

Good Governance, Transparency and Regulatory Issues in Financial Sector Development and Stability

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I. Introduction

Good governance and transparency are words of common usage in present times. Good governance connotes many things, but is anchored on the desire of the state to develop. "Development" as a concept is also fraught with a vagary of divergent factors that are not easily subjected to measurement. It has been said that it is easier to speak of rich and poor countries than to speak of developed or not developed economies because the indicators of wealth, which reflect the quantity of resources available to a society, provide no information about the allocation of those resources¹. As a result, citizens of countries having similar incomes may not enjoy similar quality of life.²

United Nations documents emphasize that "human development is best " measured by life expectancy, adult literacy, access to all three levels of education, as well as people's average income, which is a necessary condition of their freedom of choice. Therefore, the notion of development incorporates all aspects of individuals' well-being, from health status to economic and political freedom³. "Human development being the end, good governance and economic growth will be the means."⁴

Development can also be seen in both physical and psychological realities. The physical reality of development is found in the existence or availability of real and tangible structures of development or infrastructure like schools, hospitals, roads,

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¹ "What is Development?" www.worldbank.org/depweb

² see generally Bolaji Owasanoye "Rule of Law and National Development" in Rule of Law and Good Governance, Azinge and Owasanoye ed. Nigerian Institute of Advanced Legal Studies, 2009 pp. 304-324.

³ See generally UN Human Development Reports <http://undp.org>

⁴ Ibid UNHDR 1996.

bridges, factories, etc. while the psychological reality is considered essential for the enjoyment of the benefits of physical development⁵.

Good governance as a concept is generally recognized to have basic features viz. poverty alleviation; security of life and property; maintenance of law and order and an acceptable level of infrastructural development. In the context of financial sector regulation, it implies that the focus and objectives of the regulator should be how to regulate to guarantee poverty alleviation; improve the security of life and property; enhance maintenance of law and order and sustain an acceptable level of infrastructural development that would foster economic growth.

I.1 Financial Services Sector

The financial services sector of any economy is the channel through which financial resources mainly capital are transmitted to the economy. The key functions of the sector may be summarised as; mobilization of savings from different parts of the economy; allocation of capital to needy sectors based on scale of return; monitoring the use of investments either by government, corporations or individuals; and assessment and management of financial risks for investors.

Given the importance of these functions to the economic health of a nation, regulation of financial services sector is taken seriously and is the function of different agencies led by the Central Bank. The powers given central banks by law, underscore the importance of law in financial sector regulation in order to ensure the fulfilment of the objectives of the financial sector and guarantee stability and growth. In this regard, central bank regulatory powers are constantly reviewed to enable it superintend financial sector stability in response to modern trends and international best practices. For example, the powers of Central Bank of Nigeria (CBN) to regulate the financial services sector was enhanced by the passage of the Central Bank Act of 2007⁶.

I.2 Regulation and Development

Regulation as a concept in economic management is founded on the ideology of development as a key objective of governance. As was noted by White⁷ -

⁵ Amartya Sen (1999). *Development as Freedom*. (Alfred Knopf: New York) p. 75

⁶ Before 2007 the CBN Act was revised in 1991 33 years after the enabling act was first passed.

⁷ Developmental States and Socialist Industrialization in the Third World' *Journal of Development Studies*, 21, 1 Oct. 1984.

"The modern notion of 'development economics' rests on a more or less explicit concept of the state as a crucial stimulant and organizer of socio-economic progress. This intellectual paradigm has drawn historical sustenance from the argument that the developmental process is less 'spontaneous' more subject to teleological determination, with the state as the major agent of social transformation in both capitalist and socialist contexts..."

In other words, we cannot separate state intervention by regulation as a necessary factor in the objective of development or good governance. The limit of state intervention is, thus, defined by the statutory power to regulate. The power of the CBN to regulate the financial services sector is found in the CBN Act⁸ and the Banks and Other Financial Institutions Act⁹. Specifically, section 2(a) of the CBN Act gives it power to promote monetary stability in Nigeria. This it does by issuing monetary policy circulars from time to time. These policy circulars are obligatory on players in the sector and are regarded as subsidiary instruments having the force of law.¹⁰

This position is affirmed by sections 56 and 59(2) (a) of Banks and Other Financial Institutions Decree No. 25 of 1991, which gives the Governor of the Central Bank power to make regulations to control institutions under his jurisdiction generally and mandates every bank to comply with the Monetary Policy Guidelines and other directives as the Bank may, from time to time specify, respectively.

II. Transparency and Accountability

Transparency and accountability are expressions of common usage in Nigeria although they are vanishing ideals. Every institution of government appears to idolise the concepts, but the more they are highlighted, the more elusive they appear to be in practical terms and implementation. The recent global financial crisis revealed the underbelly or absence of transparency and accountability in Nigeria's financial services sector.

The global financial crisis underscores the importance of regulation but also its limitations. There is no doubt that the financial crisis was accentuated by the

⁸ No. 63 of 2007

⁹ Decree No. 25 of 1991, now Cap. B3 LFN 2004

¹⁰ See section 12(1) Interpretation Act cap 192 LFN 1990

absence of transparency and accountability and the failure of the rule of law wherein regulators failed to use law to minimise the impact of the crises on the local economy. The crisis also revealed the underbelly of legal regulation, indicating that many aspects of finance, financial policy and financial law and regulation need rethinking at international, regional and domestic levels. We must, however, not lose sight of the fact that the reaction of the regulatory authorities to the crisis was situated within the statutory powers. Such powers were invoked to address the crises as soon as the regulator found the political will to act. In other words, on the one hand, the crises escalated because the law was not followed, while on the other hand, the ultimate power to address the crises was found within the law as soon as the regulator found the courage to act.

III. Rule of Law in Financial Sector Regulation

The rule of law is a mix of technical or procedural components, as well as substantive moral content that encompass a system where institutions and officials are guided and constrained by the law, i.e., government that is accountable to, not above, the law; a body of laws that are transparent, reasonably predictable, validly derived, and fairly and equitably applied; laws, principles and procedures that protect those civil, political, and economic rights that have become enshrined as universal human rights; and a fair and effective legal system led by an independent and professionally competent judiciary that acts as the final arbiter of the law. The term "rule of law" also relates to the process rather than substance and refers to law made by legitimate authority, certain, clear, publicly accessible, consistent, prospective, and commanding obedience.

One of the challenges faced by rule of law in Nigeria is that its principles are hardly observed. Access to legislation and regulatory guidelines or subsidiary instruments both substantive and subsidiary is a major challenge¹¹. For example, the CBN monetary policy circulars have the force of law as subsidiary instruments made pursuant to its powers under section 51 of the CBN Act but the policies are not readily accessible by the public either in printed format or on CBN website. For effective financial sector regulation, it is not only financial services providers who ought to be notified of the CBN circulars, members of the public for whom

¹¹ Different versions of laws already passed and in the process of being passed are often in circulation to the consternation of the end user. Recently, the Senate raised alarm at the prevalence of differing versions of law on sale on street corners. It is said that eight or more versions of the Petroleum Industry Bill exist in Nigeria

such regulations are made ought to have easy access to such circulars. This will also assist transparency as we will discuss later. There is also the challenge of blatant disobedience to laws and the inability or lack of will power on the part of regulator and law enforcers to command obedience and punish offenders.

In the context of financial services, absence of rule of law means that uncertainty will reign in the economy. Without transparent legal rules, the cost of doing business rises with further consequences leading to increased cost of raising capital, higher risk premiums, and lack of fidelity amongst players. Debtors will not repay debts because they know that laws and contract obligations are not consistently enforced. In such a set-up, corruption thrives and spreads like a virus. Therefore, the rule of law provides an essential framework for economic activity.

IV. Some Regulatory Powers of CBN Relative to a Developing Economy

Given the wide powers of CBN in its enabling statutes it is not possible to discuss in-depth all its regulatory powers in a short paper of this nature, therefore, we will focus on the following viz. payment system regulation, external reserves management, power of supervision and micro credit policy framework.

IV.1 Payments System

Payments system is important for the proper functioning of financial markets and the economy. There is a linkage between an effective payment system and the economy as a whole. Thus, problems affecting the payments system affect the entire financial system and the economy as a whole. Section 47 of the Central Bank of Nigeria Act 2007 provides for the Bank to facilitate the efficient clearing of cheques and credit instruments and to establish clearing houses for the purpose.

The exchange of payment related information between system participants and any regulations under which payments are settled on a bilateral or multilateral basis is known as clearing. Settlement implies the actual discharge of an obligation, i.e. by debiting the specific amount from the payer's account, and crediting the payee's account, while the infrastructure, which facilitates the clearing and settlement of financial instruments is known as the payment system.¹² Efficient payments system provides the basis for the Central Bank's

¹² O. J. Nnanna and M. Ajayi : The Role of Payments System in Liquidity Management: Central Bank in Perspective. CBN BULLION Vol 29 No 1 Jan -March 2005 p.34

liquidity forecasting and management process, the features of which affect the demand and supply of bank reserves, credit delivery and support for economic growth.

The modernisation of the process for handling payments started with the Magnetic Ink Character Recognition (MICR) programme of the CBN, which involved the phased adoption of MICR technology for processing of inter- bank transfer and in- house cheques. This was followed by the establishment of Automated Teller Machines (ATMs) for cash dispensing, account balance enquiry and payment of utility cheques. The ATM in turn provided links to online customers and other account systems among bank branch network to facilitate payment services. Currently, CBN has introduced cash-less economy policy, effective April 2012 starting with a pilot in Lagos State. The policy is aimed at reducing the cost of handling cash, enhance security and diminishing the opportunities for money laundering, amongst others¹³.

Settlements through inter-branch transfers are currently undertaken almost instantaneously. Cheque clearing cycle is T+3 for local and up country. Even then the time can be shortened as the market keeps evolving with the introduction of modern facilities.

The link between the payments system and liquidity management is reflected in the interface between liquidity and payment channels.¹⁴ A major payment system failure would bring countless commercial transactions to an abrupt halt, impede the operation of business in virtually all parts of the economy and fundamentally undermine investor and business confidence. This is a major concern with regard to the introduction of the cashless economy because the infrastructure to back up the effective and efficient implementation of the policy is not yet in place while the public education component is inadequate in the light of the fact that the Nigerian economy, which is dominated by the informal sector, is largely run on cash-and-carry basis. Vulnerability to fraud is also a major concern as expressed by the security experts.¹⁵

¹³ see generally <http://www.cbn.gov.ng/cashless/> accessed, 22nd April 2012

¹⁴ Ibid p.38

¹⁵ Nation Newspaper 20th April 2012

IV.2 External Reserves Management

External Reserves are external assets of a country that are readily available to and managed by the CBs for direct financing of government's expenditure, intervention in foreign exchange markets and meeting other external financing commitments. By section 24 of the CBN Act, the Bank is required to maintain at all times a reserve of external assets consisting of all or any of the assets specified in the section.

Section 25 provides that the Bank shall use its best endeavours to maintain external reserves at levels considered by the Bank to be appropriate for the country and the monetary system of Nigeria. According to Nnadi, a distinction should be made between a country's external assets and its external reserves. A country's external assets comprise the foreign exchange holdings of the government, semi-official institutions, commercial and merchant banks and that of the Central Bank of that country while the Central Bank's component of the external assets may be interpreted as its reserves¹⁶. The reserve management strategy of the CBN is anchored on liquidity management, adequate returns and capital preservation. In this case, the Bank holds the larger proportion of its reserves in secure, liquid though low yield assets such as government bonds and time deposits with reputable international financial institutions.¹⁷

Sections 2 and 24(h) of CBN Act and Good Governance¹⁸

Section 2: Delegation of Management of Foreign Reserves

One of the much-touted reasons for the bank consolidation policy embarked upon in 2005 was the possibility of delegating the management of the nation's external reserves to the newly consolidated and stronger deposit money banks. In anticipation of this, many of them established partnerships with foreign banks. Although section 2(c) of the Act placed responsibility for management of reserves on the CBN, it was speculated that the CBN planned to delegate this function. Delegating this duty would be in breach of one of the CBN's main functions. If the law wished CBN to delegate the management of reserves it would have so expressed as done under s.36(3) which empowers it to delegate

¹⁶ Ben C. Nnadi: "International Reserve Management: A Synopsis" CBN Bullion VOL. 27 No 1 2002 p. 39

¹⁷ Sheriffdeen A. Tella: Overview of External Reserves Management in Nigeria CBN Bullion Vol. 31 No.2 April-June 2007. P1 at p.8

¹⁸ See generally H.K. Fujah CBN Act 2007 A Review. pub. HK. Fujah, 2009.

the power of collecting and paying government money in places where it has no branch.

Section 24(h) says - The Bank shall at all times maintain a reserve of external assets consisting of all or any of the following:

(h) Investment by way of loan or debenture in an investment bank or development financial institutions within or outside Nigeria for a maximum period of five years in so far as:

- (i) the amount invested is no more than 5% of the total foreign reserves;
- (ii) the reserve level at the time of investment is more than such amount as will sustain twenty four months of import; and,
- (iii) the loan or debenture is denominated in foreign currency.

The section empowers CBN to lend part of Nigeria's foreign reserves to private local and international entities ostensibly to enhance national revenue since the assets will earn interest. The provision seems to have been influenced by the positive health of the nation's reserves at the time of the passage of the 2007 Act. The rationale was that such healthy savings ought not to be left idle in the accounts. The ambiguous provision prescribes 5per cent but does not say if this is limited to one or all banks? Can CBN lend 5 per cent of foreign reserves at any point in time to each and every applicant? The answer would, in practical terms, seem to be in the negative but that does not cure the ambiguity. According to Fajah (2009), the provisions do not address some key issues.¹⁹

- (a) It assumes that the nation may never need to make provision for more than 24 months imports or that the economy is unlikely to expand to such level;
- (b) It suggests that national funds could be more secure with private entities than with public. Recent developments had, however, showed that private banks both local and international can become distress and can be wound up. Government cannot be wound up, though they may, like companies, face economic hardship. The confidence reposed in private entities to invest national reserves is misplaced and unduly optimistic. Nigeria's private

¹⁹ Ibid.

sector has not performed up to expectation in many respects nor exhibited a higher standard of probity than the public sector;

- (c) Lending will be unsecured with all the attendant risks that are associated with it. In the absence of security, what is the consideration that would be offered by the borrowers of public funds given that the CBN frowns at local banks for unsecured lending that exposes them to undue risks and threatens shareholders' and depositors' funds? How does the CBN hope to prevent risk to national funds. Besides, the suggestion of the provision negates the safety inherent in the policy that CBN cannot lend to public bodies without government guarantee. Note that section 29(e) and (g) of the Act requires CBN to lend local currency to public and private bodies only upon provision of collateral e.g. Treasury bills.
- (d) The provision benchmarks the amount lendable against the country's stock of reserves i.e. the more we save the more you can lend out. This negates the practice of lending against the borrower's capacity and not the lender's capacity. Indeed s.38 of the same Act enjoins CBN to lend to the Federal Government of Nigeria only against the FGN's actual revenue not against the money in the CBN's vaults.
- (e) The period for which money can be lent out is also questionable. Five years unsecured lending of national assets to private banks cannot be said to be prudent especially in the light of s.38 mentioned above which allows the CBN to lend local currency to Federal Government of Nigeria (FGN) for one year only. Why allow CBN to lend foreign currency unsecured for five years to private institutions?
- (f) Will the CBN make provision for such loans in its books and accounts as it mandates banks to do? Will the CBN humbly anticipate the failure of some of the loans and provide for them? If yes, how much of the loan it grants will it provide for without making its books and the economy look negative in presentation and projections.

Section 24(h) makes the CBN attractive to banks that it is supposed to regulate. Though regarded as lender of last resort, with the possibility of generous unsecured money available for five years, CBN may become the first and last

port of call for banks looking for cheap and free foreign currency. The question of whether the CBN will be morally upright in its dealings with those to whom it has lent money remains unclear? It may, thus, be asked, is this good governance?

If, as has recently happened, the local banks that borrow under this provision become insolvent for any reason, the CBN is required to bail them out with naira as lender of last resort. In this regard, public funds suffer double jeopardy in the hands of unscrupulous local banks.

In the light of the explanations by the CBN to states calling for the disbursement of savings in foreign reserves that they have already shared the naira equivalent through the approved revenue allocation formula, therefore, technically speaking, the money no longer belongs to states or FGN, would it not amount to releasing the same money into the economy twice if same were to find its way back through loans to private banks? Could this induce inflation? How much control would the CBN place on dollar loans to local banks. Is there any possibility that such money could be round trip by local banks to the foreign exchange market.

The 2007 re-enactment of the CBN Act seems to suggest that the CBN suddenly developed a commercial approach to managing public assets by seeking to invest foreign reserves in a manner that jeopardises the economy.

V. Supervision

Banks and Other Financial Institutions Act (BOFIA) empowers the CBN to conduct special examination. In order to properly appreciate the extent of these powers especially in the light of recent actions taken by the CBN against weak banks and the challenge of those actions, we will set out extensively the powers of CBN on supervision of banks. Section 33 of the BOFIA provides:

- (1) The Governor shall have power to order a special examination or investigation of the books and affairs of a bank where he is satisfied that-
 - (a) it is in the public interest so to do; or
 - (b) the bank has been carrying on its business in a manner detrimental to the interest of its depositors and creditors; or
 - (c) the bank has "insufficient" assets to cover its liabilities to the public; or
 - (d) the bank has been contravening the provisions of this Act; or
 - (e) an application is made thereof by-

- (i) a director or shareholder of the bank; or
- (ii) a depositor or creditor of the bank;

This provision is strengthened by section 35 of the BOFIA, which gives similar wide powers over a failing bank including power to prohibit a failing bank from extending any further credit facility for a stated period; remove, for reasons to be given in writing, any manager, director or officer of the bank, notwithstanding anything in any written law, or any limitations contained in the memorandum and articles of association of the bank; appoint any person as director of the bank and order that the person so appointed be paid by the bank such remuneration as may be set out in the order; appoint any person to advise the bank in relation to the proper conduct of its business, and provide, in order for the person so appointed to be paid by the bank, such remuneration as may be set out in the order. If the steps enumerated above have been taken and the affected bank does not improve, the CBN might, under section 36 and 37 of the BOFIA hand over the failing bank to the Nigerian Deposit Insurance Corporation (NDIC) being the undertaker, to see to the painful euthanasia or otherwise of the bank.

These wide powers empower the CBN to maintain financial stability and consequently manage the economy and were recently used to sack the CEOs of eight banks and liquidated three banks. Furthermore, protection of depositors helps to prevent widespread panic withdrawal and damage to the economy by ultimate collapse of affected financial institution(s).

VI. Micro Credit Regime

The micro credit regime of the CBN was designed to assist vulnerable groups and persons with a view to empowering them financially so that they can contribute to the development of the economy. If effectively implemented, the regime would have tackled unemployment and acted as booster to productive activities by the larger segment of the population. Unfortunately, like many of the development policies of the Government the micro credit regime is yet to fully achieve its objectives.

A Human Development Initiatives (HDI) Report²⁰ observed that there are more areas to be covered to address the micro finance methodologies in Nigeria,

²⁰ Human Development Initiatives: The Philosophy and Loan Lending Practices of Selected Micro Finance Banks/ Institutions in Lagos State and the Grameen Bank Model 2010 p.17

when compared with what obtains in other jurisdictions. While the Nigerian guidelines focuses more on profitability and quality of micro finance banks, those in other jurisdictions focus on maximum outreach and poverty alleviation.

In an International Conference on Micro Financing organised by the First Bank of Nigeria in 2011, the World renowned micro finance expert Mohammad Yunus criticised Nigeria's micro finance regime as being tilted in favour of the rich at the expense of the poor.²¹ Explaining the mechanism for the success of the Grameen bank, Yunus said: "What we did, was to look at conventional banking and do things the opposite way. Conventional banking is for the rich so we decided it should be for the poor. Conventional banking is for men; we set up Grameen Bank for women. Conventional banking is set up in the city, whilst microfinance bank is for the rural area. Conventional banks asks for collateral, we do not ask for collateral"²²

The HDI report showed that microfinance in Nigeria seems to focus on how to make money and not on how to assist the poor. With such a damning verdict from an internationally renowned expert and a local survey report, it is not surprising that micro financing in Nigeria has not achieved its avowed objective of developing the economy.

VII. The Global Crisis and the Nigerian Financial Sector

Initially there were conflicting opinions as to whether the Nigerian Financial System was affected by the crisis that rocked the advanced western world²³. It wasn't long, however, before it became clear to all that Nigeria was not spared. The cause of the crisis in Nigeria was not hinged on the failure of regulation, impact of corruption and poor corporate governance.

A joint CBN/ NDIC Audit investigation on the financial sector blamed the depletion of capital on poor or non-observance of corporate governance principles in the management of banks as well as outright fraudulent insider loans taken by directors of banks to fund private businesses. Investors and depositors

²¹ Yunus, Nobel Laureate, faults Nigeria's microfinance banking; Business Day 6th September 2011
<http://www.businessdayonline.com/NG/index.php/news/76-hot-topic/26923-yunusnobel-laureate-faults-nigerias-microfinance-banking> visited 25/ 10/11

²² *ibid*

²³ For instance the former Governor of Central Bank variously assured the nation that the economy was not affected by the global crisis because of the enhanced capital base of the banks. See Princess Iphie 50 years of Central Banking in Nigeria –Icons, Issues, Perspective. 2009 p 116

were deceived by the operators with false reports of good performance published annually but never challenged or sanctioned by the regulator. Reports concealed huge non-performing loans to capital market operators and effect of divestment by foreign investors afflicted by the global financial crisis.²⁴

Several local investors lost life savings in the stocks of banks as the capital market lost over 80 per cent of capitalization in one year. The attendant loss of employment in both banks and capital market underscored the depth of the crisis because the banking sector holding 65 per cent of the market capitalisation was in deep crisis.²⁵

The 2009 audit report revealed serious illiquidity and poor state of capital of five (5) out of the eleven (11) banks that were initially audited. The other fourteen (14) were later audited and their results released on October 16, and another four (4) were found to be in the same dangerous state like the first 5. Eight (8) of the distressed banks had their Management sacked and a total of ₦620 billion was injected into the affected banks by the CBN to shore up their liquidity.

It is safe to say that the crisis in Nigeria has been escalated by a combination of international and local factors. While the internationalisation of the capital market exposed the sector to the vagaries of exogenous factors, local peculiarities like high level corruption, lack of political will and more importantly failure of corporate governance escalated the impact.

One cannot conclude that the crisis is over either globally or locally. According to the G20 Declaration of 2008, "... regulation is first and foremost the responsibility of national regulators who constitute the first line of defence against market instability."²⁶ This implies that although a crisis may arise out of factors external to the economy, internal regulation remains the first line of defence. Indeed, we note that countries like Canada whose local regulators were proactive in using laws and policies as first line of defence were not burnt in the aftermath of the crisis²⁷.

²⁴ Paul Ogbuokiri: Nigeria: Banking Sector – The Turmoil, The Crisis: <http://allafrica.com/stories>. Accessed 23/10/11

²⁵ Ibid

²⁶ Declaration Summit on Financial Markets and the World Economy http://www.g20.org/Documents/g20_summit_declaration.pdf Accessed 31/10/11

²⁷ "Worldwide Financial Crisis Largely Bypasses Canada" <http://www.washingtonpost.com/wp-dyn/content/article/2008/10/15/AR20081>

The Central Bank of Nigeria, in pursuant to the CBN Act 2007 from 2008 to date, has taken different measures to address the impact of the global financial crisis in Nigeria. The Central Bank's intervention is hinged on four pillars namely:²⁸

1: Enhancing the Quality of Banks

This consist of industry remedial programmes, risk based supervision, reforms to regulation and regulatory framework, enhanced provisions for consumer protection and internal transformation of the CBN. It is under this reform head that bank chief executives were held accountable for their actions leading to the sack of same and appointment of new management for the banks.

2: Establishing Financial Stability

According to the Governor of the CBN "The key features of this pillar centre around strengthening the financial stability committee within the CBN, establishment of a hybrid monetary policy and macro-prudential rules, development of directional economic policy and counter-cyclical fiscal policies by the government and further development of capital markets as alternative to bank funding."

3: Enabling Healthy Financial Sector Evolution

Reforms in this area include banking infrastructure, banking industry infrastructure and role of the informal sector. The establishment of the Asset Management Corporation of Nigeria (AMCON) and the new banking model come under this reform head. Toxic shares of banks are assumed by the AMCON and would be retained for two years before they are traded on the open market. AMCON is billed to clear about US\$10 billion by end-2012 at a cost of roughly US\$5 billion.²⁹

4: Ensuring the Financial Sector contributes to the Real Economy

Policy measures in this regard include making more efficient the development programmes of CBN such as the Agricultural Credit Guarantee Scheme (ACGS) micro finance and the Small and Medium Enterprises (SMEs) financing schemes.

²⁸ Sanusi Lamido "The Nigerian Banking Industry: What Went Wrong and the Way Forward" Speech at Bayero University Kano Convocation Lecture, Feb 26 2010:

http://www.cenbank.org/out/speeches/2010/the%20nigerian%20banking%20industry%20what%20went%20wrong%20and%20the%20way%20forwar_d_final_260210.pdf accessed 1/11/11

²⁹ Nigerian Banking Bailout and the Anatomy of Toxic Debt: <http://newafricanpress.com/2011/05/29> accessed 25/10/11

VIII. Integrity and Financial Sector Stability

Integrity connotes ideals of fairness, honesty and fair play. An effective system of corporate governance in banks and financial institutions will impose appropriate standards of conduct on managers with effective control and monitoring procedures on banks in order to maximize opportunities for legitimate profits subject to the best interests of depositors and shareholders. Good corporate governance regulates the relationships between banks' stakeholders, their Boards and management. It prevents the abuse of power and self-serving conduct, as well as imprudent and high risk behavior by bank managers, and resolves conflicts of interests between managers and board members on the one hand and shareholders and depositors on the other.

In Nigeria there are four codes of corporate governance being implemented by the Security and Exchange Commission (SEC), the CBN, the National Insurance Commission (NAICOM) and the National Pension Commission (PENCOM). Central to these codes are issues of honesty, fairness, accountability, transparency, performance orientation and commitment to the organisation. The Codes impose both standards of conduct for managers and appropriate procedures for internal controls in order to maximise opportunities for legitimate profits subject to the best interests of stakeholders

In order to enhance the integrity of the financial markets the G20 suggest that there must be commitment to:

- bolstering investor and consumers' protection;
- avoidance of conflict of interest;
- prevention of illegal market manipulation, fraudulent activities and abuse;
- protection against illicit finance risks arising from non-cooperative jurisdictions; and
- promotion of information sharing.³⁰

It should be stated that integrity in governance either economic or political is not just the presence of rules and regulations, stipulating appropriate behaviour, but a commitment by all concerned to abide and play by those rules. It requires honest, transparent actions and not lip service. Its goal is to impact positively on the entire system.

³⁰ Ibid

Recent revelations in Nigeria's financial system indicated an abject lack of integrity. It can only be said that reports of phenomenal growth regarding these institutions were the result of unproductive activities and manipulation of books and figures. Rating agencies form a part of the charade. In 2007, Fitch rated 7 Nigerian banks amongst 1000 banks in the world, yet in May 2008, JP Morgan issued a report, which warned that the top seven banks, with a combined market capital of over US\$40 billion, might be overvalued by as much as 56 per cent³¹.

It has been noted that "Substantial amounts of money claimed by these financial institutions is unreal, with the manipulation of the financial records, irresponsible shoring up of share prices, without any genuine link to the real performance of the companies owning these shares."³² These are clear failures of integrity. Thus, for the on-going reforms to yield results players must imbibe the principles of transparency, accountability and integrity. There should also be efforts to produce money from productive activities entailing applying labour and resources to wealth creation rather than manipulating the system for quick profit.

Without integrity, bailout funds are likely to be a waste of scarce and valuable public assets and resources. Questions are already being asked on how banks are applying bailout funds. According to Kazeem:

"The bail-out funds handed out to the banks by this regime will never go into anything productive, but rather prepare a catastrophic ground for more disastrous economic woe. We are already witnessing where tax payers money given to the banks is going. Bankers are now using these funds for speculative purposes on foreign exchange.

IX. Conclusion

The global financial crises/Nigerian crisis has raised queries as to the efficacy of regulation and especially the efficiency of financial regulators. By section 13 of the BOFIA, a bank shall maintain at all times, capital funds unimpaired by losses in such ratio to all or any assets or to all liabilities or to both assets and liabilities as would be stipulated by the CBN. This is required in preventing indefinite lending, when at the threshold a bank cannot extend another loan without acquiring

³¹ Ola Kazeem: Nigeria Financial Crisis Any way out? <http://www.marxist.com/> in defence of Marxism accessed 31/ 10/11

³² *ibid*

further capital on its balance sheet. If the CBN was alert to this provision, one should ask how ailing banks acquired such huge debts on their balance sheets. One should also ask what happened to reserve requirements provisions of sections 15 and 16 of the BOFIA as well as Section 45 of the central bank Act. Imposing reserve requirements has traditionally been used by Central Banks as a means of monetary control and maintaining financial stability.

Another matter of concern is why several banks were exposed to the same debtors despite the Central Bank's established Credit Risk Management System (CRMS). Through this system CBN is to obtain returns from deposit money banks on all credit of one million naira and above for compilation and dissemination to any interested party. This enables deposit money banks to know the risk exposure of their clients and helps them to avoid risky business.

The Nigerian society's penchant for responding to the influence of personalities as opposed to the influence of institutions remains a threat to future financial stability. As long as there remain personalities bigger than the system, either notionally, practically or politically, the system will always be prone to instability without exogenous factors and the integrity of the regulator will be called to question. Furthermore, whatever reforms the CBN initiates to address the impact of the global financial crisis must be anticipatory of changes in international financial law in a way that does not result in frequent reversal of policy.

Current developments in the financial services sector have also led to questions on how wide is the financial services sector bearing in mind that many ignorant players assumed that a crisis in the capital market ought not impact banks in the way that we have seen. The question has been who ought to have acted first and how far and wide ought the action to have been?

These lapses may not be entirely the fault of the regulatory authority or that of actors in the sector but a reflection of larger ideological and cultural realities in Nigeria. As observed by Justin O'Brien³³ "There is a dynamic interplay between the culpability of individual actors and the cultural and ideological factors that, not only tacitly condone, but also actively encourage, the elevation of short-term considerations over longer-term interests"

³³ The Future of Financial Regulation: Enhancing Integrity through Design Sydney Law Review vol. 32 2010 p65 http://sydney.edu.au/law/slr/slr_32/slr32_1/O'Brien.pdf accessed 31/ 10/ 11

Following the financial sector crises of the 1990s around the world and the current global crisis, international efforts have focused on the causes of the crises, their solutions, and prevention of future crises. Attention has also increasingly turned to the role of institutions in economic development, with recent research suggesting that institutions may in fact be the most significant factor. Regulatory institutions especially must be built on principles of transparency and accountability and integrity firmly entrenched on the rule of law.

There is a need, therefore, in Nigeria to go beyond just stipulating rules of behaviour or code of conduct, but to "evaluate how these rules and principles are interpreted within specific corporate, professional epistemic communities and how these influence and are influenced by regulatory practice".

Transparency in information sharing is also critical. The G20 transparency principle anticipates enhanced disclosure rules on complex financial products and ensuring complete and accurate disclosure by firms of their financial conditions. The Declaration³⁴ requires the following:

- "The key global accounting standards bodies should work intensively toward the objective of creating a single high-quality global standard.
- "Regulators, supervisors, and accounting standard setters, as appropriate, should work with each other and the private sector on an on-going basis to ensure consistent application and enforcement of high-quality accounting standards.
- "Financial institutions should provide enhanced risk disclosures in their reporting and disclose all losses on an ongoing basis, consistent with international best practice, as appropriate. Regulators should work to ensure that a financial institution's financial statements include a complete, accurate, and timely picture of the firm's activities (including off-balance sheet activities) and are reported on a consistent and regular basis."

Implementing these standards with other reforms will greatly improve the desire for good governance and transparency in the regulation of Nigeria's financial services sector.

³⁴ Summit on Financial Markets and the World Economy :
http://www.canadainternational.gc.ca/g20/summit-sommet/g20/declaration_111508.aspx?view=d
accessed 31/10/11