[Bullion](https://dc.cbn.gov.ng/bullion)

Volume 34 | Number 3 Article 1

9-2010

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OVERVIEW OF THE FOUR PILLARS OF THE BANKING REFORMS[1]

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The CBN embarked on a banking sector reform programme between July 2004 and December 2005 to entrench a strong, diversified and reliable banking system that would ensure the safety of depositors money, play an active developmental role in the Nigerian economy and compete effectively in the African and global financial systems. Thereafter, the world witnessed a financial hurricane that was aptly titled the Global Financial Crisis/Meltdown by analysts in 2008. There is no gainsaying the fact that the crisis left in its wake, several organizations prostrate and even rendered an entire nation bankrupt. However, in Nigeria, the consolidation programme, along with the non-integration of the financial system into the international financial system, the relatively simple nature of financial products in the market, and the strong capitalization and liquidity of the banks, doused the initial effects of the global financial crisis.

The Nigeria's financial system was however, ultimately affected by the crisis with the effect more sever in banks with huge concentrations in their exposures to the capital market and oil and gas sector, weaknesses in risk management and poor corporate governance practices. The signs of distress displayed by these banks, which manifested mainly in serious liquidity strain and heavy reliance on financial support from the CBN, led to the introduction of several interim measures between 2008 and 2009. These measures included the reduction in the Monetary Policy Rate (MPR), Cash Reserve Ratio (CRR) and Liquidity Ratio; and expansion of the CBN discount window to allow additional instruments and permit banks to borrow for up to 360 days among others.

These measures did not, however, fully resolve the problems bedeviling the banking system as it remained extremely fragile with the fragility ascribed to several interdependent factors. Key among these factors were macro-economic instability caused by large and sudden capital inflows, failures in corporate governance, lack of investor and consumer sophistication, inadequate disclosure and transparency, gaps in the regulatory framework and regulations, uneven supervision and enforcement, unstructured governance and weaknesses within the CBN as well as weaknesses in the business environment. Thus, claims and counterclaims on the strength and resilience of the financial system continued to exist in the minds of analysts, investors and the public, on the true financial health of some Nigerian banks. This led to unbridled speculations and a near collapse of public confidence in the banking system, which was worrisome. The CBN, taking into cognizance the need to restore public confidence and credibility to the financial system, embarked on a risk assessment exercise to review, evaluate and determine the quality of banks' portfolio especially their exposure to margin lending (including proprietary/banks' subsidiaries) and the oil and gas sector.

The exercise confirmed the initial fears of stakeholders with respect to some institutions as it revealed among others, the existence of high percentage of non-performing loans with the poor assets quality attributable in the main to weak risk management practices, especially lax underwriting standards, preponderance of poor corporate governance practices and the absence of regulatory guidance in some areas. In addition, the management teams of some banks were discovered to have acted in manners that were detrimental to the interests of their depositors and creditors.

The reports of the risk assessment exercise formed the basis of the intervention by the CBN in some banks and the introduction of the four pillar reform programme, to guarantee the safety and soundness of the banking system. The four pillars of the banking system reforms, which is the main subject, are as follows:

- **i.** Enhancing the quality of banks;
- **ii.** Establishing financial stability;
- **iii.** Enabling healthy financial sector evolution; and
- **iv.** Ensuring that the financial sector contributes to the real economy.

Each of the pillars will be discoursed in order to enhance our understanding of the subject matter.

i. Enhancing the quality of banks, which is the first and major pillar of the reforms programme consists of a 5-part programme. These are: (a) the industry remedial programmes, which will involve the launching of a set of initiatives to fix the key causes of the

[1] *The views expressed in the paper are those of the author and do not in any way represent the official position or thinking of the Central Bank of Nigeria. The author acknowledges the comments and criticisms of anonymous reviewer.*

crisis, namely data quality, enforcement, governance, risk management and financial crime. The initiatives will be structured such that the banks carry out most of the work to imbibe new behaviours in the industry, while the CBN plays a cross-industry programme management role; (b) Regulatory reforms, which is the second part of the 5-part programme under the first pillar, is in turn broken into three parts. First, the CBN in conjunction with other regulators will embark on a systematic review of regulations and guidelines around the key causes of the crisis. Second, the CBN, under the sponsorship of the Financial Sector Regulation Coordination Committee (FSRCC), will lead a programme to fundamentally reform the financial services regulatory framework. The focus under this sub-pillar will be the harmonization and raising to world-class standards, supervision processes, technology and people. Thirdly, a centre of competence for International Financial Reporting Standards (IFRS) and N-GAAP+ will be established to support examination teams and contribute to the Nigerian Accounting Standards Board (NASB) IFRS committee; (c) The third part of this pillar will involve the CBN strengthening the implementation of the Risk Based Supervision (RBS) methodology to include examiner accreditation in RBS, industry communication and engagement as well as a monitoring mechanism to measure the programme's impact and high level response to issues raised by the industry; (d) The fourth part of the first pillar of enhancing the quality of bank, is consumer protection. The objectives of reforming consumer protection include ensuring that consumers receive an appropriate level of protection, increasing consumer understanding of basic financial services/ products and conducting customer satisfaction surveys. Currently, a Consumer Protection Unit is already functional in the newly created Financial Policy and Regulation Department of the Bank, and charged with educating consumers on financial products, responding to major consumer issues and ensuring that consumers are fairly treated by the industry. The aim is to make the CBN the consumers' advocate, setting standards of customer service for the industry. It is therefore our expectation that you will not only channel your complaints on relevant issues to the Unit but ensure that the Unit received the desired publicity in the interest of all stakeholders; (e) The fifth and final part under enhancing the quality of banks involves the internal transformation of the CBN in the areas of corporate governance, management information system, people development and disclosure. Broadly speaking, this part will involve the expansion and deepening of the CBN Board to ensure good governance, development of management information dashboards for all key job roles, expanding the role of our Human Resources Department to include the development of regulators and future industry executives, and expanding the frontiers of CBN disclosure to the levels in major investor countries such as the United States, South Africa, China and the United Kingdom.

ii. The Second Pillar of the reforms programmes is the **Establishment of Financial Stability.** The issue of financial stability has attained significant importance among central banks all over the world especially in the aftermath of the global financial crisis. The key thrust of this pillar involves the CBN providing leadership in some areas and championing some courses. The CBN will provide leadership in the establishment and functioning of the Financial Stability Committee (FSC). The FSC, which will focus on systemic stability, will be supported by a strong technical working group. The FSC along with the Monetary Policy Committee (MPC) would be at the core of the new macro-prudential framework designed to ensure that monetary policy is not only shaped by systemic risk trends but also consistent with the expanded hybrid goals for product and asset price stability. In this regard, the MPC would also be tasked with the twin monetary goals of single-digit inflation targeting and avoidance of asset price bubbles; introduction and enactment of new macro-prudential rules along with the FSC; examination of capital control approaches to prevent 'hot money' from abroad from destabilizing the capital market and economy; and developing the exchange rate regime to ensure that policies and reserves are in place to credibly defend the currency in times of distress to reduce macroeconomic volatility. Towards ensuring financial stability, the CBN would be at the heart of Nigerian economic analysis, driving the country's economic agenda. Also, the CBN would champion the development of the Capital Market through the improvement of its depth and accessibility as an alternative to bank funding as well as the development and implementation of counter-cyclical fiscal policies. In the area of fiscal policies, the CBN would champion the development of policies that are intended to reduce oil related volatility in the system either through the establishment of a stabilisation fund, such as the Sovereign Wealth Fund, as is done by other major exporters of commodities. The CBN would also champion the cause of sustainable economic growth through ensuring that our economy becomes more competitive through the provision of adequate infrastructure and a conducive business environment by the government thus making it easier to do business in the country.

iii. **Enabling Healthy Financial Sector Evolution** is the third major pillar of the reforms programme. This pillar is also broken down into several sub-pillars which are (a) ensuring the emergence of a competitive banking industry structure: There is no gainsaying the fact that the CBN has an important role to play in determining the ultimate structure of the banking sector. In this regard, the CBN would welcome foreign participation in the sector in order to improve and strengthen the financial system. The Bank would however be mindful not to allow the entry of foreign banks to affect the development of the local banking sector. Also, support would be given to domestic mergers and acquisitions activities that would create stronger banks in terms of management, IT etc; licence other types of banks to drive regional economic development and establish the Asset Management Corporation (AMCON) as part of the broad resolution strategy. The AMCON would serve, not only as a vehicle for the resolution of bad assets, but the recapitalization of the banks, as the valuation of the assets will factor in some significant recovery on the books of the banks as part of the resolution process. (b) Provision of the required infrastructure such as credit bureaux and registrars. In this regard, we have recently licensed three private Credit Bureaux and intend to work with the Securities and Exchange Commission (SEC) to create a single Registrar for all securities in the country. (c) Improvement in the cost structure for banks through cost control and business process outsourcing: This is intended to check the excessive costs in the banking system, which is attributable in the main to over building, high salaries and poor operational efficiencies. (d) Reliable and secure payment systems: The CBN would continue to encourage the development of electronic channels to drive down industry cost structure while working with the banks to improve on the quality of service delivery in order to improve customer confidence. (e) Reduction of the informal sector and greater financial inclusion: The size of the informal sector as a percentage of the Gross National Product has been estimated at 57.9% in Nigeria by the World Bank. This is higher than the positions in Brazil, Ghana, Turkey, Malaysia, South Africa etc and must be reduced to a more acceptable level in order to ensure greater financial inclusion. Enhanced financial inclusion would result in more accurate measurement of economic outputs, increase in the tax base and tax revenue, more effective policy development and more efficient use of financial infrastructure, which would in turn improve policy efficiency and help in poverty reduction.

iv. **Ensuring that the Financial Sector Contributes to the Real Economy** is the fourth and final pillar of the reforms programme. This pillar of the programme would involve the CBN as an institution, playing a key role in several areas/activities as advocate for the economic development of the country taking into cognisance its resources, independence and the respect it has in the society. The activities of the CBN in this area will include: (a) Leveraging on the role of the CBN Governor as an adviser to the President on economic matters to ensure that the financial sector contributes to the real economy. (B) Providing leadership, in the accurate measurement of the relationship between the real economy and the financial sector and the transmission mechanism. (c) Evaluating on a continuous basis, the effectiveness of existing Development Finance Institutions and initiatives in agriculture, manufacturing, and import-export credits, etc. (D) Taking a public lead in encouraging the examination of critical issues for economic development, such as the impact of infrastructure e.g. power, port and railway (e) leading further studies on the potentials of venture capital and private public partnership initiatives for Nigeria. (f) Cooperating with State governments in running pilot programmes that are aimed at directing the financial sector's contribution to the State's social economic development.

There is no doubt that striving to implement these programmes, which are designed to build a stronger and more resilient financial system, the road ahead is still long and the challenges enormous. It is therefore, critical that the implementation process is strengthened in order to enhance the efficiency of the financial system. A major challenge is to ensure that the reforms are not only embedded at the individual bank levels but are also carried on as a continuous process, and aligned to changing market and regulatory developments.