Special Remarks

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Deputy Governor, (Economic Policy),
Director, Human Resources Department,
Departmental Directors/Their Representatives,
Branch Controllers,
CBN Executives,
Distinguished Resource Persons,
Ladies and Gentlemen,

It is my honour and pleasure to make this special remark at this opening ceremony of the 16th edition of the annual in-house Executive Policy Seminar organized by the Research Department, in collaboration with the Human Resources Department. As usual, the seminar is aimed at availing the Executives of the Bank the opportunity of brainstorming on contemporary economic issues in the economy and the globe at large. In this respect, the theme of this year's Seminar **"Financial Sector Development: Challenges for Risk-Based Supervision and Effectiveness of Monetary Policy Implementation"** could not have come at a more opportune time, given the current financial meltdown ravaging global markets.

This theme, therefore, provides the opportunity for us, as Executives of the Bank, to exchange views and reflect on the implications of our ever changing financial environment on the risk management of banks and effectiveness of monetary policy implementation in Nigeria. Indeed, understanding developments in the financial sector is a cornerstone for risk management in the financial services industry and effective monetary policy making and implementation. This is true

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in normal times, and even more so in extraordinary times like we have today that the world is facing a financial crisis. It is within this context that the significance of the theme of this year's seminar can be situated.

In recent decades, the financial services industry around the world has witnessed remarkable changes, driven largely by deregulation and liberalization, increasing wave of globalization and advances in information and communications technology, leading to financial sector development. This development has played an influential role in stimulating financial innovations, integration of financial markets, greater competition in the financial institutions, and change in banking business with computers, telecommunications and satellite technologies opening new avenues for intermediation and risk management. It has also increased the breadth and depth of the financial markets, leading to a reduction in transaction costs, provided greater scope for diversification and permitted a more efficient pricing of risk, as well as improved the allocation of financial savings, by removing barriers to the flow of savings into the highest yielding investments. Improved technology and shifting institutional factors, which facilitated financial sector development, have also created hybrid assets with savings and transactions properties of varying degrees, like savings deposits or mutual fund balances. Consequently, it is increasingly difficult to demarcate between monetary and non-monetary financial assets.

Despite the positive impacts, these changes in the financial environment, particularly the structural changes in the financial markets, have equally exposed financial markets to various risks and posed several challenges for the supervisory authorities and monetary policymakers in the design and implementation of monetary policy. In effect, the financial crisis being experienced now is the negative fallout of these developments in the ever-changing financial landscape, as prudential supervision has failed to adequately deal with the increased risks and volatility in key macroeconomic variables, leading to ineffectiveness of monetary policy actions.

In the face of this development, some people have predicted the demise of currency, while others have questioned the effectiveness of monetary policy, even the ability of the supervisory authorities to contain the emerging risks that accompany the ever changing financial environment.

In Nigeria, one of the positive outcomes of the recent reforms in the financial sector is the emergence of well-capitalized banks with increased asset base, which give them the capacity to undertake bigger ticket transactions. The increased size and complexity of these emergent banks have engendered them to greater competition, product innovations and have equally exposed them to the risks associated with such scale of operations, hence, the need for the Bank to rise up to the challenge of fulfilling two of its core mandates of a safe, stable and sound financial system, and maintenance of price stability. In order to fulfill the first mandate, the Bank in 2007 had shifted from its traditional approach to supervision, which was largely rule/compliance based and was proven to be reactionary, to risk-based supervision (RBS) as the framework for supervising the Nigerian banks. The move was to cope with the emerging challenges associated with the diversified and complex operations of the banks. Consequently, a guideline for the development and management of risks by individual banks was also issued to the industry in the same year. In order to fulfill the second mandate, our present approach to monetary policy using monetary targeting, which has been largely unable to cope with the changing financial landscape, is to be replaced with an inflation targeting framework, by January, 2009.

The apparent shift in focus in both mandates is not without its challenges for the risk supervision/management of Nigerian banks and the design and implementation of effective monetary policy in the country. Specifically, the liberalization of the Nigerian financial sector, particularly the deregulation of interest have affected the monetary policy transmission mechanism, thus, creating daunting challenges for the effective conduct of monetary policy. An important element in the transmission mechanism of monetary policy is the relationship between the Central Bank's policy rate and other prices such as the money market rates, exchange rates and assets prices. These rates ultimately affect aggregate demand, inflation expectations and the rate of inflation. With financial innovations leading to the development of different financial derivatives, there has been a disconnect between these rates and the ultimate variables posing serious challenge for the effectiveness of monetary policy implementation in the country.

On the risk-based supervision/management of the banks, one big challenge is the technical capability of the supervisors. Understanding the risk management procedures and aggregating the risk profiles of banks require considerable knowledge, experience and judgment on the part of the supervisors. Special skills would also be required by supervisors to identify, understand and evaluate the impact of changes in environmental /economic factors on financial institutions that could lead to systemic risks. The implementation of risk-based supervision requires the understanding of the technicalities involved, hence, the need to train supervisors adequately for the job. It is also likely that the market will rely on the supervisory authorities to provide the relevant training for the operators. All of these call for extensive training of supervisors and operators. Another challenge is that of transparency in statutory reporting by banks. In the RBS, a high degree of reliance would be placed on the information provided by the financial institutions in respect of a bank's operations and its assets and liabilities. Data integrity is, therefore, very key as it would facilitate accurate analysis of identified risks. Even though the CBN Act and a number of CBN circulars to banks address the issue of false rendition of returns, the situation has not been totally remedied.

From the foregoing, therefore, our task in this seminar will include, among others, to critically examine the issues and problems on the ground and come up with appropriate recommendations that will assist the Bank, as both supervisory authority and monetary policymaker, in designing a framework of economic policy that would help insulate the Nigerian financial sector from the current global financial crisis. Thoughts should also be given to how the Bank can ensure the stability of the financial sector for credible conduct and implementation of monetary policy in the economy.

Against this background, experts and seasoned professionals in the relevant fields have been carefully selected as facilitators for this Seminar. I have no doubt in my mind that they will do justice to the issues involved and by the end of their presentations, you will be better informed.

Once again, I urge you to make use of this opportunity by devoting maximum time and attention to all the deliveries and actively participate in all discussions.

Before concluding these remarks, I wish to thank the Deputy Governor, Economic Policy for always honouring our invitation to grace this occasion and other tremendous support she has been giving to the Department in particular. Our gratitude also goes to the Human Resources Department for the continuous collaboration in the organization of this seminar series.

I wish all of you a rewarding Seminar and fruitful deliberations.

Thank you for your attention.