their management has been very poor because of political interference in the appointment of directors, managers and staff. Appointments were determined by political patronage rather than merit while boardroom disputes and the insecure tenure of board and management due to frequent changes in the political control of state governments further undermined the quality of management (Ebhodaghe 1994: 17). Earnings have been eroded by high operating expenses: the 14 state government banks in the survey by Ibe incurred operating expenses amounting to 76 per cent of net earnings compared to 49 per cent for other banks (Ibe 1992: 250). Many of the banks were set up without adequate capital and were unable to meet the minimum capital requirements when these were raised in the late 1980s and early 1990s.

The most important cause of the financial distress of this sector has been the accumulation of bad debts, including those extended as a result of political interference to their own governments and to politically influential borrowers. As noted above, 60 per cent of their total loan portfolio was non-performing in 1994. In June 1991 the non performing loans owed by the state governments to state government and distressed banks amounted to N795 million: this was equivalent to 16 per cent of the total classified loans of the state government banks in 1991 (Ebhodaghe 1992a: 12; NDIC 1992: 17). The fiscal crises afflicting the state governments since the early 1980s have undermined their ability to service their debts and to recapitalise their own banks. Frequent changes of government at the state level have exacerbated the problem of non performing debt, as incoming governments have not regarded the servicing of loans contracted by previous incumbents as a priority.

2.16.3 THE GROWTH OF THE LOCAL PRIVATE SECTOR BANKS

Since the mid 1980s the locally owned private sector banks (henceforth local banks) have grown rapidly, and now account for a substantial share of commercial and especially merchant banking markets.11 local banks are defined here as those banks which were set up with local private sector investors as the major shareholders, rather than by foreign investors or the public sector. In 1992 there were 33 local commercial banks and 48 local merchant banks in operation. Foreign investors held minority stakes in seven of the local commercial banks and seven of the merchant banks;e1

the rest were wholly owned by Nigerian private investors. Most of these banks were set up between 1986, when financial markets were first liberalised, and 1991, when the CBN suspended issuing new licenses in response to the emerging signs of distress in the industry. The local banks are very heterogeneous: whereas a few banks have grown into major market participants, establishing a reputation for providing efficient professional services and attracting a blue chip corporate clientele, many others have been associated with fraud and mismanagement and have experienced severe financial distress in the 1990s.

The first local banks were established in Nigeria during the late 1920s and 1930s at a time when banking was effectively unregulated and entry unrestricted. The banks were set up by local businessmen, many of whom had encountered difficulties in obtaining credit from the expatriate banks. After the end of the Second World War, there was an indigenous banking boom with 185 so called 'mushroom banks' registered between 1947 and 1952, although most did not actually commence operations. Most of the banks that did start operating collapsed within a few years due to a combination of mismanagement, insider lending and inadequate capitalisation. Only four of the banks set up by local investors during the colonial period survived until independence in 1960, all with the aid of substantial financial support from the regional governments whose explicit policy was to support the efforts of indigenous banks to finance local businesses. These banks were also used to finance political activity and to channel loans to party supporters as well as the banks' directors. The introduction of the 1952 Banking Ordinance, which for the first time in Nigeria imposed entry conditions for banks such as minimum capital requirements, and the loss of public confidence induced by the failure of local banks, brought the indigenous banking boom to an end by the mid 1950s (Nwankwo 1980: 45-53).

For a period of almost 25 years until the mid 1970s, few new banks were set up by Nigerian private investors: new investment in banking was largely initiated by foreign banks and the public sector. The Nigerian private sector began to return to banking in the mid 1970s, initially in partnership with foreign investors. From the mid 1970s until 1986, 13 private sector banks were set up in which Nigerian investors were majority shareholders: in ten of these banks foreign investors, mostly established foreign banks such as Société Générale, Citibank and Grindlays held minority stakes (the 1977 indigenisation decree barred foreigners from holding majority stakes). The 1970s were a period in which investment opportunities in the Nigerian economy expanded rapidly due to the oil boom, and in which a substantial Nigerian capitalist class emerged. The fact that Nigerian private investors entering banking, without foreign partners, were so few up until the mid 1980s is therefore rather surprising. It is probably at least partly attributable to restrictive licensing policies adopted by the authorities.

Following the introduction of the SAP in 1986 local banks were set up in much larger numbers. During 1987-92, approximately 27 local commercial banks and 42 local merchant banks were established. Not only did the rate of new entry accelerate sharply in this period, but there was also a qualitative shift in the composition of ownership, with foreign partnership limited to only four of these banks. The rest were wholly owned by the Nigerian private sector. The late 1980s and early 1990s also saw the rapid growth in the number of finance houses, some of which were affiliated to banks. In 1992, 666 finance houses were operating, but many subsequently collapsed.

The growth in the local banks can be attributed to several factors. First, the inefficiencies of the public sector banks provided opportunities for new entrants to target corporate and high income urban customers. The local banks were able to attract these customers by offering higher interest rates on deposits following interest rate deregulation in 1987. A few of the local banks have attracted customers by providing more efficient services, such as much faster loan appraisals, and innovative products.

Second, many of the banks were set up primarily so that their owners could obtain foreign exchange which could be resold at a premium. The foreign exchange market was liberalised in 1986, with the introduction of a foreign exchange auction system. Although the specific mechanism changed several times, the essence of the system involved the CBN auctioning the available foreign exchange to the banks: only the banks were authorised to bid for foreign exchange, which were then expected to supply their customers. To ensure that the available foreign exchange was distributed widely among the banks, ceilings were placed on the amount which each bank could bid for. The auction system did not eliminate the parallel market, in which a premium over the auction rate could be obtained from the sale of foreign exchange. This premium averaged 33 per cent during 1987-90 (Olisadebe 1991: 178). Consequently those with access to the foreign exchange auction could make substantial profits by reselling the foreign exchange at parallel market rates. In 1989 bureaux de change began operating, in which exchange rates approximated those on the parallel market: this provided another outlet for the banks to resell foreign exchange purchased from the auction.

Olisadebe (1991) provides an account of the foreign exchange auction systems used in Nigeria. The restriction of access to the auction to banks, combined with the allocation system which meant that even small banks were able to obtain foreign exchange, provided a powerful incentive for investors to establish banks, even if they had no interest in conducting more conventional banking business.

Third, some of the banks have been set up in order to channel customer deposits into the business ventures of their owners and to conduct other types of fraud. How extensive this has been is impossible to estimate as evidence of frauds of this nature usually only comes to light when banks are liquidated. So far only four local banks have been liquidated although many more are distressed. Each of the four liquidated banks was used for extensive insider lending, suggesting that abuses of this nature may be widespread.

Fourth, the criteria for granting banking licenses appear to have been relaxed and politicised in the second half of the 1980s. The Federal Ministry of Finance had the authority to grant licenses, with the Presidency and Federal Executive Council also involved in reviewing applications. Political influence was used to obtain licenses for applicants, many of whom had no banking experience, but did have links to the military. Moreover, the minimum capital requirements were eroded by inflation during the 1980s. By 1987 it was possible to establish a commercial bank with paid-up capital equivalent to less than $350,000 and a merchant bank with less than $0.5 million.

The local banks are urban-based and have small branch networks. Most have avoided traditional retail banking, instead concentrating on foreign exchange dealing, foreign trade financing, the financing of local businesses, and various forms of off balance sheet business.

A relatively small number have grown into major participants in the banking market: two are among the largest ten banks ranked according to deposits, while several more have gained an important share of the lucrative market for corporate finance. Many others, especially the merchant banks, have remained fringe players in the banking markets: some are little more than single branch finance houses relying on high cost wholesale deposits for funds and lending to the least creditworthy sections of the market, including to other banks and finance houses facing liquidity shortages. Inter-bank funding was a major feature of the liability structure of the local merchant banks, accounting for 44 per cent of the merchant banks' total local currency deposits in 1990/91, although its importance has diminished sharply since 1992 for reasons discussed below (Agusto and Co 1995: 17). There is a serious shortage of qualified and experienced managers in the local bank sector, and boardroom disputes, caused in part by the practice of fronting, whereby shareholders appoint nominees to circumvent restrictions in the banking laws on equity concentration, are commonplace (Ebhodaghe 1992b).

Most of the local banks were able to generate high profits during the second half of the 1980s: the cost of deposits was generally low and foreign exchange dealing was lucrative. A group of around ten local private sector banks has continued to generate reasonable profits during the 1990s, despite the problems afflicting other banks in the industry, and appears (although balance sheet data can be misleading) to have avoided serious problems with bad debt. However, many other local banks have run into serious difficulties. Four local banks were liquidated by the CBN in 1994, and a further 13 distressed local banks were taken over by the CBN in September 1995. Two other banks had their licenses suspended for persistent infractions of the banking laws in 1994 (one of which is still suspended). The merchant banks have been hardest hit by the distress in this sector: 12 of the 17 local banks liquidated or taken over by the

CBN are merchant banks. The financial distress of the local banks is attributable to the combination of bad debts, due in particular to insider lending, and a tightening of liquidity in the banking system.

Although data on the loan quality of the distressed local banks is not publicly available, a crude estimate can be obtained by subtracting data pertaining to the 25 state government banks from the aggregate data pertaining to all 45 banks considered distressed at the end of 1994, which are published by the NDIC (NDIC 1994: 9 and 43). This estimate suggests that the non-performing loans of the distressed local banks amounted to around N13.5 billion

Financial distress almost certainly involves many more local banks than those which have been liquidated or taken over so far. An additional seven local banks have not published accounts for at least two years. Moreover, there were a reported 57 banks (both public and private) regarded by the authorities as distressed in March 1995: assuming that at most 20-25 of these are Federal or state government banks, the remaining 32-37 must be local banks. As such, financial distress afflicted nearly half the 81 local banks operating in 1995.

Bad debts arose as a consequence of the difficult macroeconomic environment - increased interest rates, reduction of protection and subsidies, and economic stagnation undermined the ability of borrowers in the real sector to service their loans - and mismanagement and fraud in the banks. Prudent lending practices were not followed because boards of directors did not provide honest and effective leadership. Often being more concerned with securing credit facilities for themselves, managers were inexperienced and often lacked independence from major shareholders, while credit policies and internal controls were poor or non-existent (Mamman and Oluyemi 1994).

Insider lending is a major cause of the bad debt: insider loans accounted for 65 per cent of the total loans of the four local banks liquidated in 1994, of which less than 1 per cent has been recovered by the liquidator (NDIC 1994: 48). In addition, it is likely that inter-bank market defaults have contributed to the fragility in this sector: some of the distressed banks relied heavily on inter-bank deposits and their inability to repay their liabilities would have spread distress to other banks. The collapse of large numbers of finance companies in 1993, to which some of the local banks were exposed, also exacerbated distress among the local banks (Agusto and Co 1995: 40).

The second aspect of the distress among the local private sector banks was their worsening liquidity position. This was caused in part by their own internal problems - the deterioration in loan quality and therefore earnings - and partly by exogenous developments. During the second half of the 1980s the local banks were able to access funds from customers wishing to purchase foreign exchange, from depositors attracted by competitive deposit rates, and from the inter-bank market. However, as the number of banks expanded, competition for deposits increased while the authorities intensified their efforts to reduce bank liquidity because of mounting inflation. In 1989 the Federal Government ordered that all public sector deposits should be transferred from the commercial and merchant banks to the CBN. The CBN and NDIC had subsequently to provide N2.3 billion in loans to banks unable to meet their inter-bank obligations (Ebhodaghe 1991: 13).

Another indicator of the asset quality of the local banks can be obtained from aggregate data pertaining to the merchant banks, approximately 68 per cent of the assets of which are held by local banks (NDIC 1992: 36). In 1994, 64 per cent of the merchant banks' total loans and advances were classified as non-performing (NDIC 1994: 9). As these figures cover all merchant banks, both non-distressed and distressed, the non-performing loans of the distressed merchant banks are an even larger percentage of their total lending.

Two of the liquidated merchant banks had respectively 68 per cent and 84 per cent of their total deposit liabilities from Inter-bank deposits (Manu 1994: 20).

This was followed in the early 1990s by the issuance of stabilisation securities by the CBN to those banks with excess liquidity. The consequence was a reduction in the aggregate liquidity of the banking system which contributed to a sharp rise in interest rates on inter-bank deposits. Inter-bank rates rose to 115 per cent in December 1992. Moreover the availability of funds on the inter-bank market diminished sharply when some banks began to default on their inter-bank market obligations in 1992/93 and when the finance companies began to collapse in 1993. As the scale of the fragility in the industry became apparent, depositors withdrew funds from banks suspected of being distressed into those perceived as being more secure. The difficulties involved in deposit mobilisation combined with the non-servicing of a large share of their loan portfolios meant that the distressed banks became increasingly illiquid and overdrawn on their accounts with the CBN.

2.17.0 THE IMPACT OF FINANCIAL LIBERALISATION ON BANKING

Since 1986/87 the financial system has been partly liberalised with the objectives of enhancing the efficiency of resource allocation and strengthening competition. Liberalisation has entailed the removal of some of the allocative controls, the easing of entry restrictions into banking, and has undoubtedly had significant effects on banking markets. The number of banks has expanded rapidly and this has increased competition in some sections of the banking markets, mainly those serving urban and corporate customers. The growth of the local private sector banks together with the privatisation of most of the Federal Government banks has also injected a greater degree of commercial orientation into the banking system.

Despite this, financial liberalisation may have had only a limited impact in terms of improving the efficiency of resource allocation in banking markets for several reasons. The deregulation of controls has been partial and inconsistent, high rates of inflation have impeded the attainment of positive real interest rates, large government deficits have absorbed a substantial share of bank finance, and mismanagement and fraud in public and private sector banks has led to extensive waste of resources.

Although the period since the mid 1980s is regarded as being one of financial liberalisation in Nigeria, important components of the control regime, in particular the sectoral credit guidelines, and those pertaining to the maturity structure of merchants banks' loans, remained in force. Interest rates were decontrolled in 1987, but the CBN has stipulated a maximum spread between deposit and lending rates since 1989, and ceilings on bank lending rates were imposed during 1991, removed in the following year and then re-imposed at the beginning of 1994. Hence there were administrative constraints on the ability of banks to allocate and price credit according to market criteria. The inconsistency of interest rate policy was a further impediment to allocative efficiency and in particular was likely to have discouraged intermediation in long-term financial instruments.

The decontrol of interest rates in 1987 allowed nominal deposit and lending rates to rise but the attainment of positive real rates was impeded by higher rates of inflation. The inflation rate was low in the mid 1980s when the SAP was first introduced, but increased to 38 per cent in 1988 and 41 per cent in 1989, largely because of the deficit financing discussed below. Inflation subsided during 1990-91 but accelerated again in the following year, averaging 57 per cent per annum during 1992-94. In both periods of high inflation, most nominal bank deposit and lending rates lagged significantly behind the inflation rate. In 1994 interest rates were subject to administrative ceilings (with the result that real rates were highly negative), but even when the banks were not constrained by the ceilings they were clearly reluctant to raise deposit and lending rates to the levels necessary to ensure that real rates were positive. It is possible that they were deterred by the maximum allowable spread, which may not have been sufficient to compensate them for the increased default risk which a substantial rise in lending rates would have entailed. During the period since the introduction of the SAP, the attainment of positive real rates of interest has only been possible when inflation has been limited to at most about 20 per cent per annum.

An important premise of market-oriented economic reforms is that the private sector utilises resources more efficiently than the public sector, at least in respect to the production of marketable goods. A key role for financial liberalisation therefore is to facilitate a reallocation of credit from the public to the private sectors. This did not occur in Nigeria because after 1987 the

Federal Government was unable to control the size of its budget deficit and hence its domestic borrowing. During 1990-94 the overall Federal budget averaged 10.6 per cent of GDP, of which 86 per cent was financed by the domestic banking system, mainly by the CBN. To counter the inflationary effects of deficit financing, the authorities took a number of steps to absorb bank liquidity, including the issuance of stabilisation securities.

The private sector was crowded out of credit markets as a consequence, although banks may also have cut back on lending to the private sector because they perceived it to be increasingly risky given the problems afflicting the real sectors of the economy. Credit to the private sector had increased as a share of total banking system credit during the late 1980s - from 47 per cent in 1986 to 63 per cent in 1991 - but then fell back sharply to 39 per cent at the end of 1994, while in real terms it was 33 per cent lower in 1993 than at the start of the SAP in 1986. (World Bank, 1994).

As well as reallocating credit from the public to the private sector, liberalisation is intended to improve the allocation of credit. But the increasing share of loans classified as non-performing, which amounted to 40 per cent of total bank loans in 1994, is evidence of extensive misallocation of credit by the banks. Not all of these loans were to the public sector. The fact that these loans were not serviced suggests that they were not used to finance viable projects. Although some of these loans were disbursed before financial markets were liberalised, many date from the late 1980s or early 1990s, including those extended by the local banks, most of which only began operations during the liberalisation period.

It is arguable that poor design and inappropriate sequencing of the reforms made a major contribution to the financial distress which emerged in the banking industry in the late 1980s and early 1990s, in three important respects. First, the prudential legislation was revised and supervisory capacities were strengthened only several years after the de facto liberalisation of bank licensing. Second, the reforms to the foreign exchange market, which introduced a managed auction, provided a strong incentive for private investors to set up banks, not to conduct conventional banking business but to obtain access to foreign exchange at preferential rates. Hence there were both opportunities and incentives for the rapid growth of banks which lacked the managerial resources to conduct prudent banking. Third, given the macroeconomic instability afflicting Nigeria, liberalisation of entry requirements and interest rates probably increased the risks of financial fragility for even well managed banks, in particular because it intensified competition for deposits and forced up nominal deposit and lending rates.

2.18.0 RECENT DEVELOPMENTS IN THE ORGANISATION OF BANKING SUPERVISION

Before discussing a supervisory model for Nigeria, there is need to appreciate what obtains in a similar setting. It is also important to mention that the ongoing debate on whether there should be a single supervisor or multiple supervisors within a country or monetary zone is beyond the scope of this paper. This is particularly because the preferred arrangement is yet to emerge as there are variations of the two worldwide.

While the single supervisor arrangement, separate from the Central Bank, is being favoured in Europe and some developed countries, the USA favours the multiple supervisors approach.

Those who canvassed for convergence of regulatory structure had put forward a lot of argument in its support. Some of the argument advanced for its adoption could be summarized as follows.

- Less chance for bureaucratic turf battles.
- Consolidated expertise under one roof, which expedites decision-making in case of a crisis.
- Joint team supervision is possible because of the consolidation of all the regulatory powers in one agency.
- It is more efficient as a one-stop-shop.

- Better co-ordination between the Central Bank and the Regulator is much easier to determine.
- Eliminates conflict and minimises any attendant regulatory bottlenecks.

The protagonists of the multiple regulators approach have also supported their position with the following argument:

- It ensures that special agencies maintain regulatory oversight over areas in which they have developed expertise.
- It makes room for expedited intervention in particular financial segments thus preventing risks of contagion.
- The Central Bank is actively engaged in the supervision of banking system and is able to react quickly to matters germane to the stability of the financial system as well as engender confidence in it.

In developing countries, a single supervisor model is not only preferred, such a supervisory body should be the Central Bank or it should be under its control. This preference is hinged mainly on the argument that central banks in developing countries are perceived to have expertise, independence, and credibility and also better placed to achieve and to maintain adequate funding during trouble times, according to Charles A. E. Goodhart (2000). Ruth de Krivoy (2000) has provided three reasons why banking supervisors should come under the Central Bank of Venezuela:

- Outside the Central Bank, there will be political interference with supervisors;
- Outside the Central Bank, there is a greater likelihood of corruption and inefficiency; and
- Outside the Central Bank, funding for banking supervision is less likely to be adequate.

In one of her conclusions, she emphasized that the Central Bank should "play a role in banking supervision, since the Central Bank is the lender of last resort." She thus emphasizes three requirements for the institutional framework that will best serve to promote stable money and sound and safe banking as follows:

- Rests upon politically independent institutions;
- Allows proper coordination between monetary policy and banking regulation and supervision; and
- Enables officials to anticipate systemic risk and to react to it in a timely and efficient manner.

In yet another conclusion, she reasons that “giving supervisory powers to an independent Central Bank is especially advantageous if public institutions are weak, coordination between different public sector agencies is troublesome or skilled human resources are scarce. A Central Bank is usually a country’s most prestigious and well-equipped institution, and is in good position to hire, motivate and keep skilled staff.”

2.18.1 Organisation of Banking Supervision in West African Monetary Union (WAMU)

The first monetary zone in West Africa known as West African Monetary Union (WAMU) is composed of eight French-speaking countries, namely: Benin, Burkina Faso, Cote d’Ivoire, Guinea-Bissau, Mali, Niger, Senegal and Togo. In 1990, the WAMU Banking Commission was established for the supervision of the banking system within the Union. The Commission is funded by the Central Bank of West African States and has its Secretariat in Abidjan, Cote d’Ivoire. The Commission carries out both on-site and off-site supervision of 64 banks and 26 other financial institutions in the Union. The total asset of the banking system was 5,300 billion CFA Francs equivalent to about US $7 billion as at 31st December, 2001.

The organisation of banking activities is governed by a uniform Banking Act for all member States of WAMU within a community-based framework. This entails that the WAMU Council of Ministers determines the general framework and ensures the overall cohesion of the community-based mechanism. The functions and powers of the various Authorities involved and the strategy for the coordination of their activities are spelt out in the general framework. Thus, banks and financial institutions are answerable to a triple authority in varying degrees. The three authorities are:

- Ministry of Finance in the country of location as the national monetary authority;
- The Central Bank of West African States, the issuing authority which manages the common currency (CFA Franc) and which drafts relevant regulations particularly in the area of banking. It also has the responsibility to supervise banks; and
- The WAMU Banking Commission which is responsible for the regulation and monitoring of the banking system within the union.

The framework is constantly reviewed in the light of developments in the world and the union's financial system.

The WAMU Banking Commission has the Governor of BCEAO as Chairman and 17 other members. It meets once in a quarter. It performs the following functions:

- Ensures compliance with requirements on the integrity and qualification of promoters and managers during licensing as well as adequacy of capital, technical and human resources;
- Monitors and determines the maintenance of an adequate balance between expenditure and income, solvency status, and liquidity condition;
- Helps to restructure, rehabilitate/or close any failed financial institution in an orderly manner.

The decision of the commission is legally binding on the parties concerned and could sanction banks that contravene banking laws, rules and regulations. It issues circulars to which banks should comply.

A single licensing mechanism was adopted in 1998 and that simplified the extension of offices by a licensed institution in a country to other member states. The BCEAO is the licensing authority.

The withdrawal of a license is always a problem as even when the commission has asked that a licence be withdrawn, the Minister of Finance of the country where the failed bank is located may not agree. That is a complicated problem for the commission.

The commission is proposing that a deposit insurance scheme be established to address the problem of bank closure since depositors will have financial protection up to the insured amount in the event of liquidation.

2.18.2 Organization of Banking Supervision in the EURO Zone

Banking supervision in the Euro Zone is the responsibility of each member state.

This is generally outside the ambit of their central banks. There are various committees put in place to harmonise and coordinate banking supervision within the zone. Except for these committees, the supervisory structures prior to the establishment of the Zone have largely remained unchanged. Let us briefly highlight the changes.

In furtherance of the protocols and treaties establishing the European Economic and Monetary Union (EMU) in October 1998 the Governing Council of the European Central Bank (ECB) established the Banking Supervision Committee (BSC) of the European System of Central Banks (ESCB). The BSC replaced the Banking Supervisory Subcommittee (BSSC) of the European Monetary Institute following the establishment of ECB and the Euro system. The Euro system is made up of the eleven national central banks of the countries forming EMU. Membership of the BSC is drawn from the 15 EU members states' central banks, the ECB, and banking supervisory authorities in each country.

The BSC is charged with the responsibility to assist in a smooth conduct of supervisory and financial stability policies within the zone. In order to achieve that, the BSC reviews developments in the banking and financial systems and also monitors the stability of the banking and financial sectors and promotes cooperation between the Euro system and banking supervisors. It also performs advisory services to ECB on the Euro system and banking supervisors, and also serves as the forum for consultations among the EU banking supervisors on issues not related to the supervisory functions of the Euro system.

The major role of BSC in the financial stability of EU is in the specification of institutional framework for financial stability. This is done within a variety of national structures and practices which are harmonised in line with the treaty establishing the European Community. Under the aegis of the EU Treaty, the Euro system is to contribute to the smooth conduct of policies pursued by competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system - Article 105 (5). Article 105(4) of the Treaty and Article 25.1 of the statute of the (ESCB) also accords an advisory function to ECB in the regulatory process of maintenance of the stability of the financial system in the monetary union States. Although Article 105(5) of the Treaty applies only to participating countries, the cooperation within the BSC involves all the central banks and supervisory authorities of the 15 member states. In order words, the BSC is the major forum for addressing the relevant issues of cooperation between the Eurosystem and the supervisory authorities of the EU countries.

The specific issue of prudential supervision within the mandate of the BSC includes, examination of macro-prudential issues, reviewing of development in the financial systems and the promotion of smooth exchange of information between the Eurosystem, banking and other supervisory authorities. In addition the BSC serves as the link pin or bridge between ECB and member states' National Central Banks (NCB) for the sharing of useful information on monetary policy and payment and securities settlement systems. This is done in order to facilitate the coordination needed between Central Banks and Banking Supervisors.

The BSC is also involved in macro-prudential analysis in the EU/euro area and at national level on the basis of a commonly agreed body of information. The framework for macro-prudential analysis relies on data obtained from the Central Bank and Supervisory Bodies and on the data on the macroeconomic and financial environment relevant to assessing the soundness of the banking sector. These indicators aim at capturing significant build- ups of risk exposure within the banking system, potential disturbances emerging from outside the banking system and channels of contention through which difficulties at one institution could spread to others. The BSC is also in close collaboration with other multilateral institutions both within and outside the EU states.

This is done in order to facilitate a global appreciation of the systemic and cross-border risks to which institutions in the member states are exposed with a view to mitigating them.

Another important organ in the Euro zone is the Banking Advisory Committee (BAC) which assists the European Commission (EC) in drawing up new proposals for European banking legislation which are to be presented to the European Parliament and the European Council. The body is also to see to the diligent application of directives, once adopted, by all the member states. The BAC is composed of high level representatives from each member state and the commission. In order to assist the BAC in its work on the correct application of the banking directives, a group on the interpretation of the banking directives examines a number of questions of interpretation either at BAC's request or on its own initiative. While the interpretation of a particular provision of a directive constitutes an important point of reference, it is not however legally binding on member States. The BAC also advises the commission on the need for EU banking regulations. Such banking regulation issues of priority to the committee includes the review of capital adequacy rules, presentation of proposals to the commission on the requisite legislative framework needed to facilitate effective supervision and the review of regulatory structures within and across the financial sectors in order to enhance their cooperation.

The broad mandate of the BAC allows it to extend beyond the geographical borders of the EU. The Commission involves and informs the BAC of wider international discussions in the field of banking regulation, supervision and cooperation.

Finally, another important body within the EU worthy of mention is the Financial Services Policy Group (FSPG). The FSPG consists of the personal representatives of finance ministers of the member states. The body is set up to assist the commission in drawing up the Action Plan for financial services in the zone on an on-going basis.

2.19.0 BANK CONSOLIDATION IN NIGERIA: PROCESSES AND PROSPECTS.

The Nigerian banking sector has undergone remarkable changes over the years, in terms of the number of institutions, ownership structure as well as the depth and breadth of operations. These changes have been influenced largely by the challenges posed by the deregulation of the sector, globalization of operations, technological innovations and the adoption of supervisory and prudential requirements that conform to international standards. The deregulation of the sector which began during the period 1986 to 1990 was followed by a flood of new banks. The existence of so many banks, coupled with the non-compliance with market regulations by majority of the players, poor management, poor credit policy insider dealings/abuses, economic recession, etc. led to high incidence of distress in the banking industry in the 1990s.

Furthermore, CBN's surveillance on banks recently revealed deterioration in banks' overall performance, based on CAMEL parameters. Banks' performance rating in 2004 showed that 10 banks were rated as sound, while 51, 16 and 10 banks were rated as satisfactory, marginal and unsound, respectively. Against this background, the CBN in July 2004 rolled out a 13-point reform agenda aimed at consolidating the banking sector and preventing the occurrence of systemic distress.

Two major elements in the reform package were the requirement that the minimum capitalization for banks should be N25 million with effect from end – December 2005, and that the consolidation of banking institutions through mergers and acquisitions should be initiated.

Some of the goals the CBN intends to achieve by consolidating the Nigerian banking sector include:

- creating a sound and more secure banking system that depositors can trust;

- building domestic banks that investors can rely upon to finance investments in the Nigerian economy;
- encouraging industry consolidation and reducing system risks;
- reduction of interest rate on lending to single digit;
- fighting corruption and white-collar crimes through improved transparency and accountability, and insisting on sound corporate governance practices in the financial services sector;
- driving down cost structure of banks, improving banks' efficiency, encouraging competition with the goals of lowering interest rates and providing cheap credit to the economy; and
- meeting international benchmarks and minimum requirements for the integration of regional financial systems.

This section examines the rationale, options and processes of bank consolidation, as well as the challenges and prospects for Nigeria.

2.19.1 RATIONALE FOR BANK CONSOLIDATION

Business consolidation through mergers and acquisition has become a global phenomenon to achieve economies of scale and higher productivity. The need for financial institutions to merge becomes even more imperative in the face of the onslaught of greater competition arising from globalization and the presence under World Trade Organization (WTO) for countries to open up their financial markets to further entry of foreign banks. For this reason, many countries are moving towards consolidating their banking system and Nigeria cannot be an exception.

A number of reasons have been advanced on why firms are consolidating or merging and some important factors driving consolidation have been identified. Our focus is on bank consolidation, but one should note that much of the same philosophy and rationale for bank mergers applies to other industries as well. Two primary factors affecting the need for banks to remain competitive are technology and deregulation. Whilst technology has blurred the lines of specialization among financial intermediaries, deregulation has significantly changed the way banks do business and where they do business. Technological improvement also means more change and the breakdown of traditional barriers, such as geography and product varieties. The two forces of technology and deregulation, working together, have resulted in what is referred to as the global economy. Also, the mixing together of technology and deregulation has produced rapid change that increasingly blurs accepted boundaries of time, geography, language, industries, enterprises, economies and regulations. As a result, many merger partners today are creating financial supermarkets, where customers can have one-stop financial services.

In addition to market consideration, regulatory factors have accounted for some bank consolidation in different parts of the world. For example, the consolidation that took place in Lebanon, Malaysia, Kenya and South Africa were mainly policy-induced.

The jurisdiction for consolidation and enhanced capital requirement for Nigerian banks lies in the weakness and distressed condition of the banking sector. In addition, there were a large number of small players that could not operate profitably in a narrow margin market. Several of them were unable to support the real sector of the economy because of their small size, and hence the tendency to resort to sharp practices in order to make ends meet. Finally, several of the banks operated under a weak corporate governance structure, reflecting a rudimentary, internal control system as many were family-controlled banks. Thus, the banking sector reforms initiated by the CBN were designed to ensure a diversified, strong and reliable banking sector that would ensure the safety of depositors' money, as well as enable the banks play active developmental role in the Nigerian economy, and have the capability of emerging as competent and competitive players in the regional and global financial system. The reforms were aimed at creating a strong banking system, while consolidation was expected to address the problems of distress and technically insolvent institutions without resorting to the liquidation.

The major objectives of the banking system are to ensure price stability and facilitate rapid economic development. Regrettably, these objectives have remained largely unattained in Nigeria as a result of some deficiencies. These include:

I. Low Capital Base:

The average capital base of Nigerian banks is US$10 million, which is very low compared to that of banks in other developing countries like Malaysia where the capital base of the smallest bank is US$526 million. Similarly, the aggregate capitalization of the Nigerian banking system at N311 billion (US$2.4 billion) is grossly low in relation to the size of the Nigerian economy and in relation to the capital base of US$688 billion for a single banking group in France and US$541 billion for a bank in Germany.

II. A Large Number Of Small Banks With Relatively Few Branches:

The 89 banks in Nigeria as at the end of May, 2005, had a total of 3,382 branches whereas the eight banks in South Korea have about 4,500 branches.

III. The Dominance Of A Few Banks:

The top 10 banks control about 50.8% of the aggregate assets; 51.7% of total deposit liabilities and 45% of the aggregate credits.

IV. Poor Rating Of A Number Of Banks:

Though the banking system in Nigeria is, on the average, rated satisfactory, a detailed analysis of the condition of individual banks, as at December, 2004, showed that no bank was rated very sound. Only 10 were adjudged sound, with 51 satisfactory, 16 marginal and 10 unsound. In addition to the above inadequacies, the Nigerian banking system suffers from the following operational problems:

I. Weak corporate governance, evidenced by inaccurate reporting and non-compliance with regulatory requirements, declining ethics and gross insider abuse, resulting in huge non-performing insider related credits;

II. Insolvency evidenced by negative capital adequacy ratios of some banks and completely eroded shareholders' funds caused by operating losses;

III. Over dependence on public sector deposits, foreign exchange trading and the neglect of small and medium-scale private savers.

It is evident from the foregoing assessment of the performance of the Nigerian banking system, that it is fragile and plays a marginal role in the development of the real sector. It is, in effect, not in a position to meet the nation's ideal of a strong, competitive and reliable banking system, which depositors can trust, investors rely upon, and the nation depend upon to facilitate its economic growth. It therefore requires urgent and fundamental restructuring and refocusing.

The current banking system reform represents the fundamental restructuring needed to address the structural and operational problems of the system, in order to create a strong and reliable banking sector which will play active developmental roles in the Nigerian economy, and be a competent and competitive player in the global financial system. The Governor of the Central Bank of Nigeria (CBN) in his address to the Bankers' Committee, on July 6, 2004, enunciated the thrust of the banking system reform program in his '13-point reform agenda'.

Two major elements of the reform agenda are the requirement for Nigerian banks to increase their shareholders' funds to a minimum of N25 billion by the end of December, 2005, and consolidation through mergers and acquisition (M&A).

Mergers and acquisition, as a preferred form of business growth, has become a global phenomenon due to its inherent advantages.

In the United States of America, there have been over 7,000 cases of bank mergers since 1980, while the same trend has occurred in the United Kingdom and other European countries. Specifically, in the period 1997-1998, 203 bank mergers and acquisitions took place in the Euro area.

In 1998 a merger in France resulted in a new bank with a capital base of US$688 billion, while the merger of two banks in Germany in the same year created the second largest bank in Germany with a capital base of US$541 billion. In many emerging markets, including Argentina, Brazil and Korea, consolidation has also become prominent, as banks strive to become more competitive and resilient to shocks as well as reposition their operations to cope with the challenges of the increasingly globalized banking systems.

2.19.2 COUNTRY EXPERIENCES

The financial services industry is restructuring and consolidating at an unprecedented pace around the globe. Particularly, in the United States and Western Europe transactions are numerous and breathtaking. Restructuring is also going on in Asia. Most striking is probably the ever escalating scale of mergers in banking. In the United State of America, there had been over 7,000 cases of bank merges since 1980, while the same trend occurred in the UK and other European countries. In Africa, where many banks are small in size in terms of their market capitalization, mergers in terms of volume and value have been relatively low. The five largest banks in Africa - Standard Bank Group, ABSA Bank Ltd, Nedcor Ltd, First National Bank Ltd, Investee Group Ltd - are based in South Africa and are all the result of mergers and consolidations. Standard Bank Group is the largest banking group in South Africa and Africa as a whole and was the result of the consolidation of several financial institutions over a period of ten years. As at end-December 2003, its shareholder funds totaled R28,667 million or $4,609 million. Similarly, the Amalgamated Banks of South Africa (ABSA) Limited is the second largest in the country and Africa as a whole with a shareholder fund base of R19,350 million or $3,111 million. The bank was the result of the merger of over fifteen commercial banks, wholesale banks, finance houses, asset management companies, life assurance companies, insurance companies and advisory services across South Africa, Namibia, Tanzania, Mozambique and Zimbabwe. As a result of the merger, the bank has been able to create a powerful financial base that enables it to provide services to selected markets in the UK, USA, China, Hong Kong, Singapore and a substantial part of Africa.

In the case of Kenya, the initial consolidation of financial institutions was liberalization of the financial sector in the early 1990s. This saw most banks consolidating their non-bank financial institutions subsidiaries. Besides, the government also addressed the capitalization issue of the banking industry through periodic amendments to the Banking Act. The Banking Act amendment in 1997 required banks to raise their paid-up capital from US $1,028,453.90 to US $2,742,543.70 over a two-year period. Further amendment to the Act in 1999 raised the capital gradually to reach US $6,856,359.30 for banks and US $5,114,844.00 for non-bank financial institutions by the end of 2005.

The key learning points from the merger of banks in the two African countries are as follows:

i). In South Africa, bank mergers resulted in the emergence of the four largest conglomerates commanding perhaps 80% of the banking market plus a dominant share of the insurance and mutual fund sectors.

ii). Of the top 50 banks in sub-Saharan Africa, the first five positions are occupied by South African banks.

iii). In 2003, South African banks accounted for 70% of aggregate Tier 1 capital (i.e. ordinary shareholders' equity and retained earnings)of the sub-Saharan banking sector followed by Nigeria (8%) land Mauritius (3.8%).

iv). The higher capital resulting from the mergers has reduced the danger of bank collapse, enabling the banks to give more advances and make the necessary investments for better customer care.

v). The resulting economies of scale have rendered the banks more competitive and profitable. The merged banks, most of which were local, have been able to offer worthwhile competition to the foreign-owned banks.

vi). Shareholders of the merged institutions have enjoyed better returns.

2.19.3. OPTIONS AND PROCESSES OF BANK CONSOLIDATION IN NIGERIA.

Merging institutions can be classified into two:

- Mergers of un-equals (the acquisition of one firm by another firm that is typically much larger and stronger) and mergers of equals (the so- called mega mergers, of which the large mega bank deals are typical).

  In the case of mergers of un-equals, it has been observed that bank acquisition tends to conform to a "survival of the fittest" syndrome, in which the less profitable and relatively slow-growing banks are more susceptible to being acquired. Also, banks with smaller market share, a lower capital ratio and those that devote a smaller fraction of their assets to lending tend to attract acquirers. Taken together, all these factors point toward relatively weaker banks attracting acquirers. When such banks are acquired, it creates the possibility of improved performance.

  Experience has shown that most organizations that engage in mergers of equals perform better than the two firms standing alone. The combination of the two or more banks into one enhances the possibility of raising profits through either what is referred to as cost efficiencies (on the input side) or revenue efficiencies (on the output side). Consequently, combined banks often shift their product mix to more loans and higher-valued products.

  In order to streamline and set the pace for the consolidation of banks, the CBN approved the Guidelines and Incentives on Consolidation in the Nigerian Banking Industry.

  The guidelines stated that the only legal modes of consolidation allowed are mergers and outright acquisition/takeover. A mere group arrangement is not acceptable for the purpose of meeting the stipulated N25 billion capitalization requirement for banks. Therefore, all banks that have other banks as subsidiaries or have common ownership were encouraged to merge.

There were however, several options opened to Nigerian banks to meet the stipulated minimum capital base requirement. These included:

- To approach the capital market for funds through an Initial Public Offer (IPO), Private placement or Rights Issue;
- To consolidate through a merger with like-minded and synergy-producing banks;
- To acquire another bank or be available for acquisition; and
- To close shop and surrender the banking license.

In line with the approved options, some banks have attempted to meet the required minimum shareholders funds by accessing the capital market whilst others are pursuing private placement alternative. Some doubts have, however, been expressed whether the Nigerian capital market has the depth, breath and resilience to absorb the many bank issues that have emerged from the market recently. The lack of adequate absorptive capacity of the capital market may be a constraint for banks wishing to raise capital from the market.

In anticipation of the likely problems that may be encountered in the consolidation process, the CBN provided some incentives for banks that consolidate and/or are able to achieve the set minimum capital base within the stipulated period, as follows:

- Authorization to deal in foreign exchange;
- Permission to take public sector deposits and recommendation to collect public sector revenue;
- Prospects of managing part of Nigeria's external reserves, subject to prevailing guidelines.

Other incentives that would be available in the process of meeting the problems include:

- Tax incentives in the areas of capital allowances, company income tax, stamp duties, etc.
- Reduction in transaction costs;
- Provision of technical assistance; and

- Provision of a held desk to fast-track approvals.

At the end of the consolidation exercise, only 25 (Twenty five) banks comprising 3 (three) stand-alone banks and 22 merging groups were able to scale the twenty-five billion naira hurdle of the Central Bank of Nigeria.

2.19.4. CHALLENGES OF BANK CONSOLIDATION

Consolidation of banks is in fact a very difficult art. It requires extreme care, a clear methodology and a strong leadership from the highest levels of management. Successful mergers and acquisitions eventually depend very much on the ability of management to conceive well thought through strategies, to develop synergies, combine cultures, and motivate teams.

When banks opt to achieve their objectives of meeting the minimum shareholders' fund base requirement through consolidation, several challenges will have to be faced and handled with utmost care by both the consolidating entities and the regulatory bodies. Among the major challenges that may be faced by the banks include:

- Attitudinal change by bank owners and management, who may resist corporate consolidation for fear of losing control and erosion of their powers.
- Rigidities in bank ownership, which include a complicated web of cross-shareholding that bind banks to insurance companies, industrial groups and other banks.
- The corporate structure can pose problems especially in cases where the Memoranda and Articles of Association of a bank specifically prevent merges and take-overs;
- Inherent natural resistance to cultural imposition which can create post-merger trauma, as some dominant banks may be tempted to force their smaller merger partner(s) to assimilate/adopt their organizational culture; and

- Increased cost of maintaining several deposit accounts and higher cost and complexity of servicing a larger number of shareholders, as consolidation often results in larger size, larger shareholder base and larger number of depositors.
- Redundancy cost in the areas of Information Technology, Human Resources, and fixed assets such as branch offices.

The regulatory authorities on their part would also face some daunting challenges, including;

- Ensuring that provision of adequate safety nets and compensation packages are made by the merging banks to ameliorate for potential job losses arising from mergers;
- Appropriate mechanisms for protecting possible disenfranchisement of small depositors who may not be welcomed by the emerging mega-banks;
- The regulatory authorities, especially SEC, would need to be empowered to be active in the market to prevent threat to competitive market and monopolistic tendencies of mega-banks from consolidation. Also, the NDIC and CBN would need to constantly monitor the activities and performance of the emerging mega-banks to prevent bank distress and failures.

Post-consolidation era would likely pose some challenges to all stakeholders in the banking system. On the part of banks, they will require strong management teams that are committed to bringing about overall performance improvements and capacity enhancements. The ensuing paradigm shift would require that new strategies would have to be conceptualized and articulated to address the increasingly complex issues that will arise during post consolidation era. At the industry level, it would not just be a question of mega banks emerging, rather the new financial landscape will compel bank management to re-examine their existing business models to see where their strengths lie and to what opportunities these strengths could be applied to enhance returns. There may be need to move toward strategic differentiation among banks in order to better serve the relevant market segments or niches. This may involve market specialization or functional specialization as banks decide which functional areas or combinations of risk management, customer service, product innovation, to exploit and maximize to their advantage.

At the individual banking institution level, the ability to make real improvement would also depend very much on the availability of competent human resources.

The quality of manpower will be a defining element of performance and competition among banks. Attracting the best skills and talents in the industry must also be complemented with better management and communication so that there is an awareness and understanding of visions and shared values throughout the organization. Towards this end, training and development of employees must be seen as an important contributing factor towards value creation within the banks.

To ameliorate the effect of possible job losses or redundancies resulting from the consolidation of banks, the monetary authorities should ensure that the existing staffs are compensated by the consolidated entity in line with industry standards.

The challenges before the CBN in ensuring the realization of the objectives of the banking system reforms were enormous, especially as it was a pioneering effort with no previous internal experience in consolidation to draw from. Experiences of other countries, though, germane, could not represent an absolute fit to our peculiar economic environment. Some of these challenges that have been thrown up by the exercise, which the CBN was working hard to contain, included the following:

I. Lack of country experience and technical knowledge on large scale consolidation, manifesting partly in paucity of experienced staff on the subject of mergers and acquisition on both the regulators' and operators' sides;

II. Dominant government ownership in some banks and its implication for good corporate governance in emergent banks;

III. The possibility of inflow of laundered funds into the system and the stretched supervisory capacity as a result of the plethora of capital verification exercises arising from mass recapitalization by banks;

IV. Enormous cost of consolidation, which initially discouraged the banks;

V. The problem posed by delinquent assets and non-performing loans of banks, which might distort the balance sheet of emergent banks if not well handled. The situation was worsened by the prevalence of falsified records/accounts that were kept by the banks;

VI. Operational challenge arising from ICT systems and cultural integration as a result of mergers and acquisition;

VII. Supervision and regulation of mega banks; and

VIII. Possible litigations on mergers and acquisition.

Consequently, the CBN had to adopt the following measures to address some of the challenges and also carry all stakeholders along to ensure a seamless transition that would meet the objectives of the exercise:

i. The CBN contacted the World Bank and the IMF for technical assistance in order to benefit from the experiences of other countries that had undertaken similar banking reforms.

ii. Recognizing the challenge posed by Government's ownership of banks to the efficient and effective management of such banks in Nigeria, the CBN advised all tiers of government, through a circular, to reduce their investment in banks to not more than 10 percent of a bank's equity capital before the end of 2007.

iii. The CBN and SEC jointly and separately organized seminars and workshops, on mergers and acquisition, while further efforts were intensified to build the needed capacity in the area.

iv. The Consultative Committee on Banking Reform was set-up to, among others address issues of concessions on statutory fees payable to government agencies in respect of increase in paid-up capital, stamp duty, registration and filing fees, tax issues such as un-recouped losses, capital allowance and perfection of title documents.

v. Furthermore, the cooperation of the judiciary was necessary for the achievement of the goals of the reform program. The understanding of the courts and the expeditious handling of cases in order to circumvent the tortuous legal process in respect of possible consolidation-related litigations would greatly facilitate the realization of the objectives. This would therefore be handled by the Consultative Committee.

vi. Managing the nonperforming loans (NPLs) of the banking system would also pose a big challenge to the restructured institutions. Accordingly, the CBN proactively embarked on the establishment of an Asset Management Corporation (AMC), which would purchase such NPLs in order to free the affected banks from such burden and consequently improve on their capital base.

vii. The post consolidation mega institutions, would perhaps pose the greatest challenge in the areas of corporate governance, supervision, ICT integration, etc. To address these concerns, the CBN would immediately put in place, a regulatory framework that would guarantee the best practice in the board and top management of banks. The framework, which would cover the roles of and relationship between board and management, separate responsibilities of the Chairman and chief Executive Officer as well as the composition and roles of relevant board committees would need to be enforced faithfully to avoid a major crack in a mega bank that might result in a systemic distress.

viii. It is inevitable that some of the mergers and acquisition will result in redundancies of human resources especially where skills and competencies are duplicated. The CBN has taken steps to ensure that the personnel whose services will no longer be required are paid off in accordance with the terms of their employment.

2.19.5. PROSPECTS AND BENEFITS OF CONSOLIDATING NIGERIA'S BANKING INDUSTRY.

In spite of the constraints and challenges highlighted above, the prospects and benefits of banking system consolidation in Nigeria are numerous. The financing of huge projects will no longer present difficulties to the banks as the emerging banks would be able to undertake large transactions such as investments in technology, including oil and gas, telecommunications, power and construction industry. The achievement of an improved capital for a bank implies unproved capacity to create loan assets. Thus, a stronger banking industry which the post-consolidation era entails would be able to proactively and adequately support the real sector of the economy with better capital adequacy to long-term funds or reduced interest rates.

The benefits of bank consolidation have been listed severally, particularly with reference to Nigerian banking. Some of these are obvious and quite rational, while some others are spurious and require much agonizing over to convince skeptics. The obvious ones are discussed in this paper as follows.

The process should cause to evolve banks that are better capitalized and bigger because the new minimum capital of N25 billion is a growth inducer. The average ratio of banks' equity to total liabilities in Nigeria during 1991 to 2004 was 5.86%, which translates into a multiplier of 17.06 and an average business volume of N426.6 billion (or balance sheet footing) for any bank in compliance with the new minimum capital (Soludo 2005). In a global survey of the ratio of banks' equity to total liabilities, banks were found to fall in the range 4.4% to 5.5%, implying multipliers of between 18.18 and 22.73. If these are set against the new minimum capital requirement in Nigeria, the banks should grow to balance sheet size of between N454.5 billion and N568.25 billion (Soludo 2005). Strong capital is a basic indication of solvency, and it will take a while along with careless risk-taking for any of the newly capitalized banks to walk its way into insolvency.

From experience, bank customers have tended to shift their deposits from smaller to big (or mega) banks in the thinking that they are safer, a phenomenon that is generally referred to as “the flight to safety” and quite pervasive whenever there are concerns about the state of health of the banking system. The mega banks that evolve through industry consolidation should have stronger appetite for big risks and thus be better able to finance key growth sectors of the Nigerian economy. The pattern in the past had been that financing for mega and high-risk projects in Nigeria came from external sources, with Nigerian banks either at the periphery or not featuring at all.

The income and experience fallout of such projects have invariably gone to the foreign financiers. Banking system consolidation will therefore, bring Nigerian banks into the mainstream of financing large ticket transactions and thus create opportunity for capacity building in their Nigerian staff.

The consolidation exercise should provide a vehicle for taking out the weak banks in the system in an orderly manner. This has always been a major challenge to banking systems, especially the evolving ones like Nigeria’s. There is still some concern though that some weak banks might end up having no “suitors” and thus require further attention (beyond the merger and acquisition option) from the regulatory authorities. Such banks might, at the end of the day, be “forced into a marriage of convenience” and supported through an Asset Management regime that discounts their deficient risk assets as well as some new capital injection.

Another benefit of the ongoing consolidation exercise is the expansion of the shareholding base of Nigerian banks, thus eliminating the phenomenon of “family banks” and the tendency for poor corporate governance arising from such ownership pattern. Again, the argument could go in two directions.

First is that ownership spread is not equivalent to ownership diffusion. The former refers to the number and possibly the geographical spread of shareholders, which the quest for the high minimum capital has made most banks pursue. The latter concerns the extent of individual holding and control of the emerging institutions from the exercise. Fact is that there is hardly any business that has no historical root in a family or group of families, while the influence of families (either in shareholding or control over activities/ decisions) remains pervasive globally. Secondly, family control through ownership does not necessarily lead to compromise of standards and poor corporate governance.

Precluding these is largely a matter of the nature and firmness of internal control measures as well as their enforcement. Integrity plays a vital role in this as much as the values of the organization do. Where individual organizations define clearly what they stand for and the public good plays a prominent role in that, the tendency is for good corporate governance to be the norm.

The real challenge is not the ownership structure, but the adequacy of internal controls, their enforcement and close monitoring by the supervisory/regulatory authorities. This requires the Central Bank to define and set the minimum standards in this respect, and ensure that operators are encouraged actively to implement them. Vender Vennet (1997) found that domestic mergers improved profitability and operational efficiency, but cross-border acquisitions were a surer source of cost efficiency.

The Nigerian banking experience puts this to test, as big banks had to learn from the smaller and leaner banks in the areas of operational efficiency and profitability. The growth patterns of some of the newer generation banks has proved, so far, that mergers are not a sufficient condition for growth – a vision, a strategy and solid commitment to both are the key. Beyond the obvious benefits listed in the preceding seven paragraphs, there are complementary benefits as well. These include:

1. Stricter industry regulation and supervision through new rules, capacity building and deployment of information communication technology (ICT) by the Central Bank and the other banking system regulatory/supervisory agencies. These have been demonstrated by not only the Central Bank, but by the Securities and Exchange Commission, the Nigerian Stock Exchange, Federal Inland Revenue service, etc.

2. Industry cleansing which results from stricter and more professional supervision and regulation. In this vein, a self-regulatory body like the Chartered Institute of Bankers of Nigeria has joined forces with the Central Bank and the other agencies listed above. This development reinforces good corporate governance and promises better health of the banking system in future.

Other benefits derivable from consolidation of banks include:

- Greater efficiency and cost effectiveness;
- Enhanced ability to compete in the market place, both domestically and internationally;
- Leveraging on technology; and
- Diversification of broader array of products.

The thrust of bank consolidation, so far, has been on strengthening the banking system's resource and capital base and expanding operational networks. This is only the initial phase of the consolidation process. With the potential increase in competition, the banks would now be expected to go beyond the traditional, basic banking areas to engage themselves in complementary measures of efficiency. These include the shift of the payments and settlement system to real-time gross basis and the introduction of credit rating to allow for early identification of problems and improvement in credit risk management.

In the medium term, as the banks gain the necessary expertise and resources to intermediate larger volumes of funds for customers whose needs have grown in size and complexity, we hope to see the emergence of Nigerian banks with a regional orientation. Beyond that, perhaps we can eventually be witnesses to the evolution of some Nigerian financial institutions with transnational reach.

Furthermore, consolidation of banks is a potent tool for realizing the expanding possibilities for new and better financial products and services. On the other hand, it connotes a corresponding increase in the responsibilities of the monetary authorities in ensuring the stability and robustness of the financial system. As the apex regulator of the Nigerian financial system, the CBN has gone some distance in achieving the right balance in the right direction.

This is demonstrated by its commitment to see that the consolidation process is a success. So far, the bank has provided various incentives and created the enabling environment to encourage the banks, in response, the banks had switched from the initial posture of opposition to embrace the consolidation process wholeheartedly. Already, the consolidation efforts are yielding positive signs of success.

There is, however, the urgent need to overhaul the legal processes in order to complement the efforts of the regulatory authorities in realizing a sound and stable banking system. In the wake of the growth in the volume and complexity of financial transactions involving both local and foreign investors after the consolidation exercise, there is need for both the legislature and the judiciary to cooperate as well as work closely in the implementation of the existing banking laws in order to engender confidence in the new financial landscape.

Also, the need for timely adjudication of cases pending in the courts cannot be over emphasized.

It is also expected that consolidation of Nigerian banks will help the merged/acquired banks harness with greater efficiency their collective experience, expertise and technological know-how. Banks are therefore expected to imbibe best-practice corporate governance, improve on self-regulation, institute IT-driven culture, and seek to be competitive in today’s global world. In the emerging landscape, banks would need to recognize the greater role of knowledge and information and communication technology (ICT).

These will create increased convenience, increased access to information, speed of transactions, and enhanced control and management of resources. Also, in the transition towards a consolidated banking industry, strong corporate governance and risk management would become key elements of successful institutions. With the larger pool of resources after the merger process, banks are expected to further enhance these capabilities.

2.19.6 Rationale for Banking System Reform in Nigeria

The major objectives of the banking system are to ensure price stability and facilitate rapid economic development. Regrettably, these objectives have remained largely unattained in Nigeria as a result of some deficiencies. These include:

I. Low Capital Base:

The average capital base of Nigerian banks is US$10 million, which is very low compared to that of banks in other developing countries like Malaysia where the capital base of the smallest bank is US$526 million. Similarly, the aggregate capitalization of the Nigerian banking system at N311 billion (US$2.4 billion) is grossly low in relation to the size of the Nigerian economy and in relation to the capital base of US$688 billion for a single banking group in France and US$541 billion for a bank in Germany (Imala, Odufu 2005).

II. A Large Number Of Small Banks With Relatively Few Branches:

The 89 banks in Nigeria as at the end of May, 2005, have a total of 3,382 branches whereas the eight banks in South Korea have about 4,500 branches.

III. The Dominance Of A Few Banks:

The top 10 banks control about 50.8% of the aggregate assets; 51.7% of total deposit liabilities and 45% of the aggregate credits.

IV. Poor Rating of A Number Of Banks:

Though the banking system in Nigeria is, on the average, rated satisfactory, a detailed analysis of the condition of individual banks, as at December, 2004, showed that no bank was rated very sound. Only 10 were adjudged sound, with 51 satisfactory, 16 marginal and 10 unsound. In addition to the above inadequacies, the Nigerian banking system suffers from the following operational problems: I. Weak corporate governance, evidenced by inaccurate reporting and non-compliance with regulatory requirements, declining ethics and gross insider abuse, resulting in huge non-performing insider related credits; II. Insolvency evidenced by negative capital adequacy ratios of some banks and completely eroded shareholders' funds caused by operating losses III. Over-dependence on public sector deposits, foreign exchange trading to the neglect of small-and medium-scale private savers.

It is evident from the foregoing assessment of the performance of the Nigerian banking system, that it is fragile and plays a marginal role in the development of the real sector. It is, in effect, not in a position to meet the nation's ideal of a strong, competitive and reliable banking system, which depositors can trust, investors rely upon, and the nation depend upon to facilitate its economic growth. It therefore requires urgent and fundamental restructuring and refocusing.

The current banking system reform represents the fundamental restructuring needed to address the structural and operational problems of the system, in order to create a strong and reliable banking sector which will play active developmental roles in the Nigerian economy, and be a competent and competitive player in the global financial system. The Governor of the Central Bank of Nigeria (CBN) in his address to the Bankers' Committee, on July 6, 2004, enunciated the thrust of the banking system reform program in his '13-point reform agenda'.

Two major elements of the reform agenda are the requirement for Nigerian banks to increase their shareholders' funds to a minimum of N25 billion by the end of December, 2005, and consolidation through mergers and acquisition (M&A).

Mergers and acquisition, as a preferred form of business growth, has become a global phenomenon due to its inherent advantages.

In the United States of America, there have been over 7,000 cases of bank mergers since 1980, while the same trend has occurred in the United Kingdom and other European countries.

Specifically, in the period 1997-1998, 203 bank mergers and acquisitions took place in the Euro area.

In 1998 a merger in France resulted in a new bank with a capital base of US$688 billion, while the merger of two banks in Germany in the same year created the second largest bank in Germany with a capital base of US$541 billion. In many emerging markets, including Argentina, Brazil and Korea, consolidation has also become prominent, as banks strive to become more competitive and resilient to shocks as well as reposition their operations to cope with the challenges of the increasingly globalized banking systems" (Amugo 2002).

Other objectives given for banking sector reforms as encapsulated in the reform agenda announced by the Governor of the CBN on July 6, 2004 were as follows:

I. Requirement that the minimum capitalization for banks should be N25billion with full compliance before end-December 2005.

II. Phased withdrawal of public sector funds from banks, starting in July 2004.

III. Consolidation of banking institutions through mergers and acquisitions.

IV. Adoption of a risk-focused and rule-based regulatory framework.

V. Adoption of zero tolerance in the regulatory framework, especially in the area of data/information rendition/reporting. All returns by banks must now be signed by the Managing Directors of banks.

VI. The automation process for rendition of returns by banks and other financial institutions through the electronic Financial Analysis and Surveillance System (e-FASS).

VII. Establishment of a hotline, confidential internet address (Governor@cenbank.org) for all Nigerians wishing to share any confidential information with the Governor of the Central Bank on the operations of any bank or the financial system. Only the Governor has access to this address.

VIII. Strict enforcement of the contingency planning framework for systemic banking distress.

IX. The establishment of an Asset Management Company as an important element of distress resolution.

X. Promotion of the enforcement of dormant laws, especially those relating to the issuance of dud cheques and the law relating to the vicarious liability of the board of banks in cases of failings by the bank.

XI. Revision and updating of relevant laws and drafting of new ones relating to effective operations of the banking system.

XII. Closer collaboration with the Economic and Financial Crimes Commission (EFCC) in the establishment of the Financial Intelligence Unit (FIU) and the enforcement of the anti money laundering and other economic crime measures.

XIII. Rehabilitation and effective management of the mint to meet the security printing needs of Nigeria.

2.20.0 SUPERVISION OF RESTRUCTURED BANKS

The early 1990s witnessed the distress and subsequent collapse of some banks. Out of the debris of some of the distressed banks have emerged recapitalised and restructured banks, wearing new names and flaunting impressive business visions and mission statements.

However, there are fears that the banking industry may witness yet another distress, considering the fact that those factors which caused the distress of the 1990s still persist. Such factors include poor management, low capital base, chronic illiquidity, and poor quality of risk assets, outright frauds through unconventional and unprofessional banking practices, a harsh economic terrain and inconsistent government policies.

Currently, recapitalised/restructured banks are subjected to the same supervisory framework, as other banks, which do not take cognizance of their peculiarities. It is therefore imperative to fashion a proactive framework for monitoring these banks. A workable supervisory framework should be one that is anchored on conservatism and prudence. Therefore, a basic starting block would be the formulation of a set of guidelines by the regulatory authorities, against which the performance of the restructured banks will be measured. Based on this fundamental premise, the following framework would be ideal:

The formal ratification of the bank's business plan by the regulatory authorities, after due evaluation and amendment.

Fresh funds injected into the bank should be domiciled in an escrow account with the CBN, and released after the fulfillment of specific conditions, such as the appointment of boards and top management, submission of acceptable organogram, etc.

The regulatory authorities should put the institutions under constant supervisory oversight, to curtail over-ambitious policies and activities, by monitoring the overall performance, on say, a quarterly basis. In this regard, supervisory attention should ensure that: expansion (e.g. branch expansion) is controlled to avoid over-trading and excessive overheads; the controls in place are effective; and risk assets are created with caution and prudence.

The constant review of the board/top management profile, including an in-depth evaluation of the minutes of board and top management meetings, to ascertain the quality of deliberations vis-a-vis the overall policy direction, would serve a useful tool.

Supervision should focus on the exhaustive review of income and expenditure profiles to forestall unconventional accounting practices and reporting of false profits. Furthermore, the management should be constantly schooled in prudence on overheads.

The supervisory framework should incorporate the appraisal of the bank's subsisting ability to attract and retain competent and well-motivated personnel, which invariably, is an essential ingredient for business survival. To ensure their continuing viability, the banks should embrace good corporate governance exemplified by:

1. The installation of virile, robust and visionary boards and managements, based on the "fit and proper persons" maxim;

2. Appropriate management oversight, depicted by expert risk management abilities, to hedge externalities in particular;

3 avoiding over-riding individual interest, to minimise conflicts; and

4 Appropriate re-orientation and checks on inherited staff to minimize culture contamination.

An effective supervisory framework would involve prompt and uncompromising sanctioning of infractions. As desirable as a regime of stringent supervision is in the management of restructured institutions, the rules should, however, be flexible enough to encourage the optimal exploitation of viable business opportunities. That is, the supervision need not necessarily be so hounding as to stifle a bank's normal growth.

Given that the failure of some banks in the 1990s was, perhaps unfairly blamed on the ineffectiveness of the supervisory authorities, the imperative for a proactive supervisory apparatus, that would live up to its functions of ensuring a stable and sound financial system cannot be over-emphasized. To meet this challenge, the doctrine of self-regulation by operators, should be encouraged and stringent laws against financial malpractices enacted and faithfully enforced to achieve the intended purpose.

Finally, it must be recognised that the overall supervisory objective would be to ensure that the restructured banks uphold high standards of transparency and ethics, to regain public confidence.

2.21.0 ASSESSMENT OF COMPLIANCE WITH THE BASLE CORE PRINCIPLES

The World Bank Financial Sector Mission commenced the assessment of the Basle Core Principles in Nigeria through its initial visit in January 1999. Following the response to its questionnaires and subsequent discussions with the regulatory authorities in Nigeria, the mission issued a report on the degree of compliance with the principles. For the purpose of the assessment, the 25 Basle Core Principles were further expanded to 30 [principle 1 dealing with the preconditions for effective supervision was further broken into 6] while the state of compliance was categorised into four, namely, fulfilled, largely fulfilled, largely unfulfilled and unfulfilled.

The World Bank, during the presentation of its findings on the financial sector to the Nigerian authorities in June 2000, observed that the supervisory framework displayed rules and procedures adequate for effective supervision. The report also commended the adequate legal framework and the remarkably effective job done in dealing with troubled banks.

Details of some of the Mission's assessments and comments by the regulatory authorities are highlighted below.

2.21.1 Permissible Activities of Licensed Institutions

Under the current regulatory framework, regulators are in a position to ensure that all banks and non-bank financial institutions including finance companies, primary mortgage institutions, discount houses and bureaux de change are licensed. Beyond the institutions under the CBN regulatory purview, other operators in the financial system – capital market and insurance - must be licensed by their respective regulators - the Securities and Exchange Commission and the National Insurance Commission, respectively. In the specific case of bank licensing, there is strict control over the use of the word "bank" in the name of institutions. This principle was adjudged both from self-assessment and by the mission to have been fulfilled.

2.21.2 Regular Contact with Bank Management And Supervisors' Understanding Of Bank Operations

This principle was also considered to have been fulfilled. Mainly in the course of examination, supervisors come in close contact with the management of the supervised institutions. This has been further improved in recent times in the series of focused meetings between the supervisors and the management of supervised banks at the executive level. The approach has reduced significantly the seeming distrust between the two sides of the divide. As regards the understanding of banks' operations, supervisors display a good knowledge of activities performed by Nigerian banks, thereby enabling them to discharge their duties effectively and with credibility. The latest change in the executive management of the CBN has further enhanced this understanding, with a good representation of experienced operators in the new team.

2.21.3 Independent Validation of Supervisory Information either Through On-Site Examination Or Use Of External Auditors

This principle was adjudged to have been fulfilled. The Mission observed that full on-site examinations are conducted on the average of once in 18 months. This may not be sufficient for big banks and those in distress.

In addition, however, other types of examination such as target, which is focused on a particular area of the bank's operation (e. g. credit), maiden (usually conducted in the first 6 months of a new bank's operation) and special (for a bank that is perceived to be in serious problem) are common. With the adoption of risk-based approach to supervision, adequate coverage of the high-risk areas of banks' operations is expected. The examination cycle is also expected to shorten with the restructuring of the regulatory departments into a team-based arrangement rather than the erstwhile functional set-up. The idea of outsourcing some supervisory functions has been adopted. A policy position has already been taken in the case of community banks and a number of auditors and retired examiners have been registered for this purpose. The BOFIA requires that the financial statements of banks be audited, and approved by the CBN before publication. To ensure the independence of auditors, the banking laws require that any change of auditor by the banks must be with the approval of the CBN.

2.21.4 Consolidated Supervision

Though there is no specific provision in the banking law for consolidated supervision, the Banks and Other Financial Institutions Act requires that supervisors shall have access to all the books of a licensed bank. On the basis of this, the Nigerian supervisory authorities have commenced the supervision of related institutions on a consolidated basis. Co-operation among supervisors in the various sectors of the financial system is being greatly facilitated by the establishment of the

Financial Services Regulation Co-ordinating Committee [FSRCC]. The establishment of this body is the first major step towards incorporating specific provisions for consolidated supervision into the banking laws. Consolidated supervision is still limited within the Nigerian financial system, as offshore banking is minimal. This informed the “fulfilled” rating granted to this principle by the mission.

2.21.5 Global Supervision, Foreign Bank Branches and Cooperation with Foreign Supervisors

Very few Nigerian banks operate offshore. The few offshore operations have always been subject to supervision by the authorities with the cooperation of the host supervisors. For example, the Financial Services Authority [FSA] of the U.K. has always contacted the CBN for information on the management and internal control practices of the three Nigerian banks that have branches in the U.K.

The World Bank Mission concluded that issues related to cross-border supervision were not relevant to Nigerian banks as their activities were domestic to a very large extent.

2.21.6 Country and Market Risks

Hitherto, banks and supervisors in Nigeria had not been focusing on these issues. However, with the adoption of risk-based approach to supervision, the framework would be put in place to address the issues which are yet to be given due attention. The assessment was “not applicable” as the risk exposures were almost nil.

2.21.7 Supervisory Powers

Both the CBN and the NDIC have sufficient and comprehensive legal powers to take adequate and timely actions on banks in distress. This was demonstrated in the liquidation of 26 terminally distressed banks in 1998 and, recently, by the revocation of the licences of three (3) banks in December 2000. The World Bank Mission expressed fear about political pressure, which might hinder the supervisory authorities in exercising their powers and rated this principle as largely fulfilled.

Other principles adjudged to be largely fulfilled included those dealing with loan classification, money laundering, off-site and on-site supervision, powers to address compliance with laws, transfer of ownership, power to review acquisitions and investments, management process to control material risks and accounting policies and disclosures.

2.21.8 Internal Control

It is expected that with the risk-based approach to on-site supervision, greater and more focused attention would be given to internal control.

The appraisal of banks is focused on analysis of financial ratios and compliance with regulations. Although the CBN has enough power under the existing banking law to bring erring bank directors into line or to outrightly remove them, the critical role of the board in safeguarding the assets of the bank is not emphasized in the laws. This principle was consequently adjudged largely unfulfilled.

2.21.9 Operational Independence

The 1999 amendment to the CBN Act granted autonomy to the CBN in the execution of its functions. The World Bank Mission was, however, of the view that the CBN may not perform its duties independently from political forces since the government, from a legal standpoint, could influence most actions taken or intended to be taken by the regulatory authorities. Efforts are being focused on addressing the inadequacies in the Banking Act through appropriate amendment.

The mission found the supervisors seriously lacking in the provision and upgrading of Information Technology [IT] systems. This principle was assessed to be largely unfulfilled but efforts to achieve fulfillment were underway especially as the CBN has initiated actions to upgrade its IT systems.

2.21.10 Management Information

The Mission was of the view that Management Information Systems [MIS], which would enable supervisors to identify concentration and related issues, were lacking. The Mission concluded that the principle on management information was not fulfilled and efforts to achieve fulfillment were not underway. It however noted the efforts of the CBN to collect information on loans of N1 million and above through the Credit Risk Management System (CRMS) or Credit Bureau and advised that it should be incorporated into the supervisory data process.

2.21.11 Connected Lending

The mission was also of the view that the core principle on connected lending was largely unfulfilled and efforts to achieve fulfillment were not underway. The reason was that regulatory safeguards were not sufficient to discourage unsound lending practices, nor were penalties stiff enough to avert such unsound practices.

The issue of insider abuse had been a source of concern to regulators in Nigeria. Serious steps had been taken to address the problem including the implementation of the Failed Banks (Recovery of Debts) and Financial Malpractices in Banks Act 1994 with the cases hitherto handled by Special Tribunals now moved to dedicated divisions of the Federal High Courts.

2.21.12 Legal Framework

The core principle on legal framework and the provisions relating to the authorization of banking establishments and on-going supervision was assessed to be unfulfilled and efforts to achieve fulfillment underway, without actually stating what action had not been addressed. The Mission confirmed the granting of larger autonomy to CBN, which the regulatory authorities believed had eliminated obstacles to achieving fulfillment.

2.21.13 Prudential Reporting

The Core Principle on Prudential Reporting involving the processing of returns from banks was assessed "unfulfilled and efforts to achieve fulfillment not underway". This assessment was based on the fact that the level of the IT systems of the regulators and the banks does not allow for the best use of information. The mission believed that the Bank Analysis System (BAS) might partially remedy the situation. The authorities totally agreed with the mission's assessment but hoped that the present policy thrust of the CBN towards the development of IT would, to a large extent, remedy the situation.

2.21.14 Legal protection to supervisors and corrective action

There were other principles which, in the opinion of the mission, required legal provisions, otherwise they would remain "unfulfilled and effort to achieve fulfillment not underway". These included, among others, legal protection for supervisors, and corrective action by CBN and NDIC on distressed/failing banks without government interference. It is therefore the responsibility of the supervisors to make a comprehensive proposal to the National Assembly on the relevant provisions that need to be amended / included in the CBN and Banks and Other Financial Institutions Acts.

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CHAPTER THREE

RESEARCH METHODOLOGY

3.0 INTRODUCTION

This section of the dissertation provides an insight into the methodology adopted in the collection, analysis and interpretation of the data collated for the study. It attempts to provide a detailed analysis of the research plan and tools utilized in the actualization of this study.

3.1 RESEARCH DESIGN

Research design provides the glue that holds the research project together. A design is used to structure the research, to show how all of the major parts of the research project - the samples or groups, measures, treatments or programs, and methods of assignment - work together to try to address the central research questions.

There are various research designs but the one adopted for the purpose of this study is a cross-sectional survey.

In a cross-sectional survey, data is collected at a point in time from a sample selected to describe some larger population.

It is imperative to state here that the study is an empirical study of the impact of regulation and supervision on the activities of banks – an assessment of the roles of the CBN and NDIC.

Let us re-examine the salient roles of the Central Bank of Nigeria and the Nigerian Deposit Insurance Corporation towards bank assessment.

3.1.1 ROLES OF THE CENTRAL BANK OF NIGERIA

3.1.1a. Issuance of Legal Tender Currency Notes and Coins

The Central Bank of Nigeria engages in currency issue and distribution within the economy.

3.1.1b. Management of Nigeria's External Reserves

In order to safeguard the international value of the legal tender currency, the CBN is actively involved in the management of the country's debt and foreign exchange.

3.1.1c Debt Management

In addition to its function of mobilizing funds for the Federal Government, the CBN manages its domestic debt and services external debt on the advice of the Federal Ministry of Finance.

3.1.1d. Promotion and Maintenance of Monetary Stability and a Sound and Efficient Financial System

The effectiveness of any central bank in executing its functions hinges crucially on its ability to promote monetary stability. Price stability is indispensable for money to perform its role of medium of exchange, store of value, standard of deferred payments and unit of account.

3.1.1e. Banker and Financial Adviser to the Federal Government

The CBN as banker to the Federal government undertakes most of Federal Government banking businesses within and outside the country. The bank also provides banking services to the state and local governments and may act as banker to institutions, funds or corporations set up by the Federal, State and Local Governments.

3.1.1f. Banker and Lender of Last Resort to Banks

The Bank maintains current accounts for deposit money banks. Similarly, it undertakes trade finance functions on behalf of bank customers. Finally, it provides temporary accommodation to banks in the performance of its functions as lender of last resort.

3.1.1G. Developmental Functions of the CBN.

Consistent with its support for growth and development in the Nigeria economy, the Central Bank of Nigeria has been involved in developmental activities since its inception to date in all the sectors of the economy. Some of these activities are:-

i). Promotion of the Growth of Financial Markets.

A major function of the Bank is the promotion of the growth of the financial markets, which comprise the money, capital and foreign exchange markets.

ii). Other Promotional Activities of the Bank

Through its regulatory activities, the CBN has promoted growth in various sectors of the economy since the early 1970s to date. These include the promotion of wholly owned Nigerian enterprises, introduction of the rural banking scheme and the promotion of agricultural and manufacturing activities nationwide through its monetary policy.

iii). Establishment of Special Schemes and Funds

The Bank has been very active in the promotion of special schemes and funds to enhance economic development. These are in the areas of agricultural finance, export promotion, small and medium scale enterprises, and collaborative research/services to third parties.

3.1.2 THE ROLE OF THE NIGERIAN DEPOSIT INSURANCE CORPORATION (NDIC)

A well-designed DIS contributes to the stability of a country's financial system by reducing the incentives for depositors to withdraw their insured deposits from banks following rumors about their financial conditions. Functional roles of the NDIC include:

3.1.2a Payment of Liquidation Dividend to Depositors

In addition to the payment of insured depositors of closed banks, depositors with credit balances in excess of the guaranteed amount are also paid liquidation dividends based on the volume of proceeds of the closed banks' assets realized by the Corporation.

3.1.2b Payment of Liquidation Dividend to General Creditors

Similarly, liquidation dividend is also paid to some general creditors of some of the banks realized by the Corporation from the assets of such failed bank.

3.1.2c. Recovery of Loans & Advancement

The NDIC in its bid to make payments to general creditors of failed banks, engages in the recovery of the banks loan portfolio from the outstanding debtors in the books of the banks.

3.2.0 SOURCES OF DATA AND INSTRUMENT OF DATA COLLECTION

To ensure the reliability of the information resulting from the research, the researcher deployed the use of the two data types.

The data used in this study was thus derived from both primary and secondary sources.

3.2.1 Primary Data

Primary sources are the materials on a topic upon which subsequent interpretations or studies are based, anything from firsthand documents such as poems, diaries, court records, and interviews to research results generated by experiments, surveys, ethnographies, and so on. Primary sources are records of events as they are first described, without any interpretation or commentary. They are also sets of data, such as census statistics, which have been tabulated, but not interpreted.

Primary data has the advantage of giving the researcher the opportunity to conduct an unbiased and extensive study on the research problem set out to solve.

For the purpose of this research, the researcher used the underlisted primary research data:

i. Questionnaires: A structured questionnaire was used, which contained a series of questions. A structured questionnaire has the advantage of presenting questions in sequence. It standardises the research instruments and equally removes the chances of the respondent tele-guiding the researcher. The researcher used scaled questions.

ii. Observation: Observation means that the situation of interest is checked and a person or some mechanical device records the relevant facts, actions, or behaviors.

Accurate data about what consumers do in certain situations is provided by observation. Observation does not tell why it happened.

The researcher's observation of actual impact of the regulatory and supervisory functions of the central bank of Nigeria and the Nigerian deposit Insurance Corporation on the activities of bank was made possible because of his long-standing career in the financial service sector of the Nigerian financial industry.

The writer intends to carry out a study to determine the impact of the regulatory and supervisory functions of the Central Bank and the Nigerian Deposit Insurance Corporation on the activities of Nigerian banks.

To facilitate this process, a population size of one hundred and twenty people was chosen. The distribution of the respondents was based on current employees of selected banks, the Central Bank and the Nigerian Deposit Insurance Corporation and other account holders of banks.

The questionnaires will be administered in the six commercial centers in Nigeria namely, Lagos, PortHarcourt, Onitsha, Ibadan, Abuja and Kaduna, based on the fact that these cities account for 95% of banking activities in the country and also account for the largest percentage of commercial trade activities in the country, thereby attracting the largest patronage of banking services and products.

iii. Telephone Interview: Telephone interviews are easy to administer and allow data to be collected quickly at a relatively low cost. The interviewer can clarify the questions.

Response rates tend to be higher and telephone interviewing allows for greater sample control.

3.2.2 Secondary Data

Secondary sources, on the other hand, offer an analysis or a restatement of primary sources. They often attempt to describe or explain primary sources. Some secondary sources not only analyze primary sources, but use them to argue a contention or to persuade the reader to hold a certain opinion.

A lot of materials used, especially for the theoretical framework of this study was obtained from textbooks, journals, magazines and newspapers. All these served as the secondary source of data.

In order to access this information, data was collected from the following information centers:

a. The Central Bank of Nigeria Library in Lagos

b. The Nigerian Deposit Insurance Corporation Library in Lagos

c. The University of Lagos Library

d. The use of the internet downloaded materials

c. Materials from the print media

3.3.0 RESEARCH INSTRUMENTS

The instruments of research are determined in line with the nature and objective of the research. This study was designed to be facilitated using a survey format hence the use of a carefully designed and standardised questionnaire that allows respondents to answer certain collated questions. Questioning involves using a questionnaire (data collection instrument) to ask respondents questions to secure the desired information. The result of the questionnaire was combined with data collated from secondary sources as well as observations, to draw concluding inferences.

The questionnaires would be administered in the commercial cities of Nigeria, namely Lagos (in the south-west), Port Harcourt (in the south-south), Abuja (in the north central) and Onitsha (in the east), Ibadan (West), and Kano state. A fundamental decimal guarding the distribution of the research questionnaires is the number of banks located in an area, which invariably translates into the degree of utilization of bank services and products amongst the populace in that state. Find below the distribution of banks in each state, which formed a basis for the selection of the location for the distribution of the questionnaire. (Note that the total number of banks in Nigeria pre-consolidation stood at 3,367)

Table 15

DISTRIBUTION OF BANKS IN NIGERIA

NUMBER OF BANKS IN DIFFERENT LOCATIONS			
STATE	**NUMBER**	**% oF TOTAL**	**RANKING**
LAGOS	994	29.60%	1ST
ABUJA	177	5.30%	2ND
PORTHARCOURT	173	5.20%	3RD
ONITSHA	158	4.60%	4TH
KANO	134	4.00%	5TH
OYO(IBADAN)	121	3.60%	6TH

The questionnaires were distributed in the following proportions amongst the states so listed (Table 16)

Table 16: DISTRIBUTION OF RESPONDENTS BY LOCATION

STATES	DISTRIBUTION
Lagos	100
Abuja	50
Onitsha	100
Ibadan	75
Port Harcourt	75
Kano	50
TOTAL	**500**

3.4.0 RESEARCH POPULATION

According to Asika (1991), the population of a research study is defined as the census of all items or objects that possess the characteristic or that have the knowledge of the phenomenon being studied.

To reduce the laborious process of distributing questionnaires and conducting personal interviews with the entire population in the various institutions, a random selection of selected staff was carried out in the various institutions.

The sample size determined for this study was five hundred (500) respondents which comprised of bankers, staffs of the Central Bank and the Nigerian Deposit Insurance Corporation as well as randomly selected bank depositors with or without previous experience of bank distress. A distribution profile of the respondents can be tabulated thus:

TABLE 17: DISTRIBUTION OF RESPONDENTS BY FUNCTIONALITY

RESPONDENTS	DISTRIBUTION
CBN Staffs	100
NDIC Staffs	100
Bankers	150
Depositors	150
TOTAL	**500**

3.5.0 DETERMINATION OF SAMPLE SIZE

A sample size is defined as the subject or part of the entire population of the study from which we select a few objects (people) in the population for observation and then apply what was observed to the entire population of the study. The population of this study is a finite one. This made it possible for the researcher to use "Taro Yamame's (1964, page 30) formula for determining the sample size.

The formula is given as: $S = \frac{N}{1 + N(e)^2}$

Where; S = required sample size

N = Research Population

e = Margin of error, which was peg at 3% significance level

N = Total population chosen was 500

Hence, required sample size $S = \frac{N}{1 + N(e)^2}$

$$S = \frac{500}{1 + 500(0.03)^2}$$

$$S = \frac{500}{1.45}$$

$$S = 344.83 = 345$$

A sample size of 500 respondents was used and adequate care was taken to accommodate all categories of respondents in the analysis of data. To optimise the outcome of the research the researcher restricted the distribution of the questionnaires to some select staff of the Central Bank of Nigeria, The Nigerian Deposit Insurance Corporation, selected bank staff and bank depositors within the selected cities.

The sample size of this study was taken from selected financial institutions, senior staff of the Central Bank of Nigeria, the staff of the NDIC and other bank depositors and staff of banks in the selected cities.

3.6.0 ADMINISTRATION OF QUESTIONNAIRE & INTERVIEWS

The administration of questionnaire was done in locations at Lagos Island, Victoria Island and Ikoyi (where the head offices of most banks in Nigeria are domiciled) as well as in business districts of Port Harcourt, Abuja, Ibadan, Onitsha and Kano state of Nigeria. A total of five hundred (500) copies of questionnaires were distributed.

In order to obtain data from the sample respondents, Likert scale questionnaire was designed and administered among the chosen sample size. The success in the number of respondents to the administered questionnaire was ensured through the deployment of the assistance of fellow colleagues and friends who are resident in those cities and are also staffs of either the examination department of CBN or NDIC, or the respective financial institutions, in the distribution exercise.

Interviews were conducted with key regulatory and supervisory personnel on the research topic. The distribution of interviewee shall not be less than thirty (50) and their responses were very helpful to the final outcome of the study.

The people interviewed can be categorized as follows:

1.	CBN Staff	20
2.	NDIC Staff	20
3.	Financial experts and consultants	<u>10</u>
	TOTAL	**<u>50</u>**

3.7.0 METHOD OF DATA ANALYSIS

This involves the use of some statistical tools such as percentages, mean score and Chi-square test in order to make comparison, test the hypotheses and draw conclusions;

Percentages is a statistical tool that uses 100 as its base. It is simple and makes comparison easier – percentages are used in describing relationship.

Chi-square test provides a means of comparing a set of observed frequencies with a set of expected frequencies.

The test statistic for testing hypothesis is based on this quantity.

$$X^2 = \frac{(O_i - E_i)^2}{E_i}$$

Where: O_i = the observed frequency

E_i = the expected frequency

X^2 = the value of the random variables

CHAPTER 4

DATA PRESENTATION AND ANALYSIS

4.1 DATA PRESENTATION

This chapter involves the presentation and analysis of data gathered from the questionnaires which were administered on the sample selected. For the analysis, tables, bar charts, pie charts, graphs showing trends and simple percentage will be used to present data while the test of hypothesis shall be carried out using chi-square (X^2) statistics. The statistical tool adopted was opted for because it allows for effective understanding and interpretation of results.

Furthermore, in order to reduce the bulkiness of data, the data presented and analysed are those that are considered relevant to the problems, Objectives and hypotheses of this research work.

4.2 DATA ANALYSIS

The questionnaires which were designed to get the respondents' views on a number of issues relating to an assessment of the regulatory and supervisory impact of the CBN's and the NDIC functions in relation to the activities of Nigerian banks were administered to the four units of the sample population. These are bank staff, bank depositors, NDIC staff and CBN staff. A summary of the questionnaires to each category of respondent and the response rate is presented in Table 4.1.

TABLE 4.1

PERCENTAGE DISTRIBUTION OF RETURNED QUESTIONNAIRES BY RESPONDENTS

PERCENTAGE DISTRIBUTION OF RESPONDENTS			
	Administered	**Returned/Completed**	**Percentage %**
Bank Staff	150	140	93
CBN Staff	100	90	90
NDIC Staff	100	85	85
Depositors	150	135	90
TOTAL	500	450	90

Source: Field Study

From the table above, it can be seen that a total of 500 questionnaires were administered but only 450 or 90% was completed and returned.

The average response rate of 90% or 450 questionnaire was considered adequate for our analysis.

4.2.2 RESPONDENTS' ASSESSMENT OF THE IMPACT OF REGULATION AND SUPERVISION ON NIGERIAN BANKS

In order to access the impact of regulation and supervision on Nigerian banks, through an assessment of the role of the Central Bank and the Nigerian Deposit Insurance Scheme as a case study, the degree of respondents' opinion was sought using a five-point likert scale statements and the degree of their answers measured on the following scale as shown below:

Strongly agree (5)

Agree (4)

Strongly disagree (3)

Disagree (2) and

Undecided (1)

Q1: The stability in the banking system was as a result of efficient Regulation and Supervision by the Central Bank and The Nigerian Deposit Insurance Corporation(NDIC)

TABLE 4.2.3

RESPONSE	NO. OF RESPONDENT	PERCENTAGE
Strongly agree	75	16.7
Agree	100	22.2
Strongly disagree	133	29.6
Disagree	117	25.9
Undecided	25	5.6
TOTAL	**450**	**100**

The responses in Table 4.2.3 tries to affirm whether the stability in the banking system was as a result of sound regulatory and supervisory functions of the CBN and the NDIC in Nigerian banks. From the responses, 75 (16.7%) of the respondents strongly agreed, 100 (22.2%) agreed, 133 (29.6%) and 117 (25.9%) strongly disagreed while those that were indifferent are 25 representing (5.6%)

The break down indicates that most respondents believe that the stability in the banking system was not as a result of sound regulatory functions of the CBN and the NDIC.

TABLE 4.2.4

The performance rating of NDIC/CBN in their statutory function of regulation and supervision was high within the period covered by the study

RESPONSE	**NO. OF RESPONDENT**	**PERCENTAGE**
Strongly agree	125	27.8
Agree	117	25.9
Strongly disagree	83	18.5
Disagree	75	16.7
Undecided	50	11.1
TOTAL	**450**	**100**

Table 4.24 shows that the performance rating of NDIC/CBN in the discharge of their statutory function of regulation and supervision of banks was high. 125 respondents (27.8%) strongly agreed that the performance rating of NDIC/CBN is high, 117 respondents representing (25.9%) agreed, 83 respondents (18.5%) and 75 respondents (16.7%) disagreed and strongly agreed respectively, while 50 respondents representing 11.1% were indifferent. Based on this analysis, most respondents believe that the performance rating of NDIC/CBN in the discharge of their statutory functions of regulation and supervision of Nigerian banks was high.

TABLE 4.2.5

Routine Examination by NDIC and CBN has helped to ensure a healthy banking system and further reduced interest rate abuse by banks.

RESPONSE	NO. OF RESPONDENT	PERCENTAGE
Strongly agree	121	30.5
Agree	137	20.4
Strongly disagree	92	14.8
Disagree	67	16.7
Undecided	33	7.4
TOTAL	**450**	**100**

Table 4.2.5 presents a breakdown of the analysis. From the summary table, 121 respondents representing 26.9% of the sampled population strongly agreed that the routine examination by the NDIC and the CBN has helped in ensuring a healthy banking system and further reducing incidence of interest rate abuses by banks. 137 respondents representing 30.5% of the population only agreed while 92 respondents or 20.4% of the population size and 67 respondents representing 14.8% of the populations disagreed and strongly agreed respectively. 33 respondents (7.4%) remained indifferent. The conclusion from this breakdown is that respondents believe that routine examination by the NDIC and the CBN has helped to ensure a healthy banking system and also further reduce the incidence(s) of interest rate abuse by Nigerian banks.

TABLE 4.2.6

On-site supervision has helped in reducing unprofessional and unethical conduct in the business of banking in Nigeria.

RESPONSE	**NO. OF RESPONDENT**	**PERCENTAGE**
Strongly agree	113	25.0
Agree	104	23.1
Strongly disagree	100	22.2
Disagree	71	15.8
Undecided	63	13.9
TOTAL	**450**	**100**

On analysing the responses in Table 4.2.6, (on-site supervision has helped in reducing unprofessional and unethical conduct in Nigeria banks'), it was discovered that a total of 113 (25.0%) and 104 (23.1%) of the respondents strongly agreed and agreed respectively that on-site supervision of banks has helped in reducing unprofessional and unethical conduct in Nigeria banks; it was also discovered that about 100 (22.2%) and 71 (15.8%) of the respondents strongly disagreed and disagreed respectively while those that are indifferent represent only 63 (13.9%) of the respondents. Based on this analysis, most respondents were of the view that on-site supervision of banks has helped in reducing unprofessional and unethical conduct in Nigeria banks.

TABLE 4.2.7

The activities of the CBN and the NDIC have helped to instill public confidence in the Nigerian Banking System

RESPONSE	**NO. OF RESPONDENT**	**PERCENTAGE**
Strongly agree	108	24.1
Agree	117	25.9
Strongly disagree	79	17.6
Disagree	87	19.4
Undecided	59	13.0
TOTAL	**450**	**100**

The summary of the analysis in Table 4.2.7 shows that 117 (25.9%) of the respondents agreed that the activities of the Central Bank of Nigeria and the Nigerian Deposit Insurance Corporation has helped to instill public confidence in the Nigerian Banking system. However, 108 (24.1%) strongly agreed, 87 (19.4%) and 79 respondents (representing 17.6%) disagreed and strongly agreed respectively while 59 (13.0%) respondents were indifferent. Based on this analysis, we can surmise that most respondents believe that the activities of the Central Bank of Nigeria and the Nigerian Deposit Insurance Corporation have helped to instill public confidence in the Nigerian Banking system.

TABLE 4.2.8

Effective banking supervision has helped to address corporate governance issues in Nigerian Banks

RESPONSE	NO. OF RESPONDENT	PERCENTAGE
Strongly agree	117	25.9
Agree	104	23.1
Strongly disagree	75	16.7
Disagree	92	20.4
Undecided	63	13.9
TOTAL	**450**	**100**

The summary of responses in Table 4.2.8 shows that 117 (25.9%) of the respondents strongly agreed that effective banking supervision has helped to address corporate governance issues in banks, 104 (23.1%) agreed; 75 (16.7%) disagreed; 92 (20.4%) strongly disagreed while 63 (13.9%) of the respondents were indifferent. The breakdown analysis shows that effective banking supervision has helped to address corporate governance issues in Nigerian banks.

TABLE 4.2.9

The fifty thousand Naira (=N=50,000.00) Deposit insurance coverage is sufficient to minimize the risk suffered by depositors

RESPONSE	NO. OF RESPONDENT	PERCENTAGE
Strongly agree	63	13.9
Agree	75	16.7
Strongly disagree	117	25.9
Disagree	125	27.8
Undecided	71	15.7
TOTAL	**450**	**100**

The responses in Table 4.2.9 try to affirm whether the fifty thousand Naira N50,000.00 maximum insurance coverage is sufficient to minimize the risk that the depositors of banks suffer. From the responses, 63 of the respondents (13.9%) and 75 respondents (16.7%) strongly agreed and agreed respectively while 117 (25.9%) and 125 (27.8%) of the respondents strongly disagreed and disagreed respectively whereas 71 (15.7%) of the respondents were indifferent. The breakdown analysis shows that most respondents were of the view that the fifty thousand Naira (N50, 000.00) maximum coverage is not sufficient to minimize the risk that the depositors of banks suffer.

TABLE 4.2.10

Repeated infractions by banks should lead to a loss of the operating banking license by the offending banks

RESPONSE	NO. OF RESPONDENT	PERCENTAGE
Strongly agree	154	34.3
Agree	125	27.8
Strongly disagree	75	16.7
Disagree	58	12.9
Undecided	37	8.3
TOTAL	**450**	**100**

From the summary of the analysis in table 4.2.10, 154 (34.3%) of the respondents strongly agreed that repeated infractions by banks can lead to a loss of the operating banking license by the offending banks, 125 (27.8%) agreed, 75 (16.7%) strongly disagreed, 58 (12.9%) disagreed while 37 (8.3%) were indifferent. The breakdown analysis shows that most respondents believed that repeated infractions by banks can lead to a loss of the operating banking license by the offending banks.

TABLE 4.2.11

Regular and prompt payment of claims to insured depositors has restored public confidence in Nigerian banks.

RESPONSE	NO. OF RESPONDENT	PERCENTAGE
Strongly agree	146	32.4
Agree	133	29.6
Strongly disagree	63	13.9
Disagree	83	18.5
Undecided	25	5.6
TOTAL	**450**	**100**

From the summary of the analysis in Table 4.2.11, 146 respondents (32.4%) strongly agreed that regular payment of claims to insured depositors in the event of bank liquidation would go a long way in restoring public confidence in Nigerian banks. 133 (29.6%) agreed, 83 (18.5%) and 63 (13.9%) of the respondents disagreed and strongly disagreed while 25 (5.6%) were indifferent.

The breakdown analysis shows that regular payment of claims to insured depositors in the event of bank liquidation would go a long way in restoring public confidence in Nigeria banks.

TABLE 4.2.12

Is the imposition of monetary sanctions on banks sufficient to check against unethical practices?

RESPONSE	NO. OF RESPONDENT	PERCENTAGE
Strongly agree	83	18.5
Agree	75	16.7
Strongly disagree	117	25.9
Disagree	108	24.1
Undecided	67	14.8
TOTAL	**450**	**100**

The response in Table 4.2.12 tries to affirm whether the imposition of monetary sanctions on banks is sufficient to check against unethical practices. From the opinions expressed, 83 (18.5%) strongly agreed, 75 (16.7%) agreed, 117 (25.9%) strongly disagreed, 108 (24.1%) disagreed while 67 (14.8%) the respondents were indifferent. It is interesting to note that the majority of the respondents were of the view that the imposition of monetary sanctions on banks was not sufficient to check against unethical practices.

TABLE 4.2.13

The mandatory participation of banks in the Deposit Insurance Scheme (DIS) has gone a long way in raising the awareness of NDIC activities

RESPONSE	NO. OF RESPONDENT	PERCENTAGE
Strongly agree	79	17.6
Agree	75	16.7
Strongly disagree	117	25.9
Disagree	133	29.6
Undecided	46	10.2
TOTAL	**450**	**100**

From Table 4.2.13, 79 (17.6%) and 75 (16.7%) of the respondents strongly agreed and agreed respectively, that the mandatory participation of banks in the Deposit Insurance Scheme (DIS) has gone a long way in raising the awareness of NDIC activities while 117 respondents (25.9%) and 133 respondents (29.6%) strongly disagreed and disagreed respectively. 46 (10.2%) of the respondents were indifferent.

The breakdown analysis shows that the mandatory participation of banks in the deposit insurance scheme has not gone a long way in raising the awareness of NDIC activities.

TABLE 4.2.14

Urgent attention by NDIC/CBN toward verification, processing and settlement of claims filed by depositors of failed banks would reduce the risk suffered by depositors

RESPONSE	NO. OF RESPONDENT	PERCENTAGE
Strongly agree	133	29.6
Agree	117	25.9
Strongly disagree	83	18.5
Disagree	75	16.7
Undecided	42	9.3
TOTAL	**450**	**100**

Table 4.2.14 133 (29.6%) and 117 (25.9%) of the respondents strongly agreed and agreed respectively that urgent attention by NDIC/CBN toward verification, processing and settlement of claims filed by depositors of failed banks would reduce the risk suffered by depositors. A total of 83 (18.5%) and 75 (16.7%) strongly disagreed and disagreed respectively while 42 (9.3%) were indifferent. By implication, it shows that majority of the respondents believed that urgent attention toward verification, processing and settlement of claims filed by depositors of failed banks would reduce the risk suffered by depositors.

TABLE 4.2.15

Undelayed judgement from the judiciary on failed banks would repose public confidence and stability in Nigerian banks

RESPONSE	NO. OF RESPONDENT	PERCENTAGE
Strongly agree	125	27.8
Agree	137	30.5
Strongly disagree	75	16.7
Disagree	63	13.9
Undecided	50	11.1
TOTAL	**450**	**100**

The summary of response in Table 4.2.15 shows that 125 (27.8%) of the respondents strongly agreed that undelayed judgement from the judiciary on failed banks would promote public confidence and stability of the benefit systems, 137 (30.5%) agreed, 75 (15.7%) and 63 (13.9%) strongly disagreed and disagreedrespectively, while 50 (11.1%) of the respondents were indifferent. The breakdown analysis shows that undelayed judgement from the judiciary on failed banks would repose confidence and stability in Nigerian banks.

TABLE 4.2.16

The proposed increase in the insurance limit by NDIC/CBN from N50,000 to N100,000 to insured depositors will reduce the psychological/financial trauma suffered by depositors

RESPONSE	**NO. OF RESPONDENT**	**PERCENTAGE**
Strongly agree	133	29.6
Agree	117	26.0
Strongly disagree	37	8.3
Disagree	75	16.7
Undecided	87	19.4
TOTAL	**450**	**100**

The sampled opinion in Table 4.2.16 shows that about 133 (29.6%) and 117 (26.0%) of the respondents strongly agreed and agreed respectively, that the proposed increase in the insurance limit by NDIC from N50,000 to N100,000 to insured depositors would reduce the psychological/financial trauma suffered by depositors while 37 (8.3%) and 75 (16.7%) respectively strongly disagreed and disagreed to the statement. 87 (19.4%) respondents were indifferent. Based on this analysis, it shows that majority of the respondent are supportive of the proposed increase in the insurance limit.

TABLE 4.2.17

Disclosure of banks' annual financial statements to investors and the general public would help in determining the fitness of the banks

RESPONSE	NO. OF RESPONDENT	PERCENTAGE
Strongly agree	146	32.4
Agree	125	27.8
Strongly disagree	63	13.9
Disagree	71	15.7
Undecided	46	10.2
TOTAL	**450**	**100**

The summary of the responses in table 4.2.17 shows that 146 (32.4%) and 125 (27.8%) of the respondents strongly agreed and agreed respectively, that disclosure of banks' annual financial statements to investors and general public would help in determining the fitness of the bank while 63 (13.9%) and 71 (15.7%) respectively, strongly disagreed and disagreed to the statement. 46 (10.2%) of the respondents were indifferent. Based on this, disclosure of banks' annual financial statements to depositors and investors would help in determining the fitness of banks.

TABLE 4.2.18

The introduction of prudential guidelines has promoted the nation's banking stability

RESPONSE	NO. OF RESPONDENT	PERCENTAGE
Strongly agree	133	29.6
Agree	142	31.5
Strongly disagree	75	16.7
Disagree	63	13.9
Undecided	37	8.3
TOTAL	**450**	**100**

The sampled opinion in Table 4.2.18 in response to whether the introduction of prudential guidelines has promoted the nation's banking stability indicates that 133 (29.6%) and 142 (31.5%) of the respondents uphold this statement. 75 (16.7%) and 63 (13.9%) respectively, strongly disagreed and disagreed to the statement while 37 (8.3%) of the respondents were indifferent. Based on this analysis, it shows that most respondents uphold the statement.

TABLE 4.2.19

Effective supervision of banks would ensure prudent management of bank assets and guarantee the safety of depositors' funds

RESPONSE	NO. OF RESPONDENT	PERCENTAGE
Strongly agree	113	25.0
Agree	125	27.8
Strongly disagree	100	22.2
Disagree	79	17.6
Undecided	33	7.40
TOTAL	**450**	**100**

The summary of responses in Table 4.2.19 shows that 113 (25.0%) and 125 (27.8%) of the respondents respectively, strongly agreed and agreed that effective supervision of banks would ensure prudent management of banks assets and guarantee the safety of the depositors' funds while 100 (22.2%) and 79 (17.6%) of the respondents strongly disagreed and disagreed to the statement. However, 33 (7.40%) of the respondents were indifferent. Based on this analysis, it shows that effective supervision of banks would ensure prudent management of bank assets and guarantee the safety of depositors' funds.

TABLE 4.2.20

The regulatory and supervisory functions of the CBN and the NDIC have helped to guarantee safety and promote financially sound practice in Nigerian banks

RESPONSE	NO. OF RESPONDENT	PERCENTAGE
Strongly agree	121	26.9
Agree	108	24.0
Strongly disagree	75	16.7
Disagree	92	20.4
Undecided	54	12.0
TOTAL	**450**	**100**

The sampled opinion in table 4.2.20 in response to whether the Bank and Other Financial Institution Act (BOFIA) has helped in promoting safety and sound financial practice in Nigerian banks, shows 121 (26.9%) and 108 (24.0%) respondents respectively, strongly agreed and agreed to this statement while 75 (16.7%) and 92 (20.4%) strongly disagreed and disagreed to the statement. 54 (12.0%) of the respondents were indifferent. The summary of this analysis shows that majority of the respondent upholds the statement that the Bank and Other Financial Institution Act (BOFIA) has helped to guarantee safety as promote sound financial practice in Nigerian banks.

TABLE 4.2.21

The surveillance activities of the CBN and the NDIC has helped to reduce the incidence(s) of fraud and forgery in Nigerian banks

RESPONSE	NO. OF RESPONDENT	PERCENTAGE
Strongly agree	133	29.6
Agree	108	24.1
Strongly disagree	71	15.7
Disagree	92	20.4
Undecided	46	10.2
TOTAL	**450**	**100**

From the summary of the analysis in Table 4.2.21, 133 (29.6%) of the respondents strongly agreed that the surveillance activities of the CBN and the NDIC has helped to reduce the incidence(s) of fraud and forgery in Nigerian banks; 108 (24.1%) agreed, 71 (15.7%) and 92 (20.4%) disagreed respectively, while 46 (10.2%) were indifferent. The breakdown of the analysis shows that most respondents believe that the surveillance activities of the CBN and the NDIC have helped to reduce the incidence(s) of fraud and forgery in Nigerian banks.

TABLE 4.2.22 The regulatory and supervisory functions of the CBN and the NDIC have helped boost lending to the real sector of the economy

RESPONSE	NO. OF RESPONDENT	PERCENTAGE
Strongly agree	104	23.1
Agree	117	25.9
Strongly disagree	83	18.5
Disagree	79	17.5
Undecided	68	15.0
TOTAL	**450**	**100**

From the summary of the analysis in table 4.2.22, 104 (23.1%) and 117 (25.9%) of the respondents respectively, strongly agreed and agreed that the regulatory and supervisory function of the CBN and the NDIC have helped boost lending to the real sector of the economy while 83 (18.5%) and 79 (17.5%) of the respondents respectively, strongly disagreed and disagreed whereas 68 (15.0%) of the respondents were indifferent. The breakdown of the analysis shows that most respondents supported the statement.

TABLE 4.2.23

Banks regulation and supervision have helped in guarding against insider credits and other abuses by directors, managers and other officers of the banks

RESPONSE	NO. OF RESPONDENT	PERCENTAGE
Strongly agree	142	31.7
Agree	113	25.0
Strongly disagree	87	19.4
Disagree	63	13.9
Undecided	46	10.2
TOTAL	**450**	**100**

The summary of response in Table 4.2.23, shows that 142 (31.5%) and 113 (25.0%) of the respondents respectively, strongly agreed and agreed that bank regulation and supervision have helped in guarding against insider credits and other abuses by bank directors, managers and officers of banks; 87 (19.4%) and 63 (13.9%) respectively, strongly disagreed and disagreed to the statement while 46 (10.2%) of the respondents were indifferent.

TABLE 4.2.24

Bank regulation and supervision have helped in ensuring that only men and women of impeccable character are approved as directors of banks.

RESPONSE	NO. OF RESPONDENT	PERCENTAGE
Strongly agree	138	30.5
Agree	129	28.7
Strongly disagree	83	18.5
Disagree	74	16.5
Undecided	25	5.6
TOTAL	**450**	**100**

From the summary of response in table 4.2.24 shows that 138 (30.5%) and 129 (28.7%) of the respondents respectively, strongly agreed and agreed that bank regulation and supervision have helped in ensuring that only men and women of impeccable character are approved as directors of banks; 83 (18.5%) and 74 (16.7%) respectively, strongly disagreed and disagreed while 25 (5.6%) were indifferent. The breakdown analysis shows that most respondents supported the statement.

TABLE 4.2.25

The regulation/supervision of banks has helped in boosting public confidence in banks hence reducing the amount of money in circulation outside the banking system

RESPONSE	NO. OF RESPONDENT	PERCENTAGE
Strongly agree	146	32.4
Agree	121	26.8
Strongly disagree	75	16.7
Disagree	63	13.9
Undecided	46	10.2
TOTAL	**450**	**100**

The summary of response in table 4.2.25, shows that 146 (32.4%) and 121 (26.8%) of the respondents respectively, strongly agreed and agreed that the regulation/supervision of banks has helped in boosting public confidence in banks, hence reducing the amount of money in circulation outside the banking system; while 75 (16.7%) and 63 (13.9%) of the respondents respectively, strongly disagreed and disagreed to it.

However, 46 (10.2%) of the respondents were indifferent. The breakdown analysis indicates that most respondents supported the above statement.

TABLE 4.2.26

The performance rating of NDIC/CBN in ensuring public confidence is high

RESPONSE	**NO. OF RESPONDENT**	**PERCENTAGE**
Strongly agree	183	40.7
Agree	158	35.2
Strongly disagree	33	7.4
Disagree	50	11.1
Undecided	25	5.6
TOTAL	**450**	**100**

From the summary in Table 4.2.26, 183 of the respondents representing 40.7% of the sample population strongly agreed, and 158 respondents representing 35.2% of the population agreed that the performance rating of NDIC/CBN in ensuring public confidence was high, while 33 (7.4%) and 50 (11.1%) of the respondents strongly disagreed and disagreed respectively. However, 25 (5.6%) of the respondents were indifferent. The breakdown analysis shows that majority of the respondents upheld the statement.

TABLE 4.2.27

Investors and depositors are aware of the activities of the CBN and the NDIC especially in the areas of premium charge and insurance limit

RESPONSE	NO. OF RESPONDENT	PERCENTAGE
Strongly agree	83	18.5
Agree	101	22.5
Strongly disagree	108	24.1
Disagree	117	25.9
Undecided	41	9.0
TOTAL	**450**	**100**

From summary of the table in 4.2.27, 83 respondents representing 18.5% of the population size strongly agreed; 101 respondents representing 22.5% of the respondents agreed that investors and depositors are aware of the activities of the CBN and the NDIC especially in the areas of premium charge and insurance limit, while 108 (24.1%) and 117 (25.9%) strongly disagree and disagreed respectively to it. However, 41 (9.9%) respondents were indifferent. Based on this analysis, it shows that majority of the respondents were not in support of the statement.

TABLE 4.2.28

CAMEL framework was useful for assessing the performance of banks in Nigeria

RESPONSE	NO. OF RESPONDENT	PERCENTAGE
Strongly agree	125	27.8
Agree	113	25.0
Strongly disagree	79	17.6
Disagree	100	22.2
Undecided	33	7.40
TOTAL	**450**	**100**

The summary of responses in the table shows that 125 (27.8%) and 113 (25.0%) of the respondents strongly agreed and agreed respectively that the CAMEL framework was useful for assessing performance of insured banks 79 (17.6%); 100 (22.2%) strongly disagreed and disagreed respectively while 33 (7.40%) of the respondents were indifferent. The analysis indicates that most respondents supported the statement that the CAMEL framework was very useful in assessing performance of insured banks.

4.3 HYPOTHESIS TESTING

The researcher adopted the Chi-Square goodness-of-fit test to test the hypothesis. The Chi-Square statistics formula is given as

X^2 = Summation of $(O_i - E_i)^2 / E_i$

Where O_i = Observed frequency

E_i = expected frequency

The degree of freedom n = 5, V = 5-1=4

Level of significance = 5% or 0.05

Note: E_i = total frequency 450 divided by 5 = 90

HYPOTHESIS 1

H_0: The supervisory and regulatory functions of the Central Bank (CBN) and the NDIC have been effective in curtailing distress in the Nigerian banking system

H_1: The supervisory and regulatory functions of the CBN and the NDIC have not been effective in curtailing distress in the Nigerian banking system

TABLE 4.2.34

RESPONSE	NO. OF RESPONDENT	PERCENTAGE
Strongly agree	96	21.3
Agree	129	28.7
Strongly disagree	83	18.5
Disagree	92	20.4
Undecided	50	11.1
TOTAL	**450**	**100**

Source: Field Study

DECISION RULE

If the Chi-square calculated value is greater than the Chi-square table value, accept the alternative hypothesis, but if otherwise, reject the alternative and accept the null hypothesis.

O_i	E_i	$O_i - E_i$	$(O_i - E_i)^2$	$(Oi-Ei)^2$ /Ei
96	90	5.85	34.22	0.38
129	90	39.15	1532.72	17.03
83	90	(6.75)	45.56	0.51
92	90	1.8	3.24	0.04
50	90	(40.05)	1604.00	17.82
			Total	**35.78**

DECISION

Since X^2 calculated, of the value 35.78 is less than the value of X^2 derived, i.e. 36.23 at (n-1) degree of freedom, we reject H_1 (alternative hypothesis) at 5% level of significance and accept

H_0 (null hypothesis). By this analysis, it shows that the supervisory and the regulatory functions of the CBN and the NDIC have been effective in curtailing distress in the Nigeria banking system.

Let us examine further performance indicators of banking sector soundness using the "CAMEL" parameters

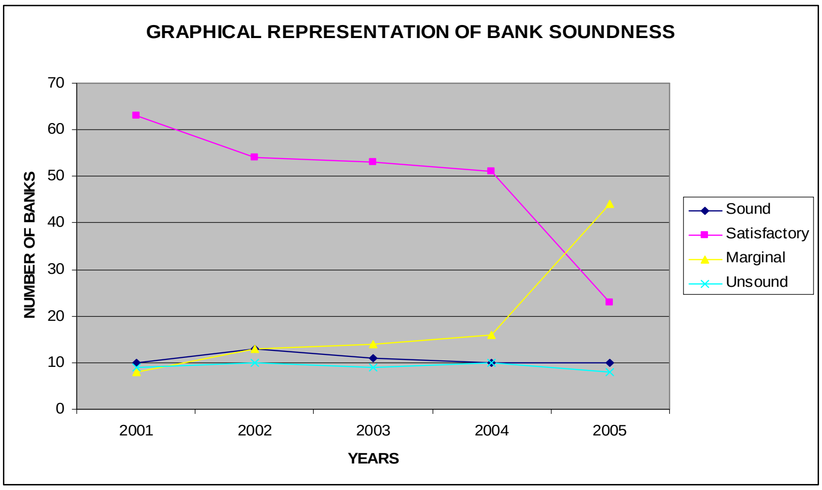
An assessment of the operational performance of banks (pre-consolidation era) revealed mixed developments. The ratings of licensed banks, using the CAMEL parameter of Capital adequacy, Asset quality, Management experience, Earning strength and Liquidity, reveals that, of the 87 licensed operational banks, only ten (ten) were adjudged financially "sound", fifty-one (51) were "satisfactory", sixteen (16) were rated "marginal" while ten (10) banks were rated "unsound" in 2004.

A RATING OF BANKS USING THE "CAMEL" PARAMETERS

CATEGORY	NUMBER			
	2001	**2002**	**2003**	**2004**
Sound	10	13	11	10
Satisfactory	63	54	53	51
Marginal	8	13	14	16
Unsound	9	10	9	10
TOTAL	**90**	**90**	**87**	**87**

Source: CBN annual Report and Statement of account 2004 & 2005

It should be noted that the marginal and/or unsound banks have exhibited such weaknesses as undercapitalization, illiquidity, weak/poor asset quality, poor earnings as well as a weak management team.



Source: CBN annual Report and Statement of account 2004 & 2005

The graph shows clearly, a fall in the soundness of banks over the period under review, which negates the respondents' view of the effectiveness of supervisory and regulatory functions of the Central Bank of Nigeria as well as the Nigerian Deposit Insurance Corporation (NDIC). Hence based on the evidence of the information presented above we conclude that the supervisory and the regulatory functions of the CBN and the NDIC have not been effective in curtailing distress in the Nigeria banking system. We accept H_1, hence banking supervision and regulation have not been able to ensure a healthy banking system.

HYPOTHESIS 2

H_O: The Regulatory and Supervisory activities of the CBN and the NDIC have boosted depositors' confidence in the Banking System

H_1: The Regulatory and Supervisory activities of the CBN and the NDIC have not boosted depositors' confidence in the Banking System

TABLE 4.2.35

RESPONSE	NO. OF RESPONDENT	PERCENTAGE
Strongly agree	113	25.0
Agree	108	24.1
Strongly disagree	83	18.5
Disagree	96	21.3
Undecided	50	11.1
TOTAL	**450**	**100**

Source: Field Study

Decision Rule:

If the Chi-square calculated value is greater than the Chi-square table value, we accept the alternative hypothesis, but if otherwise, reject the alternative and accept the null hypothesis.

O_i	E_i	$O_i - E_i$	$(O_i - E_i)^2$	$(Oi-Ei)^2$ /Ei
113	90	22.5	506.25	5.63
108	90	18.45	340.40	3.78
83	90	(6.75)	45.56	0.51
96	90	5.85	34.22	0.38
50	90	(40.05)	1604.00	17.82
			Total	**28.12**

Note: Degree of freedom n-1 = 4

Level of significance = 5%

Critical value X^2 0.05 at 4 degree of freedom = 36.23

Chi-square calculated = 28.12

Analysis of the test result (27.78<28.12). The null hypothesis (H_O) is accepted while the alternative (H_1) is rejected.

By this analysis, the Regulatory and Supervisory activities of the CBN and the NDIC have contributed positively in boosting depositors' confidence in the Nigerian banking system.

Let us examine also some technical data to test our findings:

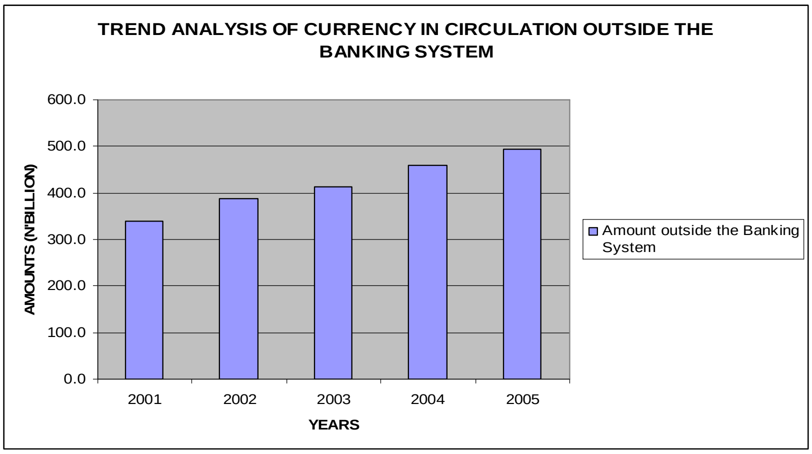
The table below tabulates the aggregate amount of money in circulation outside the vaults of money deposit banks over the period being reviewed. A cursory examination of these figures highlights the increasing trend in the amount circulating outside the coffers of deposit money banks over the years.

AMOUNT IN CIRCULATION OUTSIDE THE BANKING VAULT

YEAR	AMOUNT N' BILLION
2001	340.0
2002	387.2
2003	412.4
2004	458.5
2005	493.4

Source: CBN annual Report and Statement of account 2004 & 2005

Representing this data graphically we have:



In analyzing this data, we note that the inference drawn from the respondents lends credence to the fact that the functions of the Central Bank and the NDIC with respect to the supervision and regulation of banks have boosted depositors' confidence. However, the evidence as presented by the data does not support this decision. Hence, we reject H_o and accept H_1.

HYPOTHESIS 3

H_0: The Supervisory and Regulatory activities of the CBN and the NDIC has impacted positively on the pricing of banks products to their external customers

H_1: The Supervisory and Regulatory activities of the CBN and the NDIC has not impacted positively on the pricing of banks products to their external customers

TABLE 4.2.36

RESPONSE	**NO. OF RESPONDENT**	**PERCENTAGE**
Strongly agree	117	26
Agree	104	23.1
Strongly disagree	87	19.4
Disagree	100	22.2
Undecided	42	9.3
TOTAL	**450**	**100**

Source: Field Study

Decision Rule: If the Chi-square calculated value is greater than the Chi-square table value, we accept the alternative hypothesis, but if otherwise, we reject the alternative and accept the null hypothesis.

O_i	E_i	$O_i - E_i$	$(O_i - E_i)^2$	$(Oi-Ei)^2$ /Ei
117	90	27.00	729.00	8.10
108	90	13.95	194.60	2.16
83	90	(2.70)	7.29	0.08
96	90	9.90	98.01	1.09
50	90	(48.15)	2318.42	25.76
			Total	**37.19**

Degree of freedom n – 1 = 4

Level of significance 5%

Critical value X2 0.05 at 4 degree of freedom = 36.23

Chi-square calculated = 37.19

Since the value of X^2 calculated of 37.19 is greater than the value of the tabulated X^2 of 36.23 we accept the alternative hypothesis (H_1) and reject the null hypothesis (H_o). By this analysis, it shows that the supervisory and regulatory activities of the CBN and the NDIC have not impacted positively on the pricing of bank products and services to their external customers.

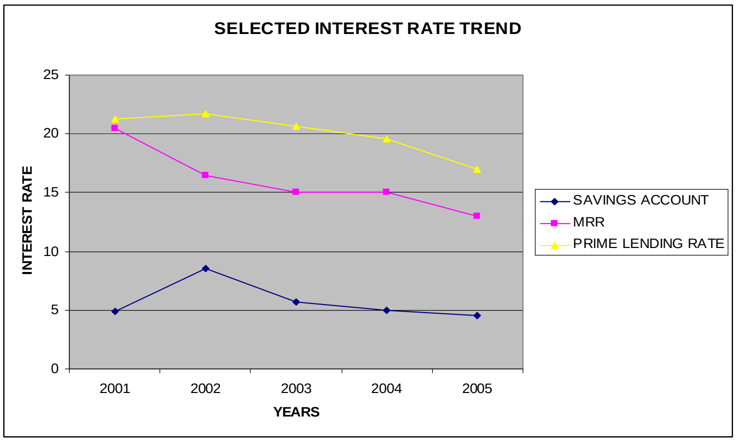
Let us examine selected data of the ruling interest rate regime over the period of the analysis.

SELECTED INTEREST RATES

ITEMS	2001 %	2002 %	2003 %	2004 %	2005 %
SAVINGS ACCOUNT	4.9	8.5	5.7	5	4.5
MRR	20.5	16.5	15	15	13
PRIME LENDING RATE	21.3	21.7	20.6	19.6	17

Source: CBN annual Report and Statement of account 2004 & 2005

The table above shows the movement in average rates for selected key drivers of rates in the money market over the period of review. It shows that interest rate for savings, and lending rate responded directly to drop in the minimum rediscount rate of the Central Bank over the period. Representing the information graphically we have:



The result of the data is in opposition to our earlier inference that the activities of the regulatory and supervisory functions of the Central Bank and the NDIC have not impacted positively on the pricing of products and services of banks to their external customers, hence we accept H_o.

HYPOTHESIS 4

H_o: The Supervisory and Regulatory functions of the Central Bank and the NDIC have been effective in improving Corporate Governance Issues in the Nigerian Banking Industry.

H_1: The Supervisory and Regulatory functions of the Central Bank and the NDIC have not been effective in improving Corporate Governance Issues in the Nigerian Banking Industry.

TABLE 4.2.37

RESPONSE	NO. OF RESPONDENT	PERCENTAGE
Strongly agree	96	21.3
Agree	83	18.5
Strongly disagree	121	26.9
Disagree	104	23.1
Undecided	46	10.2
TOTAL	**450**	**100**

Source: Field Study

Decision Rule: If the chi-square calculated value is greater than the chi-square table value, we accept the alternative hypothesis, but if otherwise, we reject the alternative and accept the null hypothesis.

O_i	E_i	$O_i - E_i$	$(O_i - E_i)^2$	$(Oi-Ei)^2$ /Ei
121	90	31.05	964.10	10.71
104	90	13.95	194.60	2.16
83	90	(6.75)	45.56	0.51
96	90	5.85	34.22	0.38
46	90	(44.10)	1944.81	21.61
			Total	**35.37**

Degree of freedom n – 1 = 4

Level of significance 5%

Critical value X^2 0.05 at 4 degree of freedom = 36.23

Chi-square calculated = 35.37

Deducing from the test result (35.37<36.23), the null hypothesis is accepted while the alternative is rejected. By this, it shows that the Supervisory and Regulatory functions of the Central Bank and the NDIC have been effective in improving Corporate Governance Issues in the Nigerian banking industry.

Let us examine data as compiled from the CBN Sub-committee on ethics and professionalism in Nigerian banks with particular reference to the amount of public complaints by customers of Nigerian banks against the banks.

Nature and Types of Public Complaints

Public complaints against banks are several and varied. The most frequent types according to the professional and ethics committee of the Banking supervision department are highlighted below:

I. Exploiting the ignorance of unsuspecting customers through excess commissions and illegal charges.

II. Refusal by banks to open certain types of accounts e.g. salary accounts.

III. Failure to issue bank statements regularly to customers.

IV. Illegal disposal of customers' properties pledged as collateral for credit facilities.

V. Shortages in cash withdrawals.

VI. Unilateral application of interest rates outside the terms negotiated with customer.

VII. Refusal to honour the terms of performance bonds.

VIII. Excess charges on bank drafts.

IX. Introduction of extraneous terms into contracts with customers, to short-change them.

X. Unauthorised/arbitrary debiting of customers' accounts.

XI. Release of funds transferred from overseas to impersonators.

XII. Imposition of previously undisclosed charges on customers' accounts.

XIII. Failure to credit customers' ledgers with the amounts deposited.

It is pertinent to observe that the trend of public complaints against banks has being rising in recent times as shown in the table

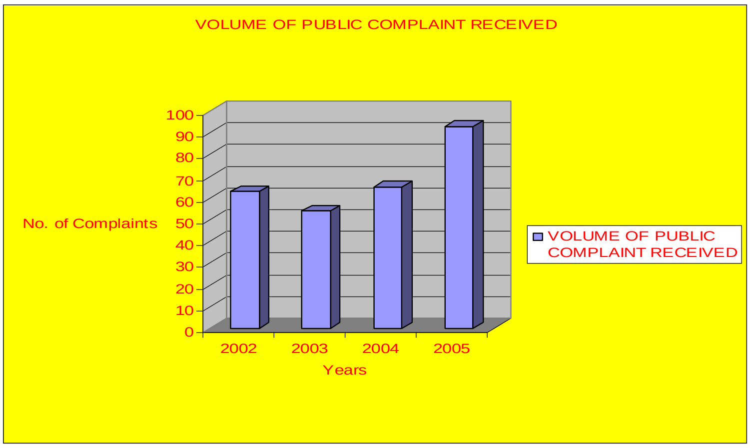
VOLUME OF PUBLIC COMPLAINT RECEIVED	
YEARS	**NUMBER**
2002	63
2003	54
2004	65
2005	93

Source: Bankers Committee Office: Banking Supervision department

From the above, the volume of complaints against banks ethics and professionalism in the conduct of their banking business as outlined above has continued to increase over the years.

Hence, based on the data provided by the central regulators, we would thus reject the Null hypothesis and accept the alternative hypothesis (H_1) which categorically states that The Supervisory and Regulatory functions of the Central Bank and the NDIC have not been effective in improving Corporate Governance Issues in the Nigerian Banking Industry.

Graphing our findings we have:



Source: Bankers Committee Office: Banking Supervision department

HYPOTHESIS 5

Ho: Effective regulations and supervisions of the CBN and the NDIC would boost the volume and the value of transactions witnessed in the Nigerian Banking Industry.

H_1: Effective regulations and supervisions of the CBN and the NDIC would not boost the volume and the value of transactions witnessed in the Nigerian Banking Industry.

TABLE 4.2.38

RESPONSE	NO. OF RESPONDENT	PERCENTAGE
Strongly agree	125	27.8
Agree	100	22.2
Strongly disagree	95	21.0
Disagree	77	17.0
Undecided	54	12.0
TOTAL	**450**	**100**

Source: Field Study

DECISION RULE

If the Chi-square calculated is greater than the Chi-square table, accept the alternative hypothesis but if otherwise, reject the alternative hypothesis and accept the null hypothesis.

O_i	E_i	$O_i - E_i$	$(O_i - E_i)^2$	$(Oi-Ei)^2$ /Ei
125	90	35.10	1232.01	13.69
100	90	9.90	98.01	1.09
95	90	4.50	20.25	0.23
77	90	(13.50)	182.25	2.03
54	90	(36.00)	1296.00	14.40
			Total	**31.43**

Degree of freedom n – 1 = 4

Level of significance 5%

Critical value X^2 0.05 at 4 degree of freedom = 36.23

Chi-square calculated = 31.43

Interpreting from the test result (31.43<36.23), the null hypothesis (H_o) is accepted while the alternative (H_1) is rejected. By this, it shows that effective regulations and supervisions of the CBN and the NDIC would boost the volume and the value of transactions witnessed in the Nigerian banking industry

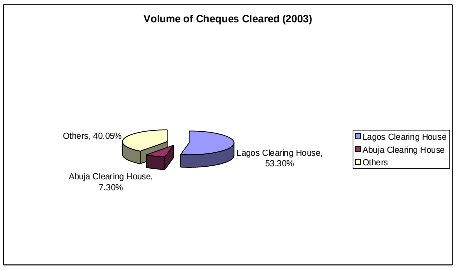
Let us however examine some empirical data as sourced from the CBN annual report:

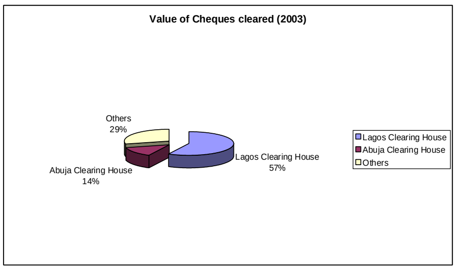
VOLUME AND VALUE OF CHEQUES CLEARED

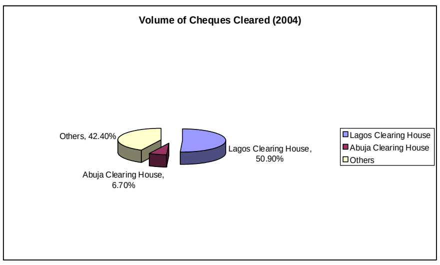
	2003		2004	
	Vol (N'billion)	**Value (N'billion)**	**Vol (N'billion)**	**Value (N'billion)**
Clearing System	12,526,643.00	8,928.40	13,997,898.00	10,996.00
Lagos Clearing House	6,679,654.00	5,132.80	7,122,056.00	5,744.20
	53.30%	57.59%	50.90%	52.20%
Abuja Clearing House	842,088.00	1,156.50	1,006,194.00	1,135.40
	7.30%	28.50%	6.70%	13.00%
Others	5,004,901.00	2,639.20	5,869,648.00	4,116.40
	40.05%	29.60%	41.90%	37.40%

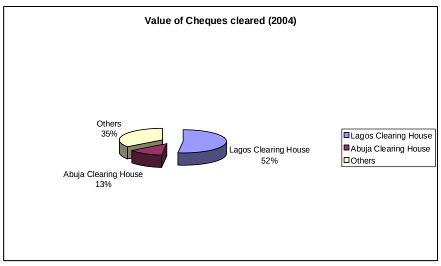
Source: CBN annual Report and Statement of account 2004 & 2005

The clearing activities involving cheques shows a further increase in 2004, reflecting some improvement in the payments system architecture, the banking habits of users as well as public confidence in the banking system. The volume and value of cheques cleared through the system rose by 11.7% and 23.2% respectively in the year 2004.









From the empirical evidence provided above, it can be deduced that the volume and value of transactions has been on the increase, hence, the null hypothesis earlier chosen is further supported by this evidence.

HYPOTHESIS 6

Ho: The Regulatory and Supervisory functions of the CBN and the NDIC have stemmed the incidence of widespread bad loan portfolio in the Nigerian banking system.

H1: The Regulatory and Supervisory functions of the CBN and the NDIC have not stemmed the incidence of widespread bad loan portfolio in the Nigerian Banking system.

TABLE 4.2.39

RESPONSE	**NO. OF RESPONDENT**	**PERCENTAGE**
Strongly agree	46	27.8
Agree	96	21.3
Strongly disagree	133	29.6
Disagree	117	25.9
Undecided	59	13.0
TOTAL	**450**	**100**

Source: Field Study

DECISION RULE

If the Chi-square calculated value is greater than the Chi-square table value, we accept the alternative hypothesis, but if otherwise, we reject the alternative and accept the null hypothesis.

O_i	E_i	$O_i - E_i$	$(O_i - E_i)^2$	$(Oi-Ei)^2$ /Ei
46	90	(44.10)	1944.81	21.61
96	90	5.85	34.22	0.38
133	90	43.20	1866.24	20.74
177	90	26.55	704.906	7.83
59	90	(31.50)	992.256	11.03
			Total	**61.58**

Degree of freedom n – 1 = 4

Level of significance 5%

Critical value X^2 0.05 at 4 degree of freedom = 36.23

Chi-square calculated = 61.58

Interpreting the test result (61.58>36.23), the null hypothesis (H_o) is rejected while the alternative (H_1) is accepted. By this, it shows that the Regulatory and Supervisory functions of the CBN and the NDIC have not stemmed the incidence of widespread of bad loan portfolio in the Nigerian banking system.

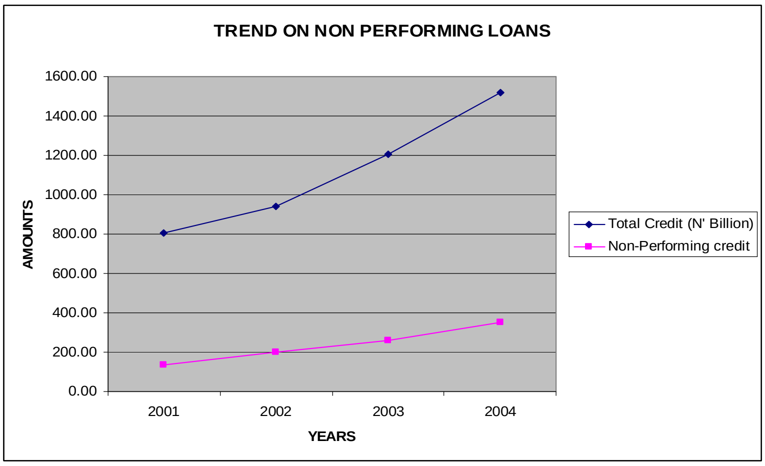
Let us examine further evidence from the books of account of insured banks to verify this statement.

ASSET QUALITY OF INSURED BANKS				
	2001	2002	2003	2004
Total Credit (N' Billion)	803.00	938.69	1205.03	1519.76
Non-Performing credit	135.71	199.66	260.19	350.82
Ratio of NPL/TL	16.90%	21.27%	29.00%	33.32%

Source: CBN annual Report and Statement of account 2004 & 2005

From the data presented above, it can be seen that the ratio of Non-performing loans to total loan portfolio in the insured banks in Nigeria has continually, been on the increase over the period of the research. Hence, we can safely conclude that the impact of regulation and supervision in stemming this syndrome have not been effective.

Plotting the graph to show the trend line, we have:



HYPOTHESIS 7

Ho: The Regulatory and Supervisory functions of the CBN and the NDIC have stemmed the distress syndrome in the Nigerian Banking Industry.

H1: The Regulatory and Supervisory functions of the CBN and the NDIC have not stemmed the distress syndrome in the Nigerian Banking Industry.

TABLE 4.2.40

RESPONSE	**NO. OF RESPONDENT**	**PERCENTAGE**
Strongly agree	113	25.0
Agree	121	26.9
Strongly disagree	79	17.6
Disagree	83	18.5
Undecided	54	12.0
TOTAL	**450**	**100**

Source: Field Study

DECISION RULE

If the Chi-square calculated value is greater than Chi-square table value, we accept the alternative hypothesis but if otherwise, we reject the alternative and accept the null hypothesis.

O_i	E_i	$O_i - E_i$	$(O_i - E_i)^2$	$(Oi-Ei)^2$ /Ei
113	90	22.50	506.25	5.63
121	90	31.05	964.10	10.71
79	90	(10.80)	116.64	1.30
83	90	(6.75)	45.56	0.51
54	90	(36.00)	1296.00	14.40
			Total	**32.54**

Degree of freedom (n – 1) = 5-1= 4

Level of significance 5%

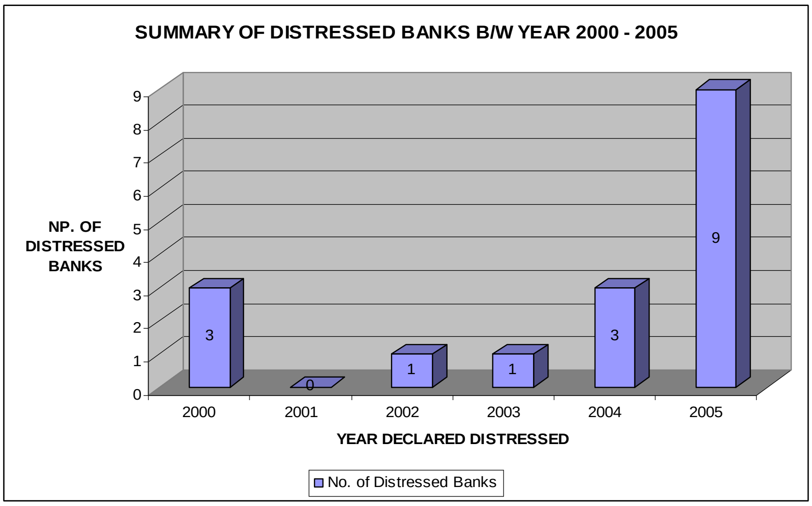
Critical value X^2 0.05 at 4 degree of freedom = 36.23

Chi-square calculated = 32.54

Interpreting the test result (32.54<36.23), the null hypothesis (H_0) is accepted while the alternative is rejected. By this, the respondents conclude that the Regulatory and Supervisory functions of the CBN and the NDIC have stemmed the distress syndrome in the Nigerian banking industry. Let us examine empirical evidence of distress to argue our interpretation of the responses from the respondents.

SUMMARY OF DISTRESS BANKS BETWEEN 2000 - 2005						
	YEAR DECLARED DISTRESSED					
	2000	**2001**	**2002**	**2003**	**2004**	**2005**
NAME						
Ivory Merchant Bank	X					
Premier Commercial Bank	X					
Rims Merchant Bank	X					
Savannah Bank			X			
Peak Merchant Bank				X		
Societe General Bank(SGBN)					X	
Bank of the North					X	
African International Bank					X	
Triumph Bank						X
Fortune Bank						X
Allstates Trust Bank						X
City Express Bank						X
Assurance Bank						X
Lead Bank						X
Eagle Bank						X
Gulf Bank Plc						X
Metropolitan Bank						X
TOTAL	**3**	**0**	**1**	**1**	**3**	**9**

Representing the data graphically we have the following outcome:



Source: CBN annual Report and Statement of account 2004 & 2005

From the evidence of the data presented above, it is clear that wide-spread evidence of distress still pervaded the system in the year 2005 despite the regulatory and supervisory activities of the Central Bank of Nigeria (CBN) and the Nigerian Deposit Insurance Corporation (NDIC).

However, while the distress in the system for the years 2000 – 2004 were largely as a result of market influences, weak capital base, low earning strength, management incompetence and board squabbles as well as liquidity crisis, the large-scale distress witnessed in the year 2005 was directly related to the regulatory proviso that mandated all banks in the country to recapitalize their shareholders funds from the initial N2 billion to N25 billion spurring banks to go into different merger and acquisition combinations in order to meet the set dead-line of December 31st 2005.

The fragile state of the industry and the lapse in the regulatory functions of the CBN and the NDIC as regulators of the banking industry was further reinforced in the case of All-States Trust Bank that ran into a liquidity binge in the middle of its capital-raising exercise through an Initial Public offer (IPO).

Given the large-scale distress syndrome and the widespread evidence of bad loans and badly-managed banks that emanated as a result of the recapitalization drive of the CBN, it is evident that the supervisory activities of the CBN have not been very effective in checking distress within the system.

Hence, in spite of the evaluation as presented by the respondents, we reject the Null Hypothesis H_0 and accept H_1.

HYPOTHESIS 8

Ho: The Insurance premium of N50, 000 payable by the NDIC to bank customers in the light of distress is sufficient to boost customers' confidence in the banking system.

H1: The Insurance premium of N50, 000 payable by the NDIC to bank customers in the light of distress is not sufficient to boost customers' confidence in the banking system.

TABLE 4.2.41

RESPONSE	NO. OF RESPONDENT	PERCENTAGE
Strongly agree	46	10.2
Agree	96	21.3
Strongly disagree	133	29.6
Disagree	117	25.9
Undecided	59	13.0
TOTAL	**450**	**100**

Source: Field Study

DECISION RULE

If the Chi-square calculated value is greater than the Chi-square table value, accept the alternative hypothesis but if otherwise, reject the alternative and accept the null hypothesis.

O_i	E_i	$O_i - E_i$	$(O_i - E_i)^2$	$(Oi-Ei)^2$ /Ei
46	90	(44.10)	1944.8	21.61
96	90	5.85	34.22	0.38
133	90	43.20	1866.24	20.74
117	90	26.55	704.90	7.83
59	90	(31.50)	992.25	11.03
			Total	**61.58**

Degree of freedom n – 1 = 4

Level of significance 5%

Critical value X^2 0.05 at 4 degree of freedom = 36.23

Chi-square calculated = 61.58

Interpreting the test result (61.58>36.23), the null hypothesis (Ho) is rejected while the alternative is accepted. By this, it shows that the insurance premium of N50, 000 payable by the NDIC to Bank customers in the light of distress is not sufficient to boost customers' confidence in the banking system.

CHAPTER 5

DISCUSSION OF RESULT

5.0.0 INTRODUCTION

The chapter attempts to collate all the research findings into a set of knowledge that would guide the recommendations and conclusions that the researcher would draw up in the next chapter.

The chapter attempts to answer the following questions:

a. Are your findings consistent with existing knowledge and views?

b. Are there any new findings in the course of the investigations?

c. What are the proofs of hypotheses earlier drawn up in the previous chapter?

5.1.0 FINDINGS

The data collated from the questionnaires were impressive based on the number of returned questionnaires to the researcher from the respondents and the level of cooperation exhibited by the respondents engaged in the oral interview via telephone.

From the statistics, four hundred and fifty respondents equaling 90% of the total population size responded to the questionnaires and submitted completed copies of the questionnaires back to the researcher.

From the results of the hypothesis testing as presented in chapter four, we can state our research findings to include:

1. The supervisory and the regulatory functions of the CBN and the NDIC have not been effective in curtailing distress in the Nigerian banking system.
2. Most respondents believed that the Regulatory and Supervisory activities of the CBN and the NDIC have not boosted depositors' confidence in the banking system.
3. Respondents also believed that the Supervisory and Regulatory activities of the CBN and the NDIC have impacted positively on the pricing of banks' products to their external customers.

4. Respondents were of the view that the Supervisory and Regulatory functions of the Central Bank and the NDIC have not been effective in improving Corporate Governance issues in the Nigerian banking industry.
5. Effective regulations and supervisions by the CBN and the NDIC would boost the volume and the value of transactions witnessed in the Nigerian banking industry.
6. The Regulatory and Supervisory functions of the CBN and the NDIC have not stemmed the incidence of widespread bad loan portfolio in the Nigerian banking system.
7. From the analysis, most respondents were of the view that the Regulatory and Supervisory functions of the CBN and the NDIC have not stemmed the distress syndrome in the Nigerian banking industry.
8. The Insurance premium of N50, 000 payable by the NDIC to bank customers in the light of distress is not sufficient to boost customers' confidence in the banking system.
9. Most respondents believed that repeated infractions by Banks can lead to a loss of the operating banking license by the offending banks.
10. Regular payment of claims to insured depositors in the event of bank liquidation would go a long way in restoring public confidence in Nigeria banks.
11. The majority of the respondents were of the view that the imposition of monetary sanctions on banks was not sufficient to check against unethical practices.
12. The result shows that majority of the respondents believed that urgent attention toward verification processing and settlement of claims filed by depositors of failed banks would help in confidence-boosting to the banks' customers.
13. Un-delayed judgment from the judiciary on failed banks would repose confidence in the banking system.

CHAPTER 6

SUMMARY OF FINDINGS,

CONCLUSIONS AND RECOMMENDATIONS

6.0 SUMMARY OF FINDINGS

This study is aimed at an appraisal of the impact of regulation and supervision on the activities of banks in Nigeria – an assessment of the roles of the CBN and the NDIC. This chapter attempts a summary of the research findings and offers the conclusions and recommendations of the researcher.

The research examined the role played by the regulatory authorities towards a healthy supervision of the operation of banks in Nigeria and also examined the tools, scope, methods and policy framework of supervision. The research theme was guided by eight hypotheses which questioned the efficacy or otherwise of the functions of the regulators. The research borrowed heavily from related research material which was appropriately referenced.

It adopted a questionnaire-based method of evaluation, testing the efficacy of each hypothesis using the chi-square method and comparing the result with empirical statistical evidences in order to form a basis of opinion.

6.1 CONCLUSION

From the investigation carried out by the researcher, the study draws the following conclusions:

- The supervisory and the regulatory functions of the CBN and the NDIC have not been effective in curtailing distress in the Nigerian banking system.
- Depositors' confidence in the banking system needs to be encouraged through an integrated process involving all stakeholders.
- The Supervisory and Regulatory activities of the CBN and the NDIC have impacted positively on the pricing of banks' products to their external customers.
- The Supervisory and Regulatory functions of the Central Bank and the NDIC have not been effective in improving Corporate Governance issues in the Nigerian banking industry.

- Effective regulations and supervisions of the CBN and the NDIC would boost the volume and the value of transactions witnessed in the Nigerian banking industry.
- The Regulatory and Supervisory functions of the CBN and the NDIC have not stemmed the incidence of widespread bad loan portfolio the in Nigerian banking system.
- From the analysis, most respondents were of the view that the Regulatory and Supervisory functions of the CBN and the NDIC have not stemmed the distress syndrome in the Nigerian banking industry.
- The Insurance premium of N50, 000 payable by the NDIC to bank customers in the light of distress is not sufficient to boost customers confidence in the banking system.
- The repeated infractions on regulatory and prudential guidelines by banks can lead to a loss of the operating banking license by the offending banks
- Regular payment of claims to insured depositors in the event of bank liquidation would go a long way in restoring public confidence in Nigerian banks.
- The majority of the respondents were of the view that the imposition of monetary sanctions on banks was not sufficient to check against unethical practices.
- The result shows that majority of the respondents believed that urgent attention toward verification; processing and settlement of claims filed by depositors of failed banks would help in confidence-boosting to the banks' customers.
- Un-delayed judgment from the judiciary on failed banks would repose confidence in the banking system.

Hence, we conclude that the Banks and Other Financial Institution Act (BOFIA) and the Central Bank of Nigeria Act of 1979 are not in themselves sufficient as tools in the hands of the regulator to effectively regulate the banking sector.

6.2 RECOMMENDATIONS

Based on the findings of this study, the banking supervisory structure currently being pursued by the regulatory authorities should stay with some slight modification.

The modification which I propose is the establishment of a committee of Banking Supervisory Authorities (CBSA). The Institutionalised CBSA to which all banking supervisory authorities (including the Central Bank of Nigeria, the National Deposit Insurance Corporation and the designate of the licensed banks amongst others) should belong, should be empowered to stipulate minimum prudential standards ranging from entry requirements, thresholds for illiquidity and insolvency, to failure resolution options. Such harmonized prudential standards should be binding on all financial institutions.

Also, banking laws, rules and regulations should be harmonized by the CBSA for adoption and execution by all licensed banking institutions. The CBSA which should have an administrative secretariat should meet quarterly, if not more frequently.

The existence of the CBSA in line with the consolidation initiative would relate with the regulatory authorities of other nations in West Africa (as a take-off initiative) and this would ease cross-border growth of banks within the sub-region. Requirements for cross-border mergers and acquisitions would be stipulated by CBSA in conjunction with the monetary authorities of other West African member states. Any bank in a member state should be able to establish branches or subsidiaries or associates provided they offer banking services within the sub-region.

Other recommendations include:

- The enforcement of effective monitoring of bank returns.
- Enforcement of stringent minimum standards for the ownership and management of banking institutions.

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PROPOSED RESEARCH QUESTIONNAIRE

SECTION A

Category of respondent.

(a) Bank staff ( ) (b) Depositors ( ) (c) NDIC staff ( ) (d) CBN staff ( )

Category of Bank Staff (for bank staff only)

(a) Junior ( ) (b) Middle Management ( ) (c) Top Management ( )

Type of account maintained (for depositors only)

(a) Current ( ) (b) Savings ( ) (c) Call ( ) (d) Time ( )

SECTION B

Answer this section by selecting one of the alternatives (1-5) you may add comment to justify your answers.

Where	5	=	Strongly Agree
	4	=	Agree
	3	=	Strongly Disagree
	2	=	Disagree
	1	=	Undecided

The supervisory and regulatory framework of bank is very effective in Nigerian banking system.

(a) Strongly Agree ( )

(b) Agree ( )

(c) Strongly Disagree ( )

(d) Disagree ( )

(e) Undecided ( )

The stability in the banking system was as a result of sound and effective supervisory and regulatory framework of banks.

(a) Strongly Agree ( )

(b) Agree ( )

(c) Strongly Disagree ( )

(d) Disagree ( )

(e) Undecided ( )

The performance rating of NDIC/CBN in controlling banks' activities is very high.

(a) Strongly Agree ( )

(b) Agree ( )

(c) Strongly Disagree ( )

(d) Disagree ( )

(e) Undecided ( )

Banks and Other Financial Institutions Act (BOFIA 1991) is adequate for supervision of financial institutions in Nigeria.

(a) Strongly Agree ( )

(b) Agree ( )

(c) Strongly Disagree ( )

(d) Disagree ( )

(e) Undecided ( )

The regulators/supervisors of banks have helped in protecting depositors' funds by restricting certain banking activities and minimizing bank losses through the Banks and Other Financial Institution Act (BOFIA).

(a)	Strongly Agree	( )
(b)	Agree	( )
(c)	Strongly Disagree	( )
(d)	Disagree	( )
(e)	Undecided	( )

Bank legislation has helped in guiding against undue influence by the bank directors, managers and officers over depositors' funds and bank activities in general through disclosure of interest in any particular advances or loans.

(a)	Strongly Agree	( )
(b)	Agree	( )
(c)	Strongly Disagree	( )
(d)	Disagree	( )
(e)	Undecided	( )

CAMEL framework is useful for assessing performance of insured banks.

(a)	Strongly Agree	( )
(b)	Agree	( )
(c)	Strongly Disagree	( )
(d)	Disagree	( )
(e)	Undecided	( )

The regular on-site inspection visit to banks has helped in identifying problem areas in banks, such as quality management, bank asset, capital funds, internal control, audit, information and account system.

(a)	Strongly Agree	( )
(b)	Agree	( )
(c)	Strongly Disagree	( )
(d)	Disagree	( )
(e)	Undecided	( )

The investigation and on-the-spot check of foreign exchange operations and interest rate has brought about improvement in the normal banking practice.

(a)	Strongly Agree	( )
(b)	Agree	( )
(c)	Strongly Disagree	( )
(d)	Disagree	( )
(e)	Undecided	( )

Persistent illiquidity, lingering boardroom squabbles, deteriorating assets quality, etc are determined through on-site supervision of banks.

(a)	Strongly Agree	( )
(b)	Agree	( )
(c)	Strongly Disagree	( )
(d)	Disagree	( )
(e)	Undecided	( )

On-site supervision has helped in reducing unprofessional and unethical conduct in Nigerian banks.

(a)	Strongly Agree	( )
(b)	Agree	( )
(c)	Strongly Disagree	( )
(d)	Disagree	( )
(e)	Undecided	( )

The off-site supervision of banks by the CBN/NDIC acts has check and analysis as well as prudential returns from banks.

(a)	Strongly Agree	( )
(b)	Agree	( )
(c)	Strongly Disagree	( )
(d)	Disagree	( )
(e)	Undecided	( )

Off-site supervision has helped in assisting the discovery of financial problems in the banks through financial ratio and periodic bank returns.

(a)	Strongly Agree	( )
(b)	Agree	( )
(C)	Strongly Disagree	( )
(d)	Disagree	( )
(e)	Undecided	( )

Off-site supervision has assisted in approving board and management positions in the bank through sufficient banking experience and post-qualification experience.

(a)	Strongly Agree	( )
(b)	Agree	( )
(c)	Strongly Disagree	( )
(d)	Disagree	( )
(e)	Undecided	( )

The approval/expansion of banks' branches has been keenly monitored through off-site supervision.

(a)	Strongly Agree	( )
(b)	Agree	( )
(c)	Strongly Disagree	( )
(d)	Disagree	( )
(e)	Undecided	( )

Effective regulation and supervision will go a long way in minimizing the negative impact of moral hazard, thereby leading to reduction in bank failure.

(a)	Strongly Agree	( )
(b)	Agree	( )
(c)	Strongly Disagree	( )
(d)	Disagree	( )
(e)	Undecided	( )

Effective banking regulation encourages quality services and promotes an efficient and competitive banking system.

(a) Strongly Agree ( )

(b) Agree ( )

(c) Strongly Disagree ( )

(d) Disagree ( )

(e) Undecided ( )

Effective regulation and effective supervision of banks have helped in ensuring prudent management of bank assets and guarantee the safety of depositors' funds.

(a) Strongly Agree ( )

(b) Agree ( )

(c) Strongly Disagree ( )

(d) Disagree ( )

(e) Undecided ( )

Effective regulation/supervision focuses attention on protecting customers' interest through the legal institution.

(a) Strongly Agree ( )

(b) Agree ( )

(c) Strongly Disagree ( )

(d) Disagree ( )

(e) Undecided ( )

Disclosure of banks' annual financial statements or audit reports will give the depositors, investors and the general public adequate information about banks' performance.

(a)	Strongly Agree	( )
(b)	Agree	( )
(c)	Strongly Disagree	( )
(d)	Disagree	( )
(e)	Undecided	( )

The introduction of prudential guidelines has promoted the nations' banking stability.

(a)	Strongly Agree	( )
(b)	Agree	( )
(c)	Strongly Disagree	( )
(d)	Disagree	( )
(e)	Undecided	( )

Disclosure of financial statements to depositors, investors and the public will go a long way in enhancing public confidence in the banks.

(a)	Strongly Agree	( )
(b)	Agree	( )
(c)	Strongly Disagree	( )
(d)	Disagree	( )
(e)	Undecided	( )

Disclosure of banks' annual financial statements to depositors, investors and the general public will help in determining the soundness of the bank.

(a) Strongly Agree ( )

(b) Agree ( )

(c) Strongly Disagree ( )

(d) Disagree ( )

(e) Undecided ( )

The fifty thousand naira (50,000) maximum coverage per depositor, is adequate to repose confidence in banks in Nigeria.

(a) Strongly Agree ( )

(b) Agree ( )

(c) Strongly Disagree ( )

(d) Disagree ( )

(e) Undecided ( )

The proposed increase in the insurance limit by NDIC/CBN from N50,000 to N100,000 will help in restoring hope and confidence in the banks in Nigeria.

(a) Strongly Agree ( )

(b) Agree ( )

(c) Strongly Disagree ( )

(d) Disagree ( )

(e) Undecided ( )

The maximum coverage of fifty thousand naira (N50, 000) per depositor in the event of bank liquidation is satisfactory.

(a)	Strongly Agree	( )
(b)	Agree	( )
(c)	Strongly Disagree	( )
(d)	Disagree	( )
(e)	Undecided	( )

The fifty thousand naira (N50, 000) maximum coverage has helped in minimizing the risk that the depositors of a bank suffered.

(a)	Strongly Agree	( )
(b)	Agree	( )
(c)	Strongly Disagree	( )
(d)	Disagree	( )
(e)	Undecided	( )

Imposition of sanctions by the CBN on banks due to non-compliance to the enabling laws, rules and regulations may jeopardize the financial activities of the bank.

(a)	Strongly Agree	( )
(b)	Agree	( )
(c)	Strongly Disagree	( )
(d)	Disagree	( )
(e)	Undecided	( )

CBN sanctions on banks can lead to taking over of management of banks and revocation of banking license.

(a) Strongly Agree ( )

(b) Agree ( )

(c) Strongly Disagree ( )

(d) Disagree ( )

(e) Undecided ( )

Imposing sanctions on banks by CBN may lead to removal/prosecution of directors and officials of the bank.

(a) Strongly Agree ( )

(b) Agree ( )

(c) Strongly Disagree ( )

(d) Disagree ( )

(e) Undecided ( )

Imposing sanctions on banks can result to payment of monetary penalty.

(a) Strongly Agree ( )

(b) Agree ( )

(c) Strongly Disagree ( )

(d) Disagree ( )

(e) Undecided ( )

Prompt settlement/reimbursement of insured depositors will cushion the adverse effects of bank failure and minimize deposit runs on other banks.

(a)	Strongly Agree	( )
(b)	Agree	( )
(c)	Strongly Disagree	( )
(d)	Disagree	( )
(e)	Undecided	( )

Regular payment of claims to insured depositors in the event of bank liquidation would go a long way in restoring public confidence in the banks in Nigeria.

(a)	Strongly Agree	( )
(b)	Agree	( )
(c)	Strongly Disagree	( )
(d)	Disagree	( )
(e)	Undecided	( )

Urgent attention towards verification, processing and settlement of claims filed by depositors of failed banks would minimize deposit runs on other banks.

(a)	Strongly Agree	( )
(b)	Agree	( )
(c)	Strongly Disagree	( )
(d)	Disagree	( )
(e)	Undecided	( )

Undelayed judgment of the Federal High Court on the failed banks will fasten the payment/settlement of depositors/creditors as well as promot public confidence in and help the stability of the banking system.

(a)	Strongly Agree	( )
(b)	Agree	( )
(c)	Strongly Disagree	( )
(d)	Disagree	( )
(e)	Undecided	( )

The public awareness of the activities of the NDIC and the CBN such as liquidation and revocation of bank license is high.

(a)	Strongly Agree	( )
(b)	Agree	( )
(c)	Strongly Disagree	( )
(d)	Disagree	( )
(e)	Undecided	( )

The mandatory participation of banks in the Deposit Insurance Scheme (DIS) has gone a long way in raising the awareness of CBN/NDIC activities.

(a)	Strongly Agree	( )
(b)	Agree	( )
(c)	Strongly Disagree	( )
(d)	Disagree	( )
(e)	Undecided	( )

Investors and depositors are aware of the NDIC's activities, especially in the areas of premium charge and insurance limit.

(a)	Strongly Agree	( )
(b)	Agree	( )
(c)	Strongly Disagree	( )
(d)	Disagree	( )
(e)	Undecided	( )