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THE ROLE OF THE CENTRAL BANK OF NIGERIA IN ENSURING SOUND, SAFE AND RELIABLE BANKING SECTOR

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The paper would cover five sections:

1. Review of the Nigerian banking system serves as an introduction;
2. The activities of the CBN in ensuring sound, safe and reliable banking sector;
3. The challenges facing effective banking supervision;
4. Review of the mitigating factors to the challenges facing effective supervision; and
5. Conclusion.

1.0 THE NIGERIAN BANKING SYSTEM

The banking system is the foundation of the major institutional mechanism for financial intermediation. It does this through the mobilization of resources from surplus units and channeling of the same to the deficit units through the extension of credits. The CBN therefore has responsibility for ensuring orderly conduct of financial intermediation within the banking system. Accordingly, the CBN Act 2007 has the promotion of a sound financial system as one of the core objectives of the Bank.

In emphasizing the cardinal functions of the banking sector in any economy, it is generally understood that a sound, safe and reliable banking sector promotes rapid economic and social development of the economy by:

i. Facilitating the effective management of the economy;
ii. Providing non-inflationary support to the economy;
iii. Enhancing greater mobilization of savings and efficient and effective channeling of funds to productive sectors of the economy;
iv. Insulating the economy as much as possible and as much as desirable from the adverse shocks of global economic downturns.

It follows, therefore, that the effectiveness of the banking system to a large extent enhances the realization of the country's economic potentials.

It is for these reasons that banks, which are the agents of financial intermediation, are sufficiently regulated so as to protect depositors, ensure the safety and soundness of individual banks, enhance the integrity of the payments system, promote healthy competition, support macroeconomic objectives of government and enkindle public confidence in the banking sector.

The CBN in pursuit of its mandate continues to work in collaboration with other stakeholders in articulating policies aimed at enhancing the integrity of the banking sector.

2.0 THE ROLE OF THE CBN IN ENSURING THE SOUNDNESS, SAFETY AND RELIABILITY OF THE BANKING SECTOR

The experience of many countries indicates that regulation and supervision are essential for a sound, stable and healthy financial system and that the need for the supervision of the banking sector becomes greater as the number and variety of financial institutions increase. Supervision entails not only the enforcement of rules and regulations, but also exercising judgment concerning the soundness of a financial institution's assets, capital adequacy, operational performance, corporate governance and management.

To underscore this requirement, the CBN performs financial stability and monetary policy roles in the economy. The fulcrum of its financial stability roles rests on the effective regulation and supervision of the banking sector. Furthermore, the CBN with effect from March 1, 2010, established a Financial Policy and Regulation Department to act as a policy research base for its financial stability function. The new Department articulates broad regulatory and supervisory policies as well as reviews, on a continuous basis, the existing policies in order to enhance the effectiveness of the regulatory and supervisory roles of the CBN.

In recognition of the need for an effective supervision of the banking sector, the CBN, as part of the internal restructuring process has strengthened its on-site and off-site supervisory functions. To this end, the CBN has commenced Risk Based Supervision (RBS) and abandoned the compliance based supervisory approach. In 2009, Risk Based Supervision approach was implemented at two banks. All examinations in 2010 and going forward will employ the RBS approach.

The new proactive supervisory approach allocates greater supervisory resources to those operations of banks that pose the greatest risks to the bank and on the entire financial system. It enables 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.*

supervisor to appraise the adequacy or otherwise of the risk-mitigants put in place by bank management. The effective implementation of RBS approach to bank supervision would largely enhance the soundness and stability of the banking sector.

Off-site supervision, a qualitative diagnosis or the core of banking regulation seeks to critically evaluate the operational parameters of a bank and its compliance with regulatory requirements. The off-site supervision of banks and discount houses had been made more potent through the use of the electronic Financial Analysis and Surveillance System (eFASS), which facilitates the on line rendition of banks' call reports.

Furthermore, a Macro-Prudential Office has been established in the Financial Policy and Regulation Department as a key element in the supervisory process. The office undertakes the analysis and review of the risks inherent in the operations of the entire banking sector.

3.0 THE CHALLENGES OF BANKING SUPERVISION

The Nigerian banking sector was tipped into crisis by the global financial crisis as a result of a number of interdependent factors. The factors include: macroeconomic instability; major failure in corporate governance at banks; limited knowledge of investment principles by investors and underdeveloped consumer protection; inadequate disclosure and transparency about the true financial condition of banks and gaps in regulation.

These factors provided the platform upon which the CBN intervened and replaced the board and management of eight distressed bank in August/September 2009. While significant milestones have been achieved in remedying the challenges affecting the CBN in the effective pursuit of its role of ensuring sound, safe and reliable banking sector through the effective and efficient regulation and supervision of the sector, the challenges remain arduous.

Some of these challenges, which require mention include:

- Weak capital base of some of the banks in the system and the inability of shareholders to effectively recapitalize them;
- The paucity of executive capacity in the industry, evidenced by limited experience of officers manning portfolios and positions beyond their capabilities;
- Problem of data integrity from bank returns;
- Poor risk management practices;
- Insider-related credits abuses evidenced by the absence of good corporate governance in the banking sector;
- The tortuous judicial process resulting in delays in the effectiveness of the supervisory processes; and
- Difficulties in the reviewing the supervisory frameworks. Amendments to the BOFI Act had been before the National Assembly since 2003 while the amendment to the CBN Act 2007 aimed at empowering the CBN during crisis situations in the banking sector is ongoing.

The imperative of the foregoing is that the supervisory process in Nigeria continues to be undermined by debilitating challenges. Accordingly, the banking system in Nigeria, unlike in other economies, has not developed the framework necessary to support the economic development of the country. The implication is that the function of the banking sector in Nigeria, as the hub of financial intermediation and engine of economic development has not fully lived up to expectations.

Notwithstanding, the CBN continues to formulate policies, issue guidelines, and adopt strategies and measures to ensure the stability and soundness of the banking sector.

4.0 REGULATORY EFFORTS AT MITIGATING THE CHALLENGES

The inability of the regulatory authorities to properly and on a timely basis identify the weaknesses in the banking sector through effective supervision contributed to the sector shock. However, recent initiatives of the CBN to reverse the deterioration in the financial condition of banks culminated in the initiation of a Four-pillar Reform Programme. The objectives of the programme are to:

- Enhance the quality of banks;
- Establish financial stability;
- Enable the evolution of a healthy financial sector; and
- Ensure that the financial sector contributes to the real sector of the economy.

The outcomes of the initiatives are beginning to yield results with the improvement in consumer confidence in the banking system. Some of such initiatives adopted to enhance the ability of the CBN to perform its role in banking sector include the following:

i. Conduct of Special Examination

In the need to determine the true condition of the banking system and to apply the appropriate remedial actions, the CBN commissioned the Special Examination of all the twenty-four universal banks in Nigeria. The Examination Reports revealed unacceptable corporate governance abuses in a number of the banks while some of the institutions were observed to be in grave financial condition. The size of non-performing loans in the sector was intolerably high while a good number of the institutions were afflicted with acute liquidity shortages. Some were indeed technically insolvent.

Consequently, the CBN dissolved and removed the management of eight banks between August and September 2009. It also injected over N620 billion of tier II capital in the banks to stabilize their operations and engender confidence in the sector. The banks that were taken over have been restructured and repositioned for recapitalization. Meanwhile the operational performances of the banks show increased stability and profitability.

ii. Establishment of Asset Management Corporation of Nigeria (AMCON)

As it was apparent that the high level of non-performing loans (NPLs) in the system would continue to undermine the effective restructuring of the banking system, it became necessary that an urgent action must be taken to free the system from the scourges of NPLs so as to provide a stable platform for the implementation of a sustainable industry reform.

To this end the CBN collaborated with the Federal Ministry of Finance and the NDIC to establish an Asset Management Corporation of Nigeria (AMCON). The AMCON Act 2010 was signed into law on July 19, 2010. The AMCON would serve as a veritable vehicle to free the banks from the weight of their non-performing assets and accelerate the process of financial revitalization of the banking sector.

iii. **Review of the Prudential Guidelines**

The Prudential Guidelines remains one of supervisors' potent tools in credit review. However, that tool was considered non-supportive of the current supervisory framework on account of its obsolescence.

The CBN has consequently reviewed the guidelines in May 2010 to take cognizance of the cash flow features of various sectors of the economy and recommend that banks should make dynamic provisions for loan losses based on counter-cyclicality of performance as against the former guideline in which provisions were pro-cyclical of performance.

iv. **The Review of Universal Banking Model**

Following the abuse of the universal banking model as a result of which banks operated as financial supermarkets with grave consequences to the soundness and stability of the banking sector, the CBN has commenced the review of the universal banking model.

Under the review, the CBN is contemplating a policy to ring-fence banks, banking operations, and depositors' funds. Banks would focus on only core banking activities and would choose to operate as one of the following categories: International, National, Regional or Specialised bank. Banks involved in other non-banking activities would be required to divest or spin off those non-banking affiliates.

The essence of the reform is to enable operators focus only on banking activities and avoid such other operations that predispose them to shock and diminution of depositors' funds.

v. **Approved Persons Regime**

To address the challenges of weak corporate governance, the CBN is reviewing the 'fit and proper persons' regime in order to ensure that only credible persons of impeccable financial, personal and professional character are allowed as major shareholders, directors and managers of banks and other financial institutions.

Upon the conclusion of the review process, it is expected that significant shareholders, holding or desiring to hold equity investment of five percent and above in the banking sector would require the prior approval of the CBN.

vi. **Review of Licensing Requirements**

Adjunct to the review of the universal banking model is the review of the licensing requirements for all categories of institutions under the regulatory and supervisory purview of the CBN.

The objective of the review is to ensure that banks maintain adequate capital to cushion the level of risks in their operations.

vii. **Code of Corporate Governance for Banks in Nigeria**

The supervisory challenges created by the high spate of corporate governance abuses compelled the CBN, in April, 2006, to issue the Code of Corporate Governance for Banks in Nigeria. The aim was to strengthen corporate governance practices in banks and sustain stability within the banking sector.

Banking industry practices leading to the removal of eight CEOs/MDs showed grave corporate governance and gross abuse within the banking sector. These abuses eroded public confidence and undermined the soundness, safety and reliability of the banking sector as the engine of growth and development of the economy. Accordingly, the CBN has taken steps to enforce compliance with the corporate governance code. The tenure limit of twelve (12) years for non-executive directors is a case in point.

viii. **Collaboration With Other Regulators of the Financial System**

The subsisting collaboration of financial sector regulators under the aegis of the Financial Services Regulation Co-ordination Committee (FSRCC) has been revitalized. The Committee meets every other month to consider issues across regulatory platforms.

5.0 CONCLUSION

Building on the remedial measures taken to mitigate the challenges in the role of the CBN in ensuring sound, safe and relible financial sector culminated in the initiation of a four-pillar reform. Towards this end, CBN's surveillance activities would focus on strengthening supervisory standards at both the micro and macro levels. Specifically, supervision would be proactive by focusing on the full implementation of risk-based-consolidated supervision.

The CBN and the Federal Ministry of Finance have successfully facilitated the establishment of an Asset Management Corporation of Nigeria (AMCON). The AMCON will reinvigorate the operational capability of the banking sector by acquiring the non-performing assets of banks in order to free such banks from the inherent provisioning requirements.

Generally, the duty of the CBN in ensuring a sound, safe, and reliable banking sector is arduous. The CBN continues to discharge that duty with courage. The role lies in the main, on the effective regulation/supervision of the banking sector. The challenges of effective supervision of the banking sector, therefore involve a comprehensive supervisory approach and good faith of all stakeholders.

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