Bullion

Volume 16 | Number 3 Article 2

9-1992

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REGULATORY FRAMEWORK OF NON-BANK FINANCIAL INSTITUTIONS IN NIGERIA

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BEING THE TEXT OF A PAPER PRESENTED AT THE SECOND NATIONAL CONFERENCE OF THE UNIVERSITY OF IBADAN BANKING AND FINANCE GRADUATE ALUMNI ASSOCIATION HELD AT IBADAN ON JULY 3, 1992.

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INTRODUCTION

It is often claimed that non-bank financial institutions in Nigeria are under-regulated. Financial experts and observers have over the years urged increased regulation of these institutions for several reasons. First, too little is known about the activities of these institutions many of which operate in the informal sector. As a matter of fact, those institutions which operate in the formal sector are not providing adequate information to the monetary authorities on their activities. Secondly, these institutions have grown in number and their monetary impact can no longer be ignored. However, this impact cannot be measured or controlled if relevant data on their operations are not available. Thirdly, since the activities of all the operators in the financial markets are interrelated, the development of a sound financial structure will not be effective if prudential regulations, the Federal Government has taken some steps in recent years to improve the regulation of some of the financial institutions. In 1991, the Banks and Other Financial Institutions Decree (BOFID) introduced a more comprehensive regulatory framework for these institutions.

The objective of this appear is to present an overview of the regulation of the non-bank financial institutions over the years. To this end, we first identify the relevant institutions termed "non-bank financial institutions". This is accomplished in Part One of the paper. In Part two, the new regulatory framework is reviewed. This is followed in Part Three by an appraisal of the problems and prospects of the regulatory framework. The final section is the summary and conclusion.

PART ONE
NON-BANK FINANCIAL INSTITUTIONS IN NIGERIA

The dividing line between banks and non-bank financial institutions (NBFIs) in Nigeria is not clear-cut. To some financial observers, banks comprise those institutions licensed as banks in accordance with the various banking laws and those created by Acts of Parliament or Decrees as specialist banks. Consequently, non-bank financial institutions are regarded as those financial institutions not defined as banks as indicated by these legislations. Non-bank financial institutions defined under this criteria will, thus, include insurance companies, finance companies, pension funds, discount houses and similar institutions and will exclude development banks. However, some problems may arise from applying this definition. First, the characteristics of development banks on the one hand and commercial and merchant banks, on the other, are quite distinct and may therefore not be conveniently grouped together as the legislations imply. For example, their sources and uses of funds are quite different. Second, the development banks are similar in many ways to NBFIs as defined above and qualify to be grouped together. To avoid the conceptual controversy, the prevailing practice is to regard as banks, the commercial and merchant banks licensed under the various banking decrees - the Banking Decree of 1969 and Bank and Other Financial Institutions Decree, 1991. Thus, NBFIs can be defined to include development finance institutions (DFIs) such as development banks as well as insurance companies, pension funds, finance companies, stock broking firms and a host of other institutions in that category.

Operational Definition

Although non-bank financial institutions embrace a variety of institutions, they have one common purpose, namely, to intermediate funds between surplus economic units and those in deficit. Thus, they complement the banks in financial intermediation, which is expected to enhance the development of a sound financial structure. This paper will, focus attention, however, on only the non-bank financial institutions defined as "other financial institutions" in the Banks and Other Financial Institutions Decree (BOFID) of 1991. According to this Decree, Other Financial Institutions" means any individual, other than the banks licensed under this Decree and institutions (NPF, NIDB, FMBN, NBCI and NACB) exempted under section 51 of this Decree which carries on the business of discount houses, finance company and money brokerage. The principal activities of these institutions include factoring, project financing, equipment leasing, debt administration, fund management, private ledger services, investment management, local purchases order financing, export finance project consultancy, financial consultancy, pension fund management and such other business the Bank may, from time to time, designate.

Background to Recent Regulatory Changes

Non-bank financial institutions as defined above were practically under no control by the Government or its agencies prior to the BOFID. They belonged to self-regulatory institutions as obtained in many countries. In some countries they operate effectively as self-regulatory institutions and pose no serious problems to the management of the economies where they operate. However, in Nigeria the activities of the institutions had, by the mid-1980s, started to cause serious concern in several quarters.

One of the reasons why some financial observers sought for reforms of the laws was that the existing framework did not allow the Central Bank to monitor the monetary impact of the operations of the BNFIs although the law existing prior to BOFID gave the Central bank the Authority to collect statistical information from any sector of the economy. This authorisation was not backed, however, by necessary enforcement power except that the CBN could pursue it in the law court - a process that was found to be cumbersome and sometimes counter productive.

The major source of the defect in the regulatory framework of the NBFIs prior to the BOFID, however, was the existence of a large informal segment which engaged in financial intermediation of various types. It will be recalled that the existence of an informal sector predated modern financial institutions. In some communities, there emerged convenient groups of mutual aid. With time, these groups developed into a variety of traditional institutions which engaged in some forms of savings mobilization, money lending, hire purchase business and similar activities. These had persisted even when modern financial institutions emerged. The inadequacies of formal financial institutions helped to encourage the growth of the traditional institutions otherwise known as the informal sector. By the mid-1980's the destabilising impact of the informal sector stated above was no longer in doubt but there were no comprehensive statistics to back up any suspicion. For instance, the hidden informal sector operators imposed higher interest rates outside the regulated rates and found patronage. By 1991, it was believed that over 1,000 finance companies were operating in the informal sector outside the purview of the monetary authorities. Their destablishing effect led to debates on the need to keep close surveillance on them. The result was the promulgation of two decrees in 1991, namely the Central Bank of Nigeria (CBN) Decree 1991 and the Banks and Other Financial Decree (BOFID), 1991 which are bound to make a significant effect on the activities of NBFIs. The new regulatory framework of the NBFIs under the new laws will now be examined.

PART TWO THE NEW REGULATORY FRAMEWORK

The Banks and Other Financial Institutions Decree (BOFID) 1991, supplemented by the CBN Decree 1991, has given more powers to the CBN guidelines and other administrative strategies for surveillance and monitoring of these institutions.

BOFID, 1991:

The major significance of the decree is that it brought under regulation, for the first time, the various operators in the informal financial sector whose impact on the economy is believed to have become increasingly substantial. The main provisions of the Decree with respect to NBFIs are as follows: *First,* the Decree prohibits the carrying out of a wide-range of non-bank financial business without a licence from the CBN. Persons already carrying on such businesses are given six months to apply for a licence (section 56 (2)). *Second* section 37 makes the Central Bank the sole authority for granting licences to operators for non-bank financial businesses excluding insurance and stock-broking firms.

Third, section 58 of the Decree makes it obligatory for these institutions to comply with the Central Bank's monetary policy guidelines and directives and to comnish such statistical and other returns as the Central Bank may require.

Fourth, section 59 empowers the CBN to supervise and regulate the institutions or undertake special examination of any of them where the Bank finds it necessary to do so. In carrying out such examination, the Bank finds it necessary to do so. In carrying out such examination, the Bank has the option to employ its own personnel or appoint agents to act on its behalf.

Fifth, the CBN is empowered by Section 51(1) to carry out special examination of development banks which otherwise are exempted from provisions of the Decree. *Sixth,* the Central Bank's power to revoke licences of other financial institutions is largely implied by section 58(4) which states that persistent failure to comply with the CBN guidelines or refusal to send returns are grounds for the revocation of license. Similarly, the Governor of the CBN is empowered to suspend an institution's licence for failure to comply with the guidelines and directives issued by the Bank. *Seventh,* section 60 was crafted to enable the Central Bank resort to the court only in extreme cases. This section gives the CBN power to impose fines of up to N100,000 for violations under the Decree. It also empowers the Governor of the CBN to suspend any licences under the Decree. This section attempts to avoid the likely paralysis that could arise in complying with those sections of the Decree which stipulate that violations of the provisions of the Decree in each case would require conviction and therefore the court process.

The CBN Decree, 1991, complements the BOFID by stipulating stiff penalties for failure of anybody or any institutions to provide information or to give correct information. The penalties for such offence on conviction are imprisonment not exceeding three years or a fine not less that N50,000 or more than N100,000 for every false information or with both such imprisonment and fine. In addition, there shall be a fine of not less than N500 or more than N2,000 for every day during which the failure to comply with a requirement of the CBN continues. Also where any person or institution fails to comply with the guidelines in respect of those engaged in financial services, they shall be guilty of offence and liable on conviction to imprisonment not exceeding three years of fine not less than N50,000 or more than N100,000 or to both fine and imprisonment.

CBN Guidelines:

One of the measures designed to give effect to the provisions of the BOFID is the preparation of guidelines for bon-bank financial institutions. Already such guidelines has been prepared for two types of NBFIs, namely, finance companies and discount houses.

(a) Finance Companies:

As stated earlier, a large number of finance companies were operating unregulated in the informal sector prior to the BOFID. In order to bring them to the open, the BOFID authorised their establishment subject to their licensing and regulation by the CBN. In response to this challenge, the CBN issued guidelines for this purpose. The guideline defines a finance company as a person licensed to carry on finance company as a person licensed to carry on finance company business while a finance company means the business of extending credit facilities to consumers and to industrial, commercial or agricultural enterprises, including lending of money, leasing business, hire-purchase business, debt factoring, project financing and consultancy, debt administration, LPO financing, export financing, consultancy, electronic fund transfer, and issuing of vouchers, credit cards and token stamps.

Among other things, the guideline specifies the application and licensing procedure, financial requirements, management requirements, conditions for commencement of operations, sources of funds, operational requirements, prohibitions, conditions for revocation of licence, and transitional arrangements. These are explained briefly:

(i) Application and Licensing Procedure

This shows the method of application, as well as the application fee, documents and other conditions which must be fulfilled before the CBN Governor may grant a licence to the finance company. This does not, however, authorise the company to commence operations until other conditions are met.

(ii) Financial Requirements:

The financial requirements stipulated by the guidelines are minimum paid-up capital - N5,000,000.00, application fee - N5,000.00, licensing fee - N50,000.00, and annual renewal fee - N5,000.00

(iii) Management Requirements:

The guideline specifies minimum qualifications and experience mandatory for others who occupy the key positions in the finance company.

(iv) Conditions for Commencement of Business:

After obtaining a licence, the promoters of a finance company are expected to comply with further conditions before the company is allowed to start business. These conditions include the submission of shareholders' register, a copy of the share certificate issued to each shareholder, and certified copies of return of allotments, particulars of Directors, memorandum and Articles of Association, certificate of incorporation and letters of offer and acceptance of employment indicating that the management team approved by the CBN has been installed.

(v) Sources of Funds

The permissible sources of funds for the finance companies are prescribed. These are mainly paid-up capital, reserves and borrowing.

(vi) Operational Requirements

The guidelines also prescribed operational requirements to ensure effective operations, such as the transfer to the reserve fund of a minimum of 12.5 per cent of profit after tax until the reserve funds equals the authorised capital and a minimum of 5 per cent subsequently. Also stipulated are time limit to submit returns including the annual audited accounts to the CBN and the procedure for advertisements, opening of new branched, changes in top management and the board and the display of interest rates.

(vii) Prohibitions

In the interest of the economy, the finance companies are prohibited from engaging in a number of activities. These include dealing in foreign currency and giving credit facility or entering into any other transaction against the security of its own shares or the shares of its holding company. Another prohibited activity is the payment of dividend on its shares until all preliminary expenses have been completely written-off and appropriate reserves maintained. Also prohibited is the engagement in business other than those for which each finance company was licensed. Although finance companies were initially forbidden from accepting deposits, the requirement has been modified to allow them to borrow a minimum of N100,000.00 from any person/corporate organisation subject to a total maximum limit for all outstanding borrowing at any one time of ten times the paid-up capital and reserves of the finance company.

(viii) Conditions for Revocation of Licence

The guidelines also stipulate that the grounds for revoking a licence granted to a finance company would include submission of false information, engaging in activities outside the scope of the licence, persistent failure to comply with requests for information, engaging in activities prejudicial to the Nigerian economy, and failure to meet obligations to customers.

(ix) Transitional Arrangements

Since a large number of finance companies were operating in the informal sector before the BOFID, the general guideline was modified to encourage those finance companies existing prior to the BOFID to operate in the formal sector. They were required to apply on or before the 19th of December 1991 in writing to the CBN and to fulfil a number of other conditions which are less stringent than those for finance companies that were not in the business prior to the BOFID.

Following the invitation to apply for licence, 636 companies had applied by June 1992 to be licensed as finance companies, 250 of which have met the requirements and are going through the processes of obtaining licences.

(b) Discount Houses

The CBN has issued guidelines also for the discount house business. The guidelines define a discount house as any person in Nigeria who transacts a discount house business consisting in the main of trading in and holding of treasury bills, commercial bills and other securities and operations which in the opinion of the CBN are those of a discount house. The objectives and principal duties of a discount house in Nigeria include the promotion of rapid growth and efficiency of the money market; acting as an intermediary between the CBN and the licensed banks; and other eligible instruments acquired by banks. Initially only a consortium of banks could be shareholders of a discount house but at present insurance and finance companies are qualified for equity participation in a discount house business.

Like that for finance companies, the guidelines for discount houses stipulated the procedures for application and licensing of discount houses as well as the following:

(i) management requirements;

(ii) financial requirements;

(iii) conditions for commencement of business;

(iv) permissible sources of funds

(v) structure of assets;

(vi) operational/prudential requirements;

(vii) prohibitions; and

(viii) conditions for revoking of license.

So far three approvals have been granted to three companies wishing to operate as discount houses.

(c) Other Administrative Strategies

In addition to issuing guidelines the CBN has put in place the general framework for the surveillance and monitoring of the non-bank financial institutions. A number of issues have been addressed in this regard. First, there has been the issue of developing appropriate CBN policies with regard to the licensing and regulations of non-bank financial institutions. This has led to a number of committees whose work has helped to design the guidelines reviewed above. Second, there is need to have adequate staff for the increased responsibilities of the CBN. This has led to increased emphasis on staff enlightenment and training. Third, the importance of the banks and the general public in the task of developing virile non-bank financial institutions has led to measures designed to enlighten non-bank financial institutions and the general public through seminars, press releases and dialogue. Fourth, the departmental structure of the CBN has been reviewed. One of the notable outcomes of the review is the creation of two departments are Banking Supervision Department which now specialises on off-site supervision and the Bank Examination Department whose focus is on-site examination. This arrangement is expected to enhance the surveillance and regulation of both banks and non-bank financial institutions.

At this juncture, the problems and prospects of the new regulatory framework of non-bank financial institutions come to mind. These are examined below.

PART THREE
PROBLEMS AND PROSPECTS

The Central Bank's increased responsibilities to supervise, regulate and conduct special examination of non-bank financial institutions have posed serious challenges to the Management of the Bank. The challenges of non-bank financial institutions are expected to be met on a continuous basis because as these institutions grow in number, the challenges would become greater and more complex. However, the management of the CBN has anticipated these problems and has started to initiate measured that will provide solutions.

One of the current problems that is expected to linger for a while is the provision of infrastructural facilities such as computers. While modest improvement has been made in this respect, there is much room for improvement. Already, the CBN has intensified efforts not only to computerise its operations but also to step the computerization of banks and non-bank financial institutions. The current practice whereby banks and non-bank financial institutions make returns to the CBN on paper forms rather than on diskettes does not enhance speed in generating vital statistics. The need for timeliness in data generation is real. Indeed, inability to get information promptly is one of the factors which will frustrate the operation of the approved discount houses and indirect monetary management. In the case of discount houses, undue delay in getting the relevant information can turn a discount house's profitable deal into losses. For example, if the bank balances at the CBN are not be able to inform the discount houses promptly whether there is surplus or shortage in the market. For effective operation of the discount houses, such information is needed promptly to enable the discount houses know hat to expect. If there is a surplus, the discount houses will take steps to mobilise the surplus while if there is shortage, the discount houses will gear up search for funds to provide accommodation to banks which have shortage of funds. While the problems associated with the computer and date generation may linger for some time, it has been observed that the CBN is currently preoccupied with finding solutions to them.

There is another important facility that is still inadequate. This is the telephone system. An efficient telephone system is required by both the regulators and operators. It is a medium to pass promptly vital information or directives within the system. This facility will be more important when the discount houses are established. The effective operation of the discount houses is enhanced by efficient telephone system. It has been observed that in countries where discount houses are operated, deals between the discount houses and banks are sealed by telephone. This increased the need to improve the telephone net-work in Nigeria as the discount houses come on stream. As regards the regulation of the approved discount houses, it will also create the need for an improved telephone system. The regulation of discount houses in Ghana and Zimbabwe relies much on the telephone "hot line" between the countries' central banks and the discount houses. This type of facility will be very useful for the CBN in sending and receiving daily information which enhance the activities in the money market.

The ease with which the CBN regulates the NBFIs depends also on the orientation of the operators. Unless these institutions appreciate their responsibilities, they are likely to engage in practices prejudicial to the economy, thereby making it difficult for them to observe the regulations. The enlightenment seminars and dialogue already initiated by the CBN could lead to more understanding on both sides and thereby complement the guidance in developing effective and efficient and non-bank financial institutions.

One of the reasons for the current regulatory framework is to bring to the open those financial institutions which operate underground. The best way to reduce the number of these operators in the informal sector is to improve the efficiency of those in the formal sector. The new regulatory framework can achieve this objective indirectly if it succeeds in making those in the formal sector efficient, thereby attracting away more of the customers of the operators in the informal market. This is expected to encourage mor of those operating without licence to join the formal sector.

It can be seen from the discussion above, that all hands must be on deck in order to develop virile non-bank financial institutions. It requires the co-operation of the institutions and their customers, the regulator, the

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ing:

1. Perhaps, a generally acceptable "Aggregate Index of Agricultural Production" based on sub-sectoral total output in each of the sub-sectors (crops, livestock, fisheries and forestry) and appropriately assigned weights to the sub-sectors, should be produced on half-yearly and annual basis either by NAIMS or the Federal Office of Statistics;
2. That an adequate training programme be developed for staff of the proposed NAIMS;
3. The NAIMS should carry out a comprehensive and incisive study of data requirements of specialised institutions and other users of agricultural data;
4. A time-table or schedule for collection, collation and dissemination of data be prepared by NAIMS in order to minimise delays in its take off.

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Government and the general public in order to create the enabling environment for non-bank financial institutions which will concerned not only with profits but also with growth and development of the economy.

SUMMARY AND CONCLUSION

The foregoing analysis has examined the regulatory framework of non-bank financial institutions (NBFIs) in Nigeria. To start with, those institutions that are often referred to as non-bank have been identified. However, it is noted that in this paper non-bank financial institutions are those defined as "other financial institutions" by the BOFID. Next, the background to the recent regulatory changes were examines. It was observed that the new regulatory framework became necessary in order to allow the monetary authorities to monitor and be able to assess the monetary impact of the operations of the NBFIs so as to enhance monetary management.

Moves to keep the NBFIs under closer surveillance in the interest of the national economy culminated in the CBN and the Bank and Other Financial Institutions Decrees of 1991 which brought under regulation, for the first time, the various operators in the informal financial sector whose impact on the economy can no longer be ignored. The other major achievement of the new laws is the provision designed to enable the monetary authorities obtain relevant information from and to impose guidelines on the NBFIs and other sectors in order to improve monetary management.

The powers assumed by the Central bank with regard to non-bank financial institutions as outlined above, have the potentials for improving the Bank's knowledge of the financial system and the economy. This is expected to enhance the effectiveness of monetary and exchange rate policies and thereby contribute to the maintenance of monetary stability and sound financial structure. However, this would require enormous human and material resources, improvement in infrastructural facilities such as computers and telephones and the cooperation and assistance of the NBFIs, the general public and the Government in order to enable the CBN to effectively monitor and regulate the institutions.