Keynote Address

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Deputy Governors,
Departmental Directors,
Branch Controllers,
Eminent Resource Persons,
Distinguished Executives,
Ladies and Gentlemen

It is my pleasure to be with the Executives of the Bank today as a Special Guest of Honour, and more especially to deliver the Keynote Address at the 2012 Executive Seminar jointly organized by the Research and Human Resource Departments of the CBN. This year is markedly different in the annals of the Executive Seminar, as it is the first time in the history of the Executive Seminar series that two seminars would be held within the same year. Ostensibly, this development has reaffirmed the possibility of hosting two editions of the seminar within a year, going forward. Ladies and Gentlemen, the CBN Executive Seminar provides a veritable forum for a reflection on contemporary financial and economic issues, particularly as they impact on our domestic economy broadly and our financial system specifically. Also, the seminar is an avenue for capacity building and human resource improvement through interactions and exchange of ideas with experts of different experience on economic and financial matters.

Let me reiterate that this year's seminar on **"Macro-Prudential Framework and Financial System Stability in Nigeria"** is thematically timely and appropriate in view of the fact that significant macro-prudential policy reforms worldwide are being designed to respond to the increasingly interconnected nature of financial institutions, markets and systems against the backdrop of the lessons from the global financial crisis (GFC). As you are all aware, the GFC exposed the outlandish financial innovations that outpaced risk management and supervisory practices, the weaknesses in self-regulation and market discipline as well as the incentives for regulatory arbitrage in all the world's major financial centres, with the spillover effects reverberating to the nooks and crannies of the global financial system. Specifically, the US sub-prime credit crisis, which built-up from early 2007, not only ravaged the American financial institutions and economy, but was in no time felt across many European and emerging economies. The spate of institutional collapses and bankruptcies that resulted from the crisis up till 2009 revealed the serious lax in regulatory and supervisory oversights by monetary authorities across the globe, and

hence their inability to regulate most of the big global financial institutions.
You will recall that the Nigeria financial system was not completely spared by the ravaging economic and financial meltdown as the second round effects rocked the stock market with about 70 per cent loss of value between 2008 and 2009, and many banks sustained huge losses due to unbridled exposure to margin-loans/capital market as well as the downstream oil and gas sector. Further inquiry also revealed critical gaps in the regulatory and supervisory frameworks as a major contributory factor to the crisis as the erstwhile universal banking practices had allowed many of our banks to evolve more complex structures by operating affiliates that engaged in businesses other than the core banking business. It is salutary to note that the aftermath of the crisis, as elsewhere, has continued to shape policy reforms to mitigate the impact of future occurrence.

Distinguished Participants, it is imperative at this point to remind ourselves what financial stability is all about. According to the Reserve Bank of Australia (RBA), "financial stability connotes a stable financial system in which financial intermediaries, markets and market infrastructure facilitate smooth flow of funds between savers and investors and, by so doing, help promote growth in economic activities". The stability of the financial system is critical because a material disruption to the intermediation process has potentially damaging implications for the real economy. Therefore, the task of ensuring financial stability is to identify the vulnerabilities within the financial system and take decisive mitigating actions, where possible.

Ladies and Gentlemen, let me reiterate that the global financial crisis has highlighted the need to manage the stability of the financial system as a whole by focusing on systemic risks. This is done through the introduction of macro-prudential policy measures across the global financial landscape to guarantee and ensure the safety and soundness of the financial system. The shift in paradigm was influenced, as noted earlier, by the realization that the traditional regulation, often referred to as micro-prudential, was insufficient to guarantee the health and safety of the financial system as a whole.

We all know that the traditional micro-prudential framework only seeks to enhance the safety and soundness of individual financial institutions, and by so doing, assumes the stability of the financial system as a whole. It also takes risks as exogenous by assuming that any potential shock triggering a financial crisis originates from outside the behavior of the financial system. Consequently, the approach does not take into cognizance that what constitutes prudent behavior from the standpoint of one institution may create broad problems for the system when all institutions engage in similar behavior. On the other hand, macro-prudential approach as a newly defined policy field focuses on the soundness and stability of the financial system as a whole. It

recognizes risk factors as a system phenomenon and thus, sets out to mitigate the systemic risks. However, it is imperative to note that macro-prudential policy framework does not seek to replace the traditional approach; rather it is essentially complementary to micro-prudential policy. Therefore, in practice macro-prudential policy often deploy traditional regulatory tools, and relies on traditional regulators for implementation and enforcement.

Though a coherent macro-prudential policy framework is still being developed by the International Monetary Fund (IMF), Bank for International Settlement (BIS) and the Financial Stability Board (FSB), many economies are starting to establish domestic macro-prudential frameworks, with varying degrees of coverage and authority. For instance, the US macro-prudential financial supervision, under the authority of the Financial Stability Oversight Council (FSOC) chaired by the US Treasury Secretary, has responsibility for identifying the risks to the financial stability and responding to emerging threats to the financial system. In the United Kingdom, the Financial Policy Committee (FPC) is saddled with the task of identifying and assessing systemic risks and selecting the most appropriate tools to address them.

The European Systemic Risk Board (ESRB) under the chairmanship of the European Central Bank (ECB) President has the responsibility, within the European Union, to prevent or mitigate systemic risks to the financial system and also to ensure sustainable financial sector. For emerging economies example, the Central Bank of Malaysia, through the Financial Stability Executive Committee, has broad powers to ensure stability of the Malaysian financial system. In the Philippines, the Financial Stability Committee under the chairmanship of the Bangko Sentral ng Pilipinas (BSP) is tasked with the mandate of monitoring financial stability.

With the IMF, BIS and FSB spearheading the development of comprehensive macro-prudential policy frameworks, there is the need to adopt a 'no one size fits all' model in formulating effective frameworks to address country/regional specific challenges. Let me stress that the cooperation of international and domestic regulatory institutions is essential given the interconnected nature of global financial institutions and cross-border systemic risks. Thus, it is pertinent for countries to adopt different mix/models based on the structure of their financial architecture and the nature/power of the regulatory authorities. And since there is no universally-accepted model, what remains paramount is the need for the supervisory institutions to rely on models that emphasise industry-wide approaches.

Distinguished Participants, you would all agree that a stable financial system is a sine-qua-non for the growth of a nation's economy. The use of distress mitigation approach would enhance the capacity of operators to facilitate the smooth delivery of financial services and safeguard the stability of the financial system. A risk-focused

banking supervision must, therefore, be anchored on an integrated and not fragmented regulation of financial institutions. Thus, the implementation of macro-prudential policies minimizes the risks of financial disruptions and engenders financial stability. A system-wide regulation and supervision will certainly impact the entire financial system and ultimately ensure an unfettered delivery of financial intermediation by banks and generally inspire public confidence in the banking industry.

Given the importance of macro-prudential regulation in overcoming the inherent weaknesses associated with the traditional micro-prudential regulation, the CBN has, thus, far embarked on far-reaching reforms, aimed at improving the supervision of the banking system in pursuance of its mandate of ensuring price and monetary stability as well as ensuring financial sector soundness and stability. First, in order to address the observed challenges of regulatory arbitrage, the universal banking model was reviewed to focus the banks toward the core banking business. Second, to promote sound risk management in the banking industry, the Bank adopted risk-based supervision and commenced the implementation of the Basel II Capital Accord.

In addition, the new macro-prudential guidelines based on forward-looking capital provisioning and driven by stress tests are being reviewed and implemented while a holistic macro-prudential framework is being designed. The Bank also places a high premium on transparency and accountability, which has necessitated the implementation of the Code of Corporate Governance with renewed vigour in order to significantly improve industry ethics, transparency and disclosure standards in the banking system. The Bank enforced uniform accounting year for all the deposit money banks and has taken steps to promote financial literacy and the protection of consumer rights. These efforts, in conjunction with other reform measures are yielding positive results and enhancing banking services in Nigeria.

Ladies and Gentlemen, in this new banking era that seeks to promote electronic transaction settlement system in order to minimize the use of cash in the economy, the adoption of macro-prudential supervision would, no doubt, induce banks to sufficiently manage their investment portfolios and foster risk management. Macro-prudential approach is expected also to elicit wide implementation of contingency plans by banks to strengthen internal controls and provide early warning signals for the quick resolution of problem areas. In addition, with supervisory authorities enhancing macro-prudential regulatory and surveillance, banks would be better able to pay more attention to issues of immediate and future threats to their operations.

Notwithstanding, the Bank hopes to continue to expedite actions in the implementation of the Basel Accords, particularly by moving towards Basel III which

provides for the strengthening of bank capital and the introduction of new liquidity requirements, a leverage cap as well as a countercyclical capital buffer in recognition of the systemic significance of financial institutions.

Let me re-affirm the commitment of the CBN in strengthening staff capacity in ensuring financial system stability. It is hoped that this Seminar would, among other issues, identify appropriate macro-prudential supervisory frameworks and tools that are capable of enhancing financial system stability and allow for more efficient and quality financial services delivery. I believe that the issues raised in this address would set the stage for further deliberations on the key issues.

Distinguished Participants, Ladies and Gentlemen, with the assemblage of experts and eminent scholars, I am very confident that the outcome of the discussions will help fashion out appropriate macro-prudential tools for robust supervision and surveillance that would stand the test of time in mitigating threats and distress in the Nigerian financial system.

Thank you very much for your attention and I wish you all great success.