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Supervision of Banking Industry in Nigeria – An Operator's Viewpoint

by

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1. Introduction

First of all, I feel most delighted to be part of this seminar which, judging from the objectives, the topical nature of the issues to be covered and the calibre of the speakers, is going to be a major learning process for the participants. It is also coming at a most auspicious time. The Nigerian banking industry has witnessed tremendous changes in the last few years and the momentum has not abated in terms of growth and diversity in spite of the blockage placed on entry. It is therefore most logical that as the regulator and the supervisory body of the industry, the Central Bank of Nigeria (CBN) should continuously update itself of the developments in the industry and in fact keep ahead of developments. I therefore identify with the effort of the Research Department and the Training Centre of the CBN in organising this seminar.

Secondly, my presence here today is like a sort of home-coming. A few years ago, I was a part of this great team and I still cherish very much, my years of association with the CBN. Of course, this places me in a unique position of having been on both sides of the divide and therefore places an extra burden on me in preparing my paper. In a way, having once been part of the regulatory system, it is like being asked to assess the efficacy of one's own medication. There is no doubt however that this kind of cross-exchange of ideas is healthy for the system.

2. The Regulatory Environment

As the title of my topic goes, I am to present from the practical point of view, the operator's assessment of the supervisory role of the Central Bank of Nigeria on banks in particular and the financial industry in general.

The starting point for supervision is obviously the existence of a set of rules or defined parameters within which financial institutions are supposed to operate. The supervisory role therefore, is to ensure that the institutions concerned operate within those rules through a system of regular monitoring. Deviations from the set rules and standards must of course, lead to sanctions.

I will not bore you or attempt to "export coal to Newcastle" by going through the details of the regulatory framework in Nigeria, its evolution and development nor try to itemise the existing and specific regulations. I expect every body in this hall to be sufficiently conversant with this and it will therefore suffice to say that the laws that regulate the operations of banking and financial institutions in the country are the Central Bank of Nigeria Decree No. 24 and the Banks and Other Financial Institutions Decree No. 25 both promulgated in 1991. The CBN

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derives its power to regulate, monitor and supervise the industry from these two decrees and the extent of its powers is total and virtually monopolistic.

3. Objectives of Banking Supervision

The objectives of banking supervision should derive from the regulatory objective of the Central Bank which is "to promote monetary stability and a sound financial system in Nigeria".

Thus, banking supervision must seek to ensure that the monetary and payment system of the country is not impaired, promote the monetisation of the economy, protect customers' interests and deposits and ensure that the confidence reposed in the monetary system which is basic to the stability of the economy as a whole is not destroyed. And how does banking supervision ensure that these objectives are realised? Simply put, by avoiding and eliminating bank failures. In whatever ways we define the roles and objectives of banking supervision, the end-point is the prevention of bank failures for as we shall see, the whole system of banking supervision and examination is to identify those things that can lead to the failure of a bank and nip them in the bud. Conversely, it is the tendency of banks to operate outside the ambit defined by banking regulation and supervision that leads to failures.

4. Importance of Banking Supervision

Stability in the banking system of a country is a *sine qua non* to the stability of the overall economy. As a reflection of this, failure of an institution in another industry, painful as it might be, does not portend as much consequences to other sectors of the economy as a bank failure. When a bank fails, its depositors are put in jeopardy, other banks become threatened and the integrity of the payment mechanism for the entire economy is compromised. Thus banking supervision whose primary objective is to forestall and prevent bank failures is crucial to the survival of the financial and economic systems.

5. Approach to Banking Supervision

Banking supervision is done in three broad ways. First, banks are supervised through returns submitted regularly to the Central Bank and in this respect the two Departments involved are Banking Supervision and Bank Examination. The monthly and quarterly returns sent to these two Departments of Central Bank constitute a veritable source of information and data base to monitor the activities of banks. If these are carefully and effectively analysed regularly, they should be able to trigger off early enough, those banks on the road to distress. Supported by the other means of monitoring to be mentioned below, the potency of these returns in enabling the CBN to ensure sanity in the banking system cannot be under-estimated.

Secondly, banks are supervised through bank examination or inspection performed on-site. These audits, carried out by the Bank Examination Department of the CBN enable the CBN to examine the books of a bank in greater details and perform more detailed investigations in areas of suspicion. In performing this role, CBN Bank Examiners have wide powers to request for whatever information are deemed necessary to the investigation. The on-site bank examinations also enable the CBN to assess the veracity of the returns that are submitted by that bank.

There is a key and crucial spill-over effect from this and that is, the knowledge that CBN examiners can swoop in at any time is enough deterrent to malpractices and this deterrent should not be under-estimated. Having been on both sides of the hill, I know what I am talking about.

Finally, effective supervision is carried out by the requirement that banks must seek the approval and permission of the CBN to do certain things. These controls exercised through the Banking Supervision Department is another effective means of supervision, as the CBN, with previous data bank, is able to compare the facts used in supporting a request to previously supplied data.

Taking altogether, the three systems of banking supervision can lead to effective control if adequately well-managed and co-ordinated.

6. Identity of Interest of Supervisors and Operators

Banks have their own internal system of supervision – i.e. their respective Inspection Division. Generally, the inspectors are dreaded and feared and are often regarded as criminal investigators. By and large, banks are trying to correct this negative image of inspectors. But it should not come as a surprise to you that CBN's Bank Examiners are sometimes regarded in similar light. Being Examiners, the result must either be pass or fail and banks sometimes find this situation uneasy. I will like to tell the story I once heard on CBN's Examiners. One of them after all the observations and allegations in his report have been debunked, explained that although he observed that the Bank had a fault-proof system, he still had to report some inadequacies otherwise his bosses will think he had not done a thorough job.

This may sound like a fiction but it indicates the way some people sometimes view CBN Bank Examiners.

I must state that since the cardinal objective of banking supervision is to ensure a healthy banking system and prevent bank failure, then both the supervisors and operators must have an identity of interest in the way they see banking examination and supervision. Any operator who therefore sees something wrong in banking examination must be suspect. In my experience both as a regulator and supervisor and also as an operator, I have never come across the report of a CBN Bank Examination which has not been beneficial to the bank examined – at least to the owners, depositors and the public at large if even the management is dishonest and fraudulent. Now, let us examine the potential benefits of banking examination to operators.

7. Benefits of Banking Supervision/Examination to Operators

A cursory look at the checklist or information requirement of CBN from a Bank it wants to examine gives an indication of the thoroughness of these examinations. The list covers all the areas of a bank's operations – lending and other risk assets, foreign operations, branch operations and the critical aspects of a bank's Balance Sheet including liquidity, capital adequacy and prudential ratios. They also look extensively into the adequacy or otherwise of the organisational resources needed to support the bank's operations. Finally, separate examinations are carried on the computer or information systems of the Bank. The report is usually copious of recommendations on the key parameters and issues. To the honest bank which seeks ways of improving on its operations, enhancing controls and protecting its assets, the CBN examination reports are regarded as most valuable documents. I have no doubt in my mind that most banks cherish these reports which they would have had to pay heavily for if they were to invite consultants to perform such studies. You will recollect that I always refer to these reports as free consultancy and I can now more than ever testify to that fact.

The requirement – which we initiated – that these reports be presented to the full Board of the bank by CBN's examiners put teeth into them as the findings can no longer be suppressed from the directors. The obligation that penalties imposed on banks for breaches of CBN's regulations and guidelines be reflected in the annual reports also serve as similar deterrent.

8. The Challenges of Banking Supervision

As earlier mentioned, the industry has grown tremendously in the last few years leading to an increase in the volume and complexity of banking supervision in Nigeria.

From a total of 28 in 1980, the number of commercial and merchant banks in the country grew steadily to 40 in 1986 before stabilising at 49 in 1987. Beginning from 1988, the growth rate in the number of banks has been phenomenal such that by 1990, the number has risen to over 100. As at today not less than 120 banks (commercial and merchant banks) operate in the country. If we add the numerous financial houses and community banks that have emerged since then, then the challenges facing the Central Bank to ensure that these institutions are adequately monitored to ensure that they operate within the confines of the law become almost mind-boggling.

Is the CBN positioned to meet this increasing challenge of banking supervision? Is it endowed with the necessary resources, in quality and quantity; materials, technical and personnel to cope with these challenges?

We are no doubt in a period of fluidity and uncertainty where nothing is constant for any length of time. Since the last wave of banking failures in the 1950s with the last recorded failure of Central Bank of Nigeria (which we need to emphasise, bears no relationship with our present day apex institution) in 1960, the industry has remained free from major distress in the banking system until the early 1990s. There is adequate evidence to show that the perceived stability in the industry has been the result of protection. In every instance that the protective system has been relaxed, there has been crisis in the system. The experience of the removal of Government funds from the banking system in 1989, the withdrawal of foreign guaranteed lending in 1989 and the effect of the introduction of the Prudential Guidelines in 1990 all come to mind. Many observers believe that where the industry is adequately deregulated and the forex business becomes less monopolistic, many banks in the system will not be able to withstand the resulting competition.

Also in 1992, the fact of distressed banks became a major issue in the industry, and this phenomenon was not peculiar to State-owned banks but to a number of the newer generation and some older generation banks. Thus, after thirty-four years of the last recorded bank failure in Nigeria, the Central Bank had to wield the big axe by closing two banks in the country in January 1994. Last week, it had to close down two other banks.

Ladies and Gentlemen, you will recollect that as the growth in number of banks gathered momentum beginning in 1988, no one in his wildest imagination even within the CBN, assumed that all banks being licenced would operate efficiently, successfully and survive. Such a utopia was never anticipated and would not reflect the realities of a competitive environment. What I am saying here is that a situation where some banks would fail was anticipated and that informed the establishment of NDIC to take care of such eventuality.

The current situation has however been worse than expected because of factors both external (not controllable) and internal to the distressed banks. The external factors are macro-economic instability fuelled by fiscal indiscipline, misapplication of some monetary tools especially stabilisation securities. The internal factors which are of course more important are the incompetence, mis-management an malpractices by the Board and Management of the affected banks. Banking supervision/examination often give an early indication of these internal critical problems.

Thus, this recent phenomenon of instability in the banking system is not due to absence of adequate regulatory framework as was in the case in the 1930s and 1950s but more to a structural and environmental phenomenon on the one hand and glaring lack of prudency on the part of some of the banks on the other hand.

If therefore, the regulatory framework is reasonably adequate, then what is the cause of the present instability in the industry? The obvious answer is that the supervisory framework needs further strengthening to cope with the rising challenges. I am in no way implying that the supervisory functions are not being well done for I know the commitment and sacrifices being made by the personnel in those functional areas. But the magnitude of growth in the finance sector will naturally lead to a time lag before resources reach commensurate level for the suprevisory functions. Of course, when one adds the propensity to beat regulations and cheat within the system, then one knows that the challenges facing banking supervision in Nigeria is a daunting one.

Problems have apparently been allowed to accumulate. To be effective, examination reports must be followed up with appropriate and timely action especially where major decisions like financial input, restructing or even liquidation are to be implemented. Too many rotten apples have been allowed to remain in the basket for too long.

On a personal note and assessment, apart from personal involvement at a stage, I have been an avid observer of the efforts of banking supervision in Nigeria both as a regulator and as an operator and I can say with a high degree of confidence that the standard of practice is quite high. As a regulator, I felt pleased with the kind of reports and response that come out of the system. As an operator, I have taken as a challenge to live within the rules and regulations of the apex bank and I have at all times found the reports of the banking examinations most useful and helpful. If the recommendations I make below are adopted and implemented, I have no doubt that the efficiency of the supervision function will even be better improved.

9. Recommendations

(a) Provision of Adequate Resources

To cope with the increasing complexity of banking supervision in a fast growing sector of the economy, the supervisory functions need to be adequately endowed in resources. These include space, equipment and modern technology, materials and most importantly adequate and well-trained resources. The system has itself to blame if the supervisory units are not adequately endowed in the face of the rapid growth in the sector they are to supervise.

(b) **Training**

To update their knowledge, expertise and techniques, there is a need for constant training of the personnel responsible for banking supervision.

(c) **Probity, Fairness and Firmness**

In a society where it is believed that everybody can be bought at a price, it behoves the personnel of banking supervision to stand above these insinuations for it is then and only then that it can bring the full force of the law and regulations to those whose stock in trade is to violate them. One hears the rumours of people buying CBN officials. I have no doubt that these are mainly rumours and it is the responsibility of those of you gathered here today to keep them rumours.

(d) **Presentation of Examination Reports**

Once the draft reports of your examinations are ready, this should be discussed at length with some key officials of the institution. I have seen instances where erroneous comments are incorporated in these reports. If the drafts are discussed, it will offer the opportunity of correcting those errors e.g. names of directors, number of branches, details of certain accounts. These unnecessary mistakes sometimes distract from the import of these reports. But banking examiners should and must never compromise on facts and evidence as they found them.

(e) **Submission of Examination Reports**

The practice of ensuring that these reports are presented to the Board of Directors of the banks should be maintained and emphasised. In particular, the reports must be presented within agreed time frame.

(f) **Follow-up and Monitoring**

I have observed that perhaps as a result of the enormity of the job, it has become difficult to follow-up on bank examination reports. The time-lag between routine bank examinations may be too long for adequate follow-up. I recommend that a diary system to monitor implementation of recommendations during bank examinations should be instituted. This will go a long way in ensuring that bank examiners meet improved position when they visit next.

(g) **Imposition of Sanctions**

Where enforcement of sanctions is lax, there is usually, little adherence to rules. Also, the easiest way to ensure that the generality of people and institutions obey laid-down regulations is to demonstrate that the consequences of violation is high and this is done most effectively by imposing and enforcing sanctions whenever the need arises.

(h) **Sourcing Personnel from the Operators**

It is said that the easiest way to break up a gang is to infiltrate it. So far, personnel have moved from the regulatory institutions to the operators in the main. The time has come to at least try to reverse this trend. I have no doubt in my mind that so much benefits would be derived if the CBN can recruit from the banking system into the supervisory functions.

(i) **Extension of Supervision to Related Companies**

It seems that, banking supervision presently concentrates only on the main institutions while there affiliates and associated companies operate mainly outside the ambit of the CBN. This situation needs to be urgently redressed in line with the Basle Convention. Banks and other financial institutions should report details of associated companies in which they have significant interest. Bank examinations should be made to cover these associates if found necessary. Thus, we have the ironic situation whereby banks are prevented from doing cer tain things but get away with it when they use affiliated companies. By and large, the distressed situation in some of the banks can be attributed to these. I suggest that the CBN should move early and strongly to cover this loophole. In the U.K. for instance, all financial institutions must provide detailed report on all such affiliates and not only that, the institution is expected to assume responsibilities for their sustenance provided they maintain a certain level of equity or constitute the single largest shareholder. That explains, why our foreign affiliate for 100 years, the Standard Chartered Bank had to reduce its shareholding in First Bank.

The reason is purely due to the regulatory requirement in the U.K. where Standard Chartered is deemed to be responsible for First Bank when in actual fact, because of the local operating environment, it has virually no control on the management of First Bank. I think we can learn a lot from this.

(j) Finally, as much as possible, CBN should in public statements avoid generalisation that tend to condemn the whole of the banking system. This dents confidence in the financial system and the first victims are the weaker ones and the immediate result is systemic, and consequent aggravation of distress and problems for CBN and NDIC. Regulatory authorities statements must always be designed to enhance confidence in the system. Where a rotten apple is discovered let it be promptly identified to the public and removed from the basket.

I thank you for listening.

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