

Central Bank of Nigeria (CBN) Statutory Supervisory Mechanisms of the Financial Sector for Economic Growth

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Abstract
Proponents of corporate governance code insist that it is the legitimate means of raising standards as opposed to legislative solution in most of the economies in the world. However, in Nigeria's case, the most sensible approach is to focus on law enforcement rather than developing new laws and codes. The agency theory is the theoretical foundation on which this paper is rooted. Anecdotal studies in support of the agency theory are disclosed. The CBN statutory mechanisms of the financial sector are highlighted for economic growth in Nigeria.

Introduction

Downs (2011) set out the case in favour of law enforcement rather than developing new laws and codes in Nigeria. He stated that despite the introduction of regulatory reforms in Nigeria to make it easier for firms to start up and operate business for economic development and growth, Nigeria in the World Bank survey "Doing Business in 2011: Reforming through Difficult Times" ranks 137 out of 183 economies on its ease of doing business. This is in comparison to the United Kingdom (UK) which ranks 4 out of 183 economies. He therefore insist that the most sensible approach is to focus on the strengthening of the existing law enforcement mechanisms rather than developing new laws and codes as a means of raising standards.

Adesina (2010), disclosed that individual banks fell into distress with 31 banks going under between 1989-1998. By 2008, the list of closed banks increased from 31 to 49 as set out below.

Table 1: List of the 49 closed banks according to the year of closure

S/N	BANKS (IN-LIQUIDATION)	DATE OF REVOCATION OF LICENCE
1.	Kapital Merchant Bank	January 21, 1994
2.	Financial Merchant Bank	January 21, 1994
3.	Alpha Merchant Bank Plc	September 8, 1994
4.	United Commercial Bank Ltd	September 8, 1994
5.	Republic Bank Ltd	June 16, 1998
6.	Abacus Merchant Bank Ltd	January 16, 1998
7.	ABC Merchant Bank Ltd	January 16, 1998
8.	Allied Bank Plc	January 16, 1998
9.	Amicable Bank of Nig. Plc	January 16, 1998
10.	Century Merchant Bank Ltd	January 16, 1998
11.	Commerce Bank Plc	January 16, 1998
12.	Commercial Trust Bank Ltd	January 16, 1998
13.	Continental Merchant Bank Plc	January 16, 1998
14.	Co-operative & Commerce Bank	January 16, 1998
15.	Credite Bank Nig. Ltd	January 16, 1998
16.	Crown Merchant Bank Ltd	January 16, 1998
17.	Great Merchant Bank Ltd	January 16, 1998
18.	Group Merchant Bank Ltd	January 16, 1998
19.	Highland Bank Plc	January 16, 1998
20.	ICON (Merchant Bankers)	January 16, 1998
21.	Lobi Bank of Nig. Ltd	January 16, 1998
22.	Mercantile Bank Nig. Ltd	January 16, 1998
23.	Merchant Bank of Africa Ltd	January 16, 1998
24.	Nigeria Merchant Bank Plc	January 16, 1998
25.	North-South Bank Nig. Plc	January 16, 1998
26.	Pan African Bank Ltd	January 16, 1998
27.	Pinacle Commercial Bank Ltd	January 16, 1998
28.	Prime Merchant Bank Ltd	January 16, 1998
29.	Progress Bank Nig. Plc	January 16, 1998
30.	Royal Merchant Bank Ltd	January 16, 1998
31.	Victory Merchant Bank Ltd	January 16, 1998
32.	Ivory Merchant Bank Ltd	December 22, 2000
33.	Premier Commercial Bank Ltd	December 22, 2000
34.	Rims Merchant Bank Ltd	December 22, 2000
35.	Savannah Bank of Nig. Plc *	February 15, 2002
36.	Peak Merchant Bank Ltd *	February 28, 2003
37.	Allstates Trust Bank Plc	January 16, 2006
38.	Assurance Bank of Nigeria Plc	January 16, 2006
39.	African Express Bank Ltd	January 16, 2006
40.	City Express Bank Ltd	January 16, 2006
41.	Eagle Bank Plc	January 16, 2006
42.	Fortune Int'l Bank Ltd*	January 16, 2006
43.	Gulf Bank Plc	January 16, 2006
44.	Hallmark Bank Plc	January 16, 2006
45.	Lead Bank Plc	January 16, 2006
46.	Liberty Bank Ltd	January 16, 2006
47.	Metropolitan Bank Ltd	January 16, 2006
48.	Trade Bank Plc	January 16, 2006
49.	Triumph Bank Ltd*	January 16, 2006

* Liquidation Suspended due to litigation.
Source: Claims Resolution Department, NDIC 2008 Annual Report

Following the banks failures of 1989-1998, the Central Bank of Nigeria (CBN) and the National Deposit Insurance Corporation (NDIC) prepared a regulatory framework on distress resolution. During the 2005 banking sector consolidation, many weak banks were saved through absorption while others that were seriously distressed found no partner and lost their operating licenses leading to the emergence of universal mega-banks with minimum share capital of N25 billion. These new universal banks had huge fund at their disposal to deploy into commercial, merchant and investment banking, sell insurance, hawk the full range of financial products and hold equity in non-financial firms.

Conceptual Issues and Theoretical Framework

To proceed further will require definition of the terms contained in this paper and the disclosure of the theoretical foundation on which it is rooted:

Statute and Statutory Provision?

Garner (2004) defined "Statute" as:

> *a law passed by legislative body, specifically legislation enacted by any law making body including legislatures, administrative boards and municipal courts.*

He went further to describe "statutory provisions" as:

> *A clause in statue, contract and other legal instrument or stipulations made before hand.*

Lile (1914) provided a more fundamental insight into statutory provision insisting thus:

> *We are not justified in limiting the statutory law to those rules only which are promulgated by what we commonly call "legislature". Any positive enactment by which the state gives the force of a law is a 'statute' whether it has gone through the usual stages of legislative proceedings or has been adopted in other modes of expressing the will of the people.*

The CBN supervisory mechanisms is in tandem with this definition. Alfaki (2006) stated that the legislation for regulating financial institutions before the 2003 code of corporate governance in Nigeria included the Company and Allied Matters Act (CAMA, 1990), Investment and Security Act (ISA), 1999, Bank and Nigerian Accounting Standard Board (NASB) Act 2003.

Despite the existence of the aforementioned regulatory provisions, lack of proper coordination, uniformity in standard of best practices and enforcement of the various laws were responsible for the failure of many companies in the financial sector.

CBN Supervisory Mechanisms?

NDIC Report (2008) disclosed that CBN rely on the lending and deposit facilities anchored on the Monetary Policy Rate (MPR) complemented with Open Market Operation (OMO), sale of foreign exchange through Wholesale Dutch Auction System (WDAS), reserve requirements and auction of treasury securities in the primary market, appointment of resident examiners in the 24 universal banks and electronic monitoring together with the enforcement of the 2006 Bank post consolidation code of corporate governance.

Financial Sector? For the purpose of this paper, comprises the following universal banks, namely; Access Bank Plc, Diamond Bank Plc, Ecobank (Nigeria) Plc, Fidelity Bank Plc, First Bank Plc, Stanbic IBTC Bank Plc, Sterling Bank Plc, UBA (United Bank for Africa) Plc, Unity Bank Plc, Wema Bank Plc and Zenith Bank Plc. The population of banks in the financial sector also included the previously consolidated banks that were nationalized recently, namely; Afribank (Nig) Plc, Bank PHB Plc and Spring Bank Plc (Now Mainstreet Bank Ltd, Keystone Bank Ltd and Enterprise Bank Ltd respectively). However, Oceanic Bank International Plc and Intercontinental Bank Plc which are intervened banks are excluded from this paper because the Nigerian Stock Exchange has placed their shares on technical suspension, following their signed transaction Implementation Agreement, until the completion of their recapitalization transaction.

Economic Growth?

According to CBN Report (2010), "Economic Growth"

> *Implies the reduction in the rate of inflation and increase in Gross Domestic Product (GDP) which is the market value of all goods and services officially made within the borders of a country in a year and in a measure of standard of living together with the current value of the naira which is an indicator of economic stability.*

Todaro and Smith (2003) defines economic growth as:

> *The steady process by which the productive capacity of the economy is increased over time to bring about rising level of national output and income.*

They stated further that rapid economic growth has been a major preoccupation of economists, planners and politicians in the least developed countries (LDCs) and developing countries including Nigeria in the last two or three decades because it has been thought to be the major precondition determining levels of living. Etah (2008) also believes that regulatory framework in Nigeria must be interlinked with global business environment and continuously modernized in line with local circumstances since securities regulators, institutional investors and a probing media are still weak. Nigeria, he further stated, needs rules to be upscaled to align with international best practices. The incidence of banking distress which is traceable to lax supervision and failure to adhere to existing regulatory provisions leading to economic stagnation.

The Theoretical Framework

The theoretical framework on which this paper is rooted is the Agency theory. The Agency theory posit that in the presence of information asymmetry the agent (in this case the directors and managers) is likely to pursue interest that may hurt the relationship between managers and equity holders with no explicit recognition of other parties interested in the wellbeing of he firm (Sanda et al 2005). The theory assume that managers are likely to place personal goals ahead of corporate goals resulting in a conflict of interest between shareholders and management. As for the financial industry, the retention of public confidence through the CBN statutory supervisory mechanisms of the financial sector for economic growth is of utmost importance given the role of the industry in the mobilization of fund, the allocation of credit to the needy sector of the economy, the payment and settlement system and the implementation of monetary policies. McColgan (2001), stated that agency conflict of interest between two parties to a contract has developed into three key problem areas, namely; (i). **Moral Hazards Conflict:** This is whereby a hypothetical scenario, a manager develop his incentive to consume prerequisites, rather than investing in positive net present value projects, increases as his ownership stake in the company declines. That is as the manager own smaller equity stakes in their companies, their incentive to work may diminish (Jensen and Meckline 1976). (ii). **Earning Retention Agency Conflict:** Jensen (1993) reaffirmed the existence of the agency conflict by arguing that managers prefer to retain earnings, whereas shareholders prefer higher level of cash distribution. Managers benefit from retained earnings as size growth grants a larger power base, greater prestige, ability to dominate the board and award themselves higher remuneration. (iii). **Time Horizon Agency Conflict**. McColgen (2001) further maintain that shareholders and managers are divided with respect to the timing of cash flow, shareholders usually will be concerned with long term positive net present value (NPV) projects into indefinite future.

However, management may only be concerned with company cash flow for their term of employment leading to a bias in favour of short term higher accounting return projects at the expense of long-term positive NPV projects. Lemo (2010) insist that the financial sector crisis led to the intervention of the CBN in 2009 among others by weak corporate governance structure and unethical practices by the banks. Based on the foregoing state of corporate governance failure, the CBN designed policy strategies and embarked on a comprehensive supervisory mechanism reforms to address the weaknesses observed in the existing corporate governance practices in the financial sector. Komolafe (2007) in his anecdotal studies disclosed instances of bank failures arising from the agency conflicts although revitalized were victims of moral hazard conflict between managers (including directors) and shareholders. Consequently, upon the mismanagement of the bank (Wema Bank Plc) by the management, the capital adequacy ratio dropped to an unacceptable negative ratio of 3.6%, thus requiring capital injection of N23 billion. The liquidity ratio of the bank was also below the required minimum of 40%. As a result, the CBN current account was consistently overdrawn to the tune of N30 billion. Likewise, borrowing from banks and discount houses to finance Wema Bank Plc obligation stood at N21.4 billion as at the examination cut of date. The removal of 13 directors from the Board of Spring Bank Plc in 2008 with the approval of the CBN was an acknowledgement of the bank's liquidity problem and gradual erosion of its shareholders fund in violation of the prudential requirement stipulated by the CBN pursuant to the provision of the Banks and Other Financial Institutions Act (BOFIA) 1991 and the CBN Act 1991.

CBN SUPERVISORY MECHANISMS OF THE FINANCIAL SECTOR

The CBN statutory supervisory mechanisms reforms over the financial sector includes increasing the minimum capital base for banks to N25 billion, phased withdrawal of public sector fund amounting to N74 billion, consolidation of banking institutions, through merger and acquisition, adoption of risk focused and rule based regulation framework especially in the area of data recording and reporting. The CBN policy reform reduced the number of banks from 89 to 24.

The CBN monetary operation rely on the deposit taking and lending rates of the banks, Nigerian interbank and exchange rates and wholesale Dutch Auction system together with monetary policy rates as stated in the money market indicators below.

Table 2: Money Market Indicators

NIGERIAN INTERBANK OFFERED RATE

Tenor	Rate% (Previous) 9 – Feb. 12	Rate % (Current) 10 – Feb. 12	Movement
Call	14.7083	14.9167	↑
7 days	15.0033	15.2917	↑
30 days	15.6250	15.8583	↑
60 days	16.0417	16.2833	↑
90 days	16.4333	16.6500	↑
180 days	16.7500	16.8333	↑
365 days	17.0833	17.2500	↑

AVERAGE TAKING AND LENDING RATES OF BANKS

Feb. 12	Week: 5	Week: 1
	30 – Jan. – 12	6 Feb. 12
SAVINGS A/C	2.3335%	2.3335%
Overnight	2.2103%	2.2103%
Strict call	2.8645%	2.8645%
7 days	3.5398%	3.5398%
30 days	6.4615%	6.4875%
60 days	6.9339%	6.9599%
90 days	7.3271%	7.3531%
180 days	7.3667%	7.4292%
270 days	8.0567%	8.0567%
365 days	8.1617%	8.1817%
OVERDRAFT:		
Prime	17.0773%	17.0772%
Normal lending	20.3040%	20.3043%
STRUCTURED LOAN		
Prime	18.1420%	18.1429%
Normal lending	20.8095%	20.8095%

EXCHANGE RATES

CURRENCY	Year start offer	Current E/d	Current Offer	Cv Y3
NGN USD	156.7000	155.5000	156.9000	0.13
NGN GBP	244.6557	246.4632	247.6456	.1.22
NGN EUR	204.3995	205.3198	297.1424	.1.34
NIGERIAN INTERBANK ($N	160.6625	158.7000	158.8000	1.16
BUREAU DE CHANGE ($N)	162.5000	159.0000	160.0000	1.54
PARALLEL MARKET ($N)	163.000	160.0000	161.0000	1.23

WHOLESALE DUTCH AUCTION SYSTEM

AMOUNT OFFERED	MARKET DEMAND	AMOUNT SOLD	DATE
US$450,000,000.00	US$450,000,000.00	US$450,000,000.00	8-Feb -12
US$250,000,000.00	-	US$250,000,000.00	1-Feb. -12

POLICY RATES

	October 11	November 11	December 11	January 12
Monetary policy rate	12.00%	12.00%	12.00%	12.00%
Standing lending rate	14.00%	14.00%	14.00%	14.00%
Standing deposit rate	10.00%	10.00%	10.00%	10.00%
Liquidity ratio	30.00%	30.00%	30.00%	30.00%
Cash Reserve ratio	8.00%	8.00%	8.00%	8.00%
Inflation rate	10.50%	10.50%	10.50%	10.50%

Source: Business Vanguard. www.vanguardngr.com 4/2/12 pp. 23-24

In furtherance of transparency and full disclosure stance of the CBN, the monetary policy committee has made it mandatory that the lending rate obtainable in all Deposit Money Banks (DMBs) in Nigeria be made public to guide business decisions. The rate are published every Wednesday on weekly basis in selected newspapers with wide geographical spread, the rates are also available on the website of the CBN. The main objectives of the monetary policy rates is to overcome the liquidity overhang and maintenance of macro economic stability, reduction in the cost of borrowing through reduced interest rate together with the maintenance of monetary and exchange rate stability.

The Open Market Operation (OMO) is part of the CBN liquidity management tool. Increased issuance of treasury securities in the primary market are used to MOP UP excess liquidity. The Nigeria Treasury Bills of various Tenors are auctioned. The CBN monetary policy rates (MPR) and cash reserve ratio remain at 12% and 8% respectively since October 2011 – January 2012, without adjustment in Table 2 above. The liquidity ratio of 30% between the same period are part of CBN's management strategy at achieving price stability. The CBN promote market-based interest rate with decisions on interest reviewed on quarterly basis. The wholesale Dutch Auction System (WDAS) is the CBN's major exchange rate policy instrument. As indicated above, the increase of supply of Foreign Exchange of US$250,000,000 – US$450,000,000 for example in February 2012 to the market by the CBN is to promote efficiency in the foreign Exchange Market by allowing market forces to determine the naira exchange rate. The CBN direct banks to submit returns on interest rates on deposits and loans and publish same in their websites. Failure to comply attract severe sanctions.

The CBN's abolition of exclusivity clauses in the agreement between International Money Transfer operators and their agents bank in Nigeria is in response to complaints of the market players over high cost of money transfer in Nigeria. violation of the CBN's directive on this matter may lead to the rejection of such agreement. The CBN statutorily monitors the banks electronically. In conjunction with the National Deposit Insurance Corporation (NDIC) carry out a once-a-year routine audit on each bank.

However, the CBN officials merely plays the ostrich as they are aware that banks actually keep many books and transmit to the regulatory agencies cooked data and not information reflecting their respective state of affairs. The same cooked books is what the CBN/NDIC examiners go through during the yearly audit visit.

Dafinone (2011) emphasized that the sole purpose of the banking sector reform is to safeguard the financial system, including protecting both investors and depositors fund, jobs and ensuring confidence of local and international public in the Nigerian economy.

Conclusion and Recommendations

It is the duty of government through its agencies like the CBN to protect the critical and sensitive financial systems and punish offenders without jeopardizing the practice of free enterprise. The nationalization (Afribank Nig. Plc, Bank PHB Plc and Spring Bank Plc) of private asset send depressing signal to local and foreign investors. Rather than seize troubled private businesses from their legitimate owners, the offending officials should be subjected to judicial process. What is required for economic development and growth is collaboration with private sector to attract direct foreign investment into the Nigerian economy because to do otherwise will further depress the economy.

According to Adesina (2010), promoting ascertainable effective supervisory mandate, will require resident examiners to remit to the CBN completed questionnaires bearing specific and duly certified data on relevant banking operations at stated short intervals within the financial year. Any false information should attract severe sanction to every member of the board of a bank even after the tenure of office has ended. This is necessary because a distress-free financial sector guarantees reliable financials and provide the basis for economic development and growth for the benefit of all.

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