NATIONAL OPEN UNIVERSITY OF NIGERIA

SCHOOL OF MANAGEMENT SCIENCES

COURSE CODE: BFN 305

COURSE TITLE: BANKING LAWS AND REGULATIONS

NATIONAL OPEN UNIVERSITY OF NIGERIA

SCHOOL OF MANAGEMENT SCIENCES

COURSE GUIDE

Course Code:	**BFN 305**
Course Title:	**Banking Laws and Regulations**
Course Developer:	**Mr. Julius Paul Eyanuku (NOUN)**
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INTRODUCTION

BFN 305 – Banking Laws and Regulations is a first semester course work of three-credit unit hours, which is available and compulsory for all learners undertaking undergraduate Programme in Banking and Finance in the School of Management Sciences. This course guide tells you briefly what the course is about, relevant textbooks to consult, and how you can work your way through these materials. It also contains some guidelines on your tutor-marked assignment.

WHAT YOU WILL LEARN IN THE COURSE

This course will equip you with the skills and techniques for effective propagation of banking laws and regulations in the banking sectors.

This Course Guide is meant to provide you with necessary information about the course, the nature of the materials you will be using and how to make the best use of the materials towards ensuring adequate success in your programme. Also included in this course guide are information on how to tackle the Tutor-Marked Assignments (TMAs). There would be tutorial sessions during which your instructional facilitator will take you through your difficult areas and at the same time have meaningful interaction with your fellow learners.

COURSE AIMS

The overall aim of the course can be summarized as introducing you, the student to the banking laws and regulations. This will be achieved in the following ways**:**

- Introducing you to the Banking Laws and Regulations
- Presenting the regulatory agencies; their evolutions and functions.
- Explaining the critical aspects of banking practices subject to control; current status of banking regulations in Nigeria;
- Making you gain understanding on banking laws and regulations and their effect on bank performance and ethics of banking.

Course Objectives

The general overall objective of the course is to introduce students to the legal framework regulating banking business in Nigeria. Very importantly, the basic principles and modalities of banking will be introduced to the students. Therefore, at the end of the course, the students should be able to:

- understand the historical development of banking in Nigeria;
- understand the general principles of banking;
- appreciate the legal framework within which banks and other financial institutions in Nigeria carry out their operations;
- know the various categories of institutions operating within the banking and sub-banking sectors in Nigeria;

- appreciate the supervisory and regulatory roles which the Nigerian laws have placed on the apex bank i.e the Central Bank of Nigeria. vis-à-vis the other banks.

Course Materials

- Course Guide
- Study Modules and Units
- Textbooks, Journals conference papers and others
- Assignment File
- Tutor Marked Assignment

Study Modules and Units

There are four modules, module 1 is made up of 6 unit, module 2 is made up of 5 unit, module 3 is made up of 5 unit and while module 4 is made up of 4 unit, making a total of twenty (20) units. The course guide is a unit on its own; therefore with the course guide and the twenty (20) units which make up the four (4) modules, you have a total of twenty (20) units to read in this course material.

Course Contents/Description: **-** This Course is a Compulsory course to be taken in first semester for Banking and Finance Students of 300 Level. The Course is designed basically to examine the legal framework for the operation of banks and some other financial institutions in Nigeria. Below are the course contents for the course.

MODULE 1 EVOLUTION, ORIGIN AND GROWTH OF BANKS

Unit 1 The Concept of Banking
Unit 2 The Nature of Banking System in Nigeria
Unit 3 Duties of Bank and Customer
Unit 4 Commercial Bank
Unit 5 Merchant Bank
Unit 6 Developed Bank and Specialized Bank

MODULE 2 THE FORMS OF BANK REGULATIONS IN NIGERIA

Unit 1 The Forms of Bank Regulations in Nigeria

Unit 2 The Need for Bank Regulations

Unit 3 Law Regulating the Operations of Banking in Nigeria

Unit 4 Regulatory Agencies; Evolution and Functions

Unit 5 Procedures for Establishing a Bank in Nigeria

MODULE 3 CRITICAL ASPECTS OF BANKING PRACTICES SUBJECT TO CONTROL, CURRENT STATUS OF BANKING REGULATIONS IN NIGERIA

Unit 1 The Concept of Capital Base

Unit 2 Banking and its impacts on the Nigeria Economy

Unit 3 Phase of Banking Sectors Reforms

Unit 4 Central Banking

Unit 5 Central Bank of Nigeria (CBN) Cash – Less Policy

MODULE 4 BANKING LAWS & REGULATIONS & THEIR EFFECTS ON BANK PERFORMANCE AND ETHICS OF BANKING

Unit 1 Measuring the effect of Regulations on performance of Banking

Unit 2 Ethics and Code of Banking Practices in Nigeria

Unit 3 Corporate Governance Code for Microfinance Bank in Nigeria

Unit 4 Code of Ethics and Professionalism in the Banking Sectors

Each Study Unit is made up of the Introduction, Objectives, Main Content, Self-Assessment Exercise, Conclusion, Summary, Tutor-Marked Assignment and References /Further Readings. Each of these Study Units should take at least 2 to 3 hours of serious concentration and reading commitment after which you are expected to do the exercises. For additional information, you can consult the textbooks and journals under References and Further Readings.

Assessment

The assessment for this course will be in two parts:

i. Continuous assessment, using the Tutor-Marked Assignment (TMA)
ii. Final written examination

Tutor-Marked Assignment

The Tutor Marked Assignment is divided into four parts namely; TMA 1, TMA 2, TMA 3 and TMA 4. The mark obtainable for each TMA is 10%. The University will give directives as to when to do these assignments and when to turn them in to your facilitator. You are expected to utilize the information gathered from the study material and the reference in doing the assignment. The assignment will count for 30% of the total course work as your best three grades will be selected.

Final Examination and Grading

The final written examination will be of 2 hours duration and will attract the remaining 70% of the total course mark. You are to expect all the areas covered in the course material as you will be assessed in any of them.

Summary

In summary, the inconsistency in monetary and regulatory policies as major setback to banks stability as the surveillance and regulatory measures of the Central Bank of Nigeria (CBN) have unfortunately been unable to keep the pace with the rapidity of the charges in the financial system. It was viewed that forging a strong bank supervision system will be one way out of financial crisis, while rationale for banks regulation as efficiency, diversity of choice, competition stability of financial system, macroeconomic stability and development and social objective .

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MODULE 1 EVOLUTION, ORIGIN AND GROWTH OF BANKS

MODULE 1

UNIT 1: THE CONCEPT OF BANKING

CONTENT

1.0. INTRODUCTION

You are warmly welcome to your first Unit of learning in this course-Banking Laws and Regulations. You have read the course guide and have known what to expect in this course. Therefore, for this first unit we shall commence with the concept of Banking and refresh your memory on the definitions and meaning of banking. We shall also look at the origin and growth of banks the world over and particularly, briefly consider the growth of banks in our country-Nigeria. Meanwhile, before you continue, let us look at the objectives of this unit.

2.0. OBJECTIVES

At the end of this unit, you should be able to:

Explain the concept of banking;

Origin of Banking; and

Explain the growth of Banking in Nigeria;

3.0. MAIN CONTENTS

3.1. The Concept of Banking

Today, the term, bank, means different things to different people in different economies. In order to reconcile the divergent views on the meaning and characteristics of banks, the banking laws in each economy provides operational definition and functional classification which governs banking practices in the economy. In practical terms, a bank means what the operating banking law in an economy defines as a bank (Ezeuduji, 2000:8).

To many people, a bank refers to an institution which accepts deposits from the public and in turn advances loans by creating credit. It is different from other financial institutions in that they cannot create credit though they may be accepting deposits and making advances. Economists on their part have defined a bank in various capacities, some emphasizing its various functions. However, a bank has been defined broadly as any financial institution that accepts, collects, transfers, pays, exchanges, lends, invests, or safe- guards money for its customers. This broader definition includes many other financial institutions that are not usually thought of as banks but which nevertheless provide one or more of these broadly defined banking services. Summarizing these definitions a bank is simply an institution which accepts deposits from the public and in turns advances loans by creating credit.

3.2. Origin of Banking

The word "bank" is used in the sense of a commercial bank. It is of Germanic origin though some people trace its origin to the French word "Banqui" and the Italian word "Banca". It referred to a bench for keeping, lending and exchanging of money or coins in the market place by money lenders and money exchangers. There was no such word as "banking" before 1640, although the practice of safe-keeping and savings flourished in the temple Babylon as early as 2000B.C.

Many of today's banking services were first practiced in ancient Lydia, Phoenicia, China, and Greece, where trade and commerce, flourished. The 200BC temples in Babylonia made loans from their treasuries as early as. The In Greece also, some elements of banking activities took place which the temples of ancient Greece served as safe deposit vaults for the valuables of worshippers. The Greeks also coined money and developed a system of credit. On the other hand, the Roman Empire had highly developed banking system, and its bankers accepted deposits of money, made loans, and purchased mortgages.

Self- Assessment Exercise 1

What do you understand by banking?

3.3. Growth of Banks

Shortly after the fall of Rome in AD 476, banking decline in Europe. The increase of trade in 13th century in Italy prompted the revival of banking. The money exchangers of the Italian states developed facilities for exchanging local and foreign currency. Soon merchants demanded other services, such as lending money, and gradually bank services were expanded. The first bank called the "Bank of Venice" was established in Venice, Italy in 1157 to finance the monarch in his war. The bankers of Lombardy were famous in England. But modern banking began with English gold smiths only after 1640.

3.3.1. Growth of Banks in Nigeria

In Nigeria, commercial banking pre - dates central banking and laid the foundation of the Nigerian financial system as far back as the late nineteenth century. The first commercial bank in Nigeria was the African Banking Corporation which opened its first branch in Lagos in 1892. The bank experienced some initial difficulties and eventually decided to transfer its interest to Elder Dempster and Co. in 1893. This led to the formation of a new bank known as the British Bank of West Africa (BBWA) in 1893 which is today known as the First Bank Nigeria PLC. Another bank known as the Bar Clays Bank DCO (Dominion, Colonial and overseas) opened its first branch in Lagos in 1917. This bank is known today in Nigeria as the Union Bank Nigeria Plc. British and French Bank, now called United Bank for Africa Plc was established in 1949 making it the third expatriate bank to dominate early Nigeria's commercial banking. The foreign banks came principally to render services in connection with international trade, so their relations at that time were chiefly with the expatriate companies and with the government. They largely ignored the development of local African entrepreneurship.

These three banks controlled almost about 90% of the aggregate bank deposits as at then. From 1914 to the early part of 1930s, several abortive attempts were made to establish locally owned and managed banks to break the foreign monopoly. This was as a result of the weakness of those indigenous banks in such areas as capitalization and management; and given the total absence of regulation by any government agency, the indigenous banks could not survive the hostile and unfair competition possed by the foreign banks. It was therefore not surprising that by 1954, a total of 21 out of 25 indigenous banks had failed and went into self – liquidation.

In a nutshell, historically, the Nigerian banking industry had evolved in four stages. The first stage can be best described as the unguided laisses – faire phase (1930-59), during which several poorly capitalized and unsupervised indigenous banks failed before their tenth anniversary. The second stage was the controlled regime (1960-1985), during which the Central Bank of Nigeria (CBN) ensured that only "fit and proper" persons were granted banking license, subject to a minimum paid – up capital. The third stage was the post Structural Adjustment Programme (SAP) or decontrolled regime (1986-2004), during which the Neo – liberal philosophy of "free entry" was over stretched and political authorities on the bases of patronage dispensed banking licenses. The emerging fourth stage is the era of consolidation (2004-to a foreseeable future), with major emphasis on recapitalization and proactive regulation based on prudential principles.

In the area of Central Banking, the West African Currency Board (WACB) carried out banking operations in the former British colonies in West Africa before independence. The problems of the WACB led to the establishment of Central Banks in these colonies. In Ghana, it came into being in 1957, in Nigeria 1959, Sierreleon in 1964, and in the Gambia 1964. The Central Bank of Nigeria (CBN) was established by the Central Bank Act of 1958. It was to replace the West African Currency Board (WACB) of the colonial government as part of the preparation for independent Nigeria.

Self-Assessment Exercise2

Carefully describe the growth of banking in Nigeria.

4.0. CONCLUSION

The above analyses show that banking business is an old business which started some centuries ago and has continues to grow over time. The growth and development of banking activities in the countries of the world differ from country to country depending on the level of economic and technological development of each country.

5.0. SUMMARY

In this unit, you have learned about the evolution, origin and growth of banks. The unit has also explained the concept of banking and has also thrown light on the growth and development of banks in the Nigerian economy.

6.0. TUTOR-MARKED ASSIGNMENT

1. Explain the concept of banking.
2. Discuss the growth of banks in the Nigerian economy

7.0.REFERENCES/FURTHER READINGS

Adekanya, F. (1986). The Elements of Banking in Nigeria:3rd Edition. Lagos; F and A Publishers.

Ezeuduji, F.U. (2000).'Historical Perspectives in Banking Practices Worldwide.' Abuja; CBN Bullion vol.24;No4.

Jhinghan, M.L.(2004).Money, Banking International Trade and Public Finance. Seventh Edition. Delhi,Vinda Publications (P)Ltd.

UNIT 2: THE NATURE OF BANKING SYSTEM IN NIGERIA

1.0 INTRODUCTION

Every discipline or field of study has its peculiar terminologies and or concepts. Some of the concepts and terms are entrenched in the relevant laws while some evolve from practice of the profession, business or trade. Some of those terms may or may not be defined by law. The need for conceptual clarification becomes necessary to lay a basic and proper background for understanding of the subject of study. This is more so that legal definitions of terms are subject to several interpretations depending on the perception of persons until such is definitely settled by judicial authority. It is against this backdrop that the definitions of the key terms such as "Bank" (Banker), "Banking Business" and "Bank Customer" will be sought from both the relevant statutes and practice for better understanding.

2.0 OBJECTIVES

At the end of the study of this unit you should be in a position to:

The needs and nature of Banking in Nigeria;

Definition of a Bank (Banker);

Define the term Banking Business; and

Identify who is a Bank Customer

3.0 MAIN CONTENT

3.1 **Needs and Nature of Banking in Nigeria**

The nature of banking in Nigeria can only be properly understood when we are able to define who is a banker, customer and what constitutes banking business.

3.1.1 Definition of Bank (Banker)

Unfortunately, both the Banks and other Financial Institutions Act (BOFIA) 2004 and the Central Bank of Nigeria, the principal statues governing banks in Nigeria have not defined what a bank is. However, by the implication of Section 55 of the CBN Act the definition of bank in the repealed Banking Act of 1990 still applies. Section 43 of the Banking Act defines a bank as "Any person who carries on banking business and includes a commercial bank, an acceptance house, discount house, financial institution and merchant bank" see also section 2(1) Evidence Act. Section 2 of the Bill of Exchange Act 2004 defines "banker" which "includes a body of persons whether incorporated or not who carry on the business of banking" Section 66 of BOFIA 2004 defines a commercial bank to mean "a bank in Nigeria whose business includes the acceptance of deposits, withdrawals by cheques" and merchant bank to mean "a bank whose business includes receiving deposits on deposit account, provisions of finance consultancy and advisory services relating to corporate and investment matters, making or managing investments on behalf of any person."

3.1.2 Banking Business.

Section 66 of BOFIA 2004 defines banking business as "The business of receiving deposits on current account, savings account or other similar account, paying or collecting cheques, drawn by or paid in by customers; provisions of finance or such other business as the Governor may, by order published in the Federal Gazette, designate as banking business" The words 'bank' or 'banker' are used interchangeably to mean one and the same thing and are referred to an incorporated and licenced corporate body and not an individual who works in a bank.

3.1.3 Bank Customer

There is no statutory definition of what bank customer is. The main requirement to become a bank's customer is having an account irrespective of what form of account (whether saving, deposit or current) provided the account is in his name. In addition one becomes a customer when he makes an offer to open an account and the banks accepts e.g. acceptance of deposit. Undoubtedly creates a binding and enforceable contract.

Self – Assessment Exercise 2

1. What do you understand by bank and banking business?
2. What qualifies a person to be a bank customer?

4.0 CONCLUSION

The conceptual clarification of the terms Bank (Banker), Banking business, and bank customer has underpinned the nature of banking in Nigeria. By all indications a bank or banker must be a body corporate established for the purpose of carrying banking business. In dong so, it renders services to persons (both corporate and natural) who are referred to as its customers.

5.0 SUMMARY

A Bank (Banker) even though it is referred to as a person, it must be a corporate body established for the purpose carrying on banking business. The business of banking is diverse but majorly and traditionally, it is the receiving of deposits on accounts, paying and collecting cheques drawn, or paid by customers and render other financial services. While bank customer is the person either as natural persons or corporate bodies who receives service from the bank.

6.0 TUTOR-MARKED ASSIGNMENT

1. Explain the following terms:

(a) Bank

(b) Banking business

(c) Bank Customer

7.0 REFERENCE/FURTHER READINGS

Afolabi, L. (1999). Law and Practice of Banking (Heinemann Educational Books (Nigeria) Plc, Ibadan).

Goldface-Irokalibe, (2001). Law of Banking in Nigeria (Supra).

UNIT 3: DUTIES OF BANK AND CUSTOMER

1.0 INTRODUCTION

The existence of rights in the banker-customer relationship automatically creates duties on each party. The rights of each party impose corresponding duty on the other party to take actions or steps that would make the other party to enjoy his right.

2.0 OBJECTIVE

The aim of this unit is that at the end of it, you should be able to:

1. know the duties the bank owe the customer
2. know also the duties the customer owe the bank.

3.0 MAIN CONTENT

3.1 Duties of Bank and Customer

3.1.1 Duties of Bank

(a) To collect cash, cheques and other payable instruments deposited by its customers.

(b) To abide by the customer's written mandate provided the account is in fund or credit arrangement has already been agreed.

the mandate is regularly drawn, and there is no legal impediment towards repayment.

(c) To give reasonable notice before closing account.

(d) To provide the customer with statement of account regularly or upon request

(e) To draw the customer's attention to any suspicious adverse or other circumstances

as may be prudent to bring to the customer's attention so as to forestall forgery or any unauthorized dealings by third parties (Layi Afolabi)

3.1.2 Duties of the Customer

(a) To give written instruction to the bank if he seeks to withdraw his money. Such instruction usually include cheques, standing orders, direct debit instructions.

(b) To inform the bank without delay of any suspicious dealings on his account as may come to his knowledge e.g. lose of cheque leave or cheque book, forgery of his signature or other things which though not forgery, may require that the banks records be amended e.g change of signature, delegation of authority to sign etc.

(c) To draw a cheque with care and diligence and in a manner that will not facilitate fraud, forgery or unauthorized alteration.

(d) To pay reasonable commission and interest on borrowed funds as agreed

(e) To repay overdrafts on demand and to repay loan and other facilities as agreed.

(f) To ensure that his account is in fund or credit arrangement made to meet cheques and other payment instructions issued (Layi Afolabi)

Self – Assessment Exercise 5

1. What are the duties the bank owes to the customer?
2. What are the reciprocal duties the customer has towards the bank?

4.0 CONLCUSION

The duties of both the bank and customer are meant to be observed. Nonobservance of any accrued duty would amount to breach of duty which can be enforced by the wronged party.

5.0 SUMMARY

The duties of the banks and the customer have been separately stated in the main content. The duties of the bank regulates his dealings on the account of the customer. On the other hand the customer duties require him to operate his account in accordance with banking practice.

6.0 TUTOR MARKED ASSIGNMENT

Mention 5 duties the customer owe to the bank

7.0 REFERENCES/FURTHER READINGS

1. Afolabi, L. (1999). Law and Practice of Banking

2. Goldface- Irokalibe, (2001). Law of Banking in Nigeria.

UNIT 4: COMMERCIAL BANKING

CONTENT

1.0. INTRODUCTION

In the last unit, you read through important definitions of banks and the evolution and growth of banks. In this unit, you are going to learn about what a commercial bank is, its functions in the economy, and the role it performs in the development of an economy. Besides, you shall also learn about how money or credit is created in an economy, the limitations of the power of banks to create credit and the concept of balance sheet.

2.0. OBJECTIVES

At the end of this unit, you should be able to;

Define and explain what a commercial bank is;

Enumerate and explain the functions of Commercial banks;

List and discuss the roles of commercial banks in economic development of a country;

Explain the concept of credit creation by commercial banks;

Illustrate the process of credit creation by commercial banks;

Discuss the limitation of the power of commercial banks to create credit;

Define balance sheet; and

Explain the asset and the liability sides of the balance sheet

3.0. MAIN CONTENT

COMMERCIAL BANKING

3.1. What are Commercial Banks?

Commercial banks are those banks which perform all kinds of banking functions such as accepting deposits, advancing loans, credit creation, and agency functions. They are also called joint stock banks because they are organized in the same manner as joint stock companies. They usually advance short-term loans to customers. Of late, they have also started giving medium term and long-term loans in Nigeria. At the expiration of the date for all commercial banks in Nigeria to meet-up with the N25billion minimum capital requirement, the total of 25 commercial banks were able to meet up with the N25billion minimum capital requirement at December 31, 2005. The following were the lists of commercial banks in Nigeria as at January 2014.

1. Access Bank - Acquired Intercontinental Bank
2. Citibank
3. Diamond Bank

4. Ecobank Nigeria - Acquired Oceanic Bank
5. Enterprise Bank Limited - Formerly Spring Bank
6. Fidelity Bank Nigeria
7. First Bank of Nigeria
8. First City Monument Bank - Acquired FinBank
9. Guaranty Trust Bank
10. Keystone Bank Limited - Formerly Bank PHB
11. Mainstreet Bank Limited - Formerly Afribank
12. Skye Bank
13. Stanbic IBTC Bank Nigeria Limited
14. Standard Chartered Bank
15. Sterling Bank - Acquired Equitorial Trust Bank
16. Union Bank of Nigeria - Owned By *Union Global Partners Limited*
17. United Bank for Africa
18. Unity Bank Plc.
19. Wema Bank
20. Zenith Bank

3.2. Functions of Commercial Banks

The Commercial banks perform very important functions in any economy. These Include:

Accepting Deposits: Commercial banks accept deposits from their customers on current and / or deposit accounts. Commercial banks perform this very important function to all sectors of the economy by making available the facilities for the pooling of savings through the acceptance of deposits from the public and then making these funds available for economically and socially desirable purposes.

Advancing Loans: Commercial banks give advances to customers in the form of loans, overdrafts, discounting bills of exchange and promissory notes. A commercial bank lends a certain percentage of the cash laying in deposit on higher interest rate than it pays on such deposits. The difference between the lending rate, and deposit rate gives the bank its profits. In making credit available, commercial banks are rendering great social services; through their actions production is increased, capital investments are expanded, and a higher standard of living is realized. The provision of credit facilities by commercial banks is very important to the economy, for it makes possible the financing of the agricultural, commercial and industrial activities of the nation.

Payments mechanism: Commercial banks make payments on behalf of their clients, exercise agency services on behalf of their clients. That is, periodic payments like insurance premiums and hire purchase installments, collection of cheques, stock and shares transactions, dividend payments etc. This function becomes increasingly important as more and more Nigerians place greater reliance on the use of cheques and credit cards.

Safe- keeping of valuables: Commercial banks safe-guard customers' important documents, certificates, jewels, ornaments, deed, bills etc. This function evolved during the gold smith banking era when gold smiths head the strongest safe or vaults that were difficult to enter even by the best of burglers. The safe-keeping of valuables is therefore, one of the oldest functions performed by commercial banks.

Credit creation: Credit or money creation is one of the most important functions of the commercial banks in an economy. It is this function that distinguishes commercial banks from other institutions. The creation of credit is accomplished by the lending and investing activities of commercial banks in cooperation with the central bank of the nation. Like other financial institutions, they aim at earning profits. For this purpose, they accept deposits and advance loans by keeping small cash in reserve for day-to- day transactions. When a bank advances a loan, it opens an account in the name of the customer and does not pay in cash but allows him to draw the money by cheque according to his needs. By granting a loan, the bank creates credit or deposit.

Commercial banks make the use of cheques : This eliminate the risks of money being stolen as well as other risks of carrying huge sums of money about.

Acting as referees: Commercial banks act as referees as to the integrity and standing of their customers.

Accelerating economic development: Their activities accelerate the economic development of a nation since they act as intermediaries between large number of depositors and borrowers.

Financing foreign trade: A commercial bank finances foreign trade of its customers by accepting foreign bills of exchange and collecting them from foreign banks. It also transacts other foreign exchange business and buys and sells foreign currency. We can thus conclude that the financing of foreign trade by commercial banks contributes to a free flow of trade between nations than if these services were not in existence.

Self-assessment Exercise1

Discuss the functions of commercial banks in Nigeria

3.3. The role of Commercial Banks in Economic Development

Apart from performing the usual commercial banking functions, banks in developing countries plays an effective role in their economic development. The majority of people in such counties are poor, unemployed and engaged in traditional agriculture. There is usually acute shortage of capital, underdeveloped transport and industrial sector. The commercial banks help in overcoming these obstacles and promote economic development. The role commercial banks plays in developing economy include:

Commercial banks encourage savings: Since investments are made out of savings, the establishment of commercial banks, especially, in the rural areas makes savings possible. Commercial banks help in mobilizing savings through a network of branch banking. They include the low income earners to save by introducing variety of deposit schemes to suit the needs of individual depositors. They also mobilize idle savings of the few rich. By mobilizing savings, the banks channelled them into productive investments, hence economic development is enhanced.

Commercial banks provide capital needed for development: Businessmen and / or entrepreneurs obtain both short – term and medium loans and overdrafts from commercial banks to start off new industries or engage in other development efforts.

Commercial banks enhance domestic trade: Commercial banks encourage trading activities within the country through making the use of cheques possible. This is more so, when they provide facilities for clearing these cheques possible.

Commercial banks enhance the development of international trade: These include acting as referees to importers, providing travellers' cheques, opening letters of credit as well as providing credit for exports. All these helps to promote international trade.

Commercial banks encourage investment: They provide direct loans to the government and individuals for investment purposes. They also buy government treasury bills or shares and thus provide money for investment or development purposes.

Commercial banks provide managerial and financial advice in the economy: They provide managerial advice to small scale industrialists who do not engage the services of specialists. They also render financial advice to their customers which include the viability of projects, loans, as well as the nature of business to invest in to the avoid bankruptcy.

Commercial banks help in monetary policy implementation: The commercial banks help the economic development of a country by faithfully following the monetary policy of the central bank. As a matter of fact, the central bank depends upon the commercial banks for the success of its policy of monetary management in keeping with the requirement of a developing economy.

3.4. Credit Creation by commercial Banks

3.4.1. The concept of Credit Creation

The creation of credit or deposits is one of the most important functions of commercial banks. Like other corporations, banks aim at earning profits. For this purpose, they accept cash in demand deposits and advance loans on credit to customers. When a bank advances a loan, it does not pay the amount in cash. But it opens a current account in his name and allows him to withdraw the required sum by cheques. In this way, the bank creates credit or deposits. Thus, the principal process by which the banking system creates deposits is the granting of loans and overdrafts. Every loan and overdraft approved by a bank creates a new deposit. Upon the granting of a bank facility, the customer can draw a cheques to effect a payment. Usually, the cheque is paid to another bank account. After the cheque has been cleared, there is an increase in the total deposits in the banking system as a new deposit has been created. To illustrate the process of deposit creation, let us show an initial cash deposit of N10,000 can yield total bank deposit of 100,000. To do this, we make the following assumptions.

i. The banking system is comprised of several banks.

ii. The statutory reserve ratio (i.e. cash to be retained) is 10%.

iii. Banks have made loans up to the limit set by the reserve requirement before the receipt of the additional cash.

iv. All bank loans are withdrawn by borrowers in currency which is spent and re deposited by the ultimate recipients of the money in the same or another bank.

v. One of the banks receive N10,000 in cash.

vi. There no cash or leakage in the banking system.

vii. There are credit-worthy customers of banks willing to borrow as much as banks are able and willing to lend.

3.4.2. Limitation of the Power of Banks to Create Credit

Although banks have the ability to create credit in the economy, their ability to do this is constrained by a number of factors. The following are some of the limitations of the power of commercial banks to create credit.

Availability of Cash: The credit creation power of banks depends upon the amount of cash they possess. The larger the cash, the large the amount of credit that can be created by banks. The amount of cash that a bank has in its vaults cannot be determined by it. It depends upon the primary deposits with the bank. The bank's power of creating credit is thus limited by the cash it possesses.

Minimum Reserve Ratio (MRR): The minimum legal reserve ratio of cash to deposit fixed by the central bank is an important factor which determines the power of banks to create credit. The higher this ratio (MRR), the lower the power of banks to create credit, and the lower the ratio, the higher the power of banks to create credit.

Availability of collateral securities: An important factor that limits the power of a bank to create credit is the availability of collateral securities. If securities are not available with the public, a bank cannot create credit. Therefore the more available collateral securities with the public, the more loans will be granted and vice versa. Hence, credit creation depends on the availability of securities.

Banking habit of the people: The banking habit of the people also govern the power of credit creation on the part of banks. If people are not in the habit of using cheques, the grant of loans will lead to the withdrawal of cash from the credit creation stream of the banking system. This reduces the power of banks to create credit to desired level.

Leakages: If there are leakages in the credit creation stream of the banking system, credit expansion will not reach the required level, given the legal reserve ratio. It is possible that some persons who receive cheques do not deposit them in their bank account, but withdraw the money in cash for spending or for hoarding at home. The extent to which the amount of cash is withdrawn from the chain of credit expansion, the power of the banking system to create credit is limited.

Credit Control policy of the Central Bank: The power of commercial banks to create credit is also limited by the credit control policy of the central bank. The central bank influences the amount of cash reserves with banks by open market operations, discount rate policy, etc. accordingly, it affects the credit expansion or contraction by commercial banks.

Economic climate: Banks ability to create credit is also limited by the economic climate prevailing in an economy. In other words, their power to create credit depends upon the economic climate in the country. In boom periods, investment opportunities increase and businessmen take more loans from banks, therefore credit expands. But in depression period when business activity is at a low level, banks cannot force business community to take loans from them. Thus the economic climate in a country determines the power of banks to create credit.

Behaviour other banks: The power of credit creation is further limited by the behaviour of other banks. If some banks do not advance loans to the extent required of the banking system, the banking system will not be "loaned up".

Self-Assessment Exercise2

Discuss the limitations of the power of commercial banks to create credit.

3.5. Balance Sheet of Commercial Banks

3.5.1. What is a Balance sheet?

A balance sheet is a statement which shows the assets and liabilities of a commercial bank on a particular date at the end of one year. The assets are shown on the right hand – side and the liabilities on the left hand side. The balance sheet of a commercial bank provides a picture of its functioning. The balance sheet of a bank gives the true picture of how a bank is doing, how strong the bank is financially, how it is affected by monetary policy at the time of the balance sheet, and what uses the bank put its money into. As in the case of every company, the assets and liabilities of a bank must balance.

Every student of economics and banking should be able to analyses the balance sheet of a bank to be able to know the financial strength of the bank and the trend of monetary market. The format of a balance sheet which every commercial bank in Nigeria is required by section 27 of Decree No. 25 of 1991 to publish not later than four months after the end of its financial year.

3.5.2 Distribution of Assets

The assets of a bank are those items from which it receives income and profit. The items on the asset-side of a balance sheet include the following:

i. The first item on the asset side is the cash in liquid form consisting of coins and currency notes lying in reserve with it and in its branches to meet the demand of their customers. An important function of a commercial bank is to provide its customers with notes and coins they need at the right time, in the right place and in the right denomination they require by keeping cash in the bank vaults and balances at the central bank of Nigeria (CBN).

ii. The second item on the right hand side of the commercial banks balance sheet is in the form of balances with the central banks and other banks. The commercial banks are required to keep a certain percentage of their time and demand deposits with the central bank. They are the assets of the bank because it can withdraw from them in cash in case of emergency or when seasonal demand for cash is high.

iii. The third item, money at call relates to very short – term loans advances to bill brokers, discount houses and acceptance houses. The banks charges low interest on these loans.

iv. The fourth item of assets relates to bills discounted and purchased. The bank earns profit by discounting bills of exchange and treasury bills of 90 days duration. Some bills of exchange are accepted by a commercial bank on behalf of its customers which it ultimately purchases. They are a liability but they are included under assets because the bank can get them rediscounted from the central bank in case of need.

v. The fifth item, investments by the bank in government securities, state bonds and industrial shares, yields a fixed income to the bank. The bank can sell its securities when there is need for more cash.

vi. The sixth item relating to loans and advances is the most profitable source of bank assets as the bank charges interest at a rate higher than the bank rate. The bank makes advances on the basis of cash credits and overdrafts and loans on the basis of recognized securities.

vii. The seventh item included liabilities of the banks customers which the bank has accepted and endorsed on their behalf. They are the assets of the bank because the liabilities of customers remain in the custody of the bank. The bank charges a minimal commission for all acceptances and endorsements which is a source of income.

viii. The eighth item relates to the value of permanent assets of the bank in the form of property, furniture, fixtures, etc. They are shown in the balance sheet after allowing for deprecation every year.

ix. The last item include profits retained by the bank after paying corporation tax and profits to shareholders.

3.5.3. Distribution of liabilities (Sources of Funds)

The liabilities of a commercial bank are claims on it, these are items which form the sources of its funds. These liabilities are in the real sense of it, public funds, hence they show the sources of funds for the banks which they invest to make profit.

i. The first item on the liabilities side is the share capital of the bank which is contributed by its share holders and is a liability to them.

ii. The second item is the reserve fund which consists of accumulated resources which are meant to meet contingencies such as losses in any year. The bank is required to keep a certain percentage of its annual profits in the reserve fund. The reserve fund is also a liability to shareholders.

iii. The third item comprises both the time and demand deposits. Deposits are the debts of the bank to its customers. They are the main source from which the bank gets funds for investment and are indirectly the source of its income. By keeping a certain percentage of its time and demand deposits in cash, the bank lends the remaining amount on interest.

iv. The fourth item is the borrowings from other banks. The bank usually borrows secured and unsecured loans from the central bank. Secured loans are on the basis of some recognized securities and unsecured loans out of its reserve funds lying with the central bank.

v. The fifth item is the bills payables. Bills payables refer to the bills which the bank pays out of its resources.

vi. Bills for collection constitute the sixth item on the liabilities side of the balance sheet of the commercial bank. These are the bills of exchange which the bank collects on behalf of its customers and credits the amount to their accounts. Hence it is a liability to the bank.

vii. The seventh item is the acceptance and endorsement of bills of exchange by the bank on behalf of its customers. These are the claims on the bank which it has to meet when the bills mature.

viii. The eighth item is the contingent liabilities which relate to those claims on the bank which are unforeseen such as outstanding forward exchange contracts, claims on acknowledged debts, etc.

ix. The last item is the profit and loss which shows profit payable to shareholders which are liabilities on the bank.

The balance sheet of a particular bank shows its financial soundness. By studying the balance sheets of the major commercial banks of a country, you can be well informed about the trend of monetary market. The bank balance sheet reflects banks credit extension on its asset side in loans and investments, and on the liabilities side reflects the bank’s operations as an intermediary in time of deposits and its role as an element in the nation’s monetary system in demand deposits.

4.0. CONCLUSION

The foregone analyses indicate that commercial banks are indispensable in the development process of an economy. Therefore, it is very essential for the government to provide the necessary conducive atmosphere for commercial banks to operate in the economy.

5.0. SUMMARY

In this unit, we have learned about;

i. What a commercial bank is,

ii. The functions of commercial banks,

iii. The role of commercial banks in economic development of a country

iv. The concept of credit creation by commercial banks

v. The limitations of the power of banks to create credit

vi. The concept of a balance sheet

6.0. TUTOR-MARKED ASSIGNMENT

1. Discuss the functions of commercial banks in Nigeria.

7.0.REFERENCES/FURTHER READINGS

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UNIT 5: MERCHANT BANKING

CONTENT

1.0. INTRODUCTION

In the last unit, we have learned about the evolution of Merchant bank in the economy. It was very clear that bank is primarily concern about advancing short-term loans to its customers. The question therefore is who meets the needs of those who are in need of long-term loans? In this unit, you shall learn about the Concept of Merchant Bank and at the end of the unit, you shall appreciate its functions in the economy as a provider of long-term funds for development.

2.0. OBJECTIVES

At the end of this unit, you should be able to:

Explain the concept of Merchant bank;

State and explain the functions of a Merchant Bank;

Differentiate between the banking services and the corporate services of the Merchant Bank; and

Differentiate between Merchant bank and Commercial bank.

3.0 MAIN CONTENET

MERCHANT BANKING

3.1. The Concept of Merchant Banking

Merchant banks could be defined in terms of the functions they perform in an economy. Merchant banks in different countries perform various functions but there are some activities that are basic to all of these functions. These are “deposit banking, underwriting, and the management of clients”. Talking of “deposit-banking”, the merchant banks do not mean the same thing as did the commercial banks. Merchant banks are involved in wholesale banking whereas commercial banking is simply involved in retail banking.

A Merchant Bank is a financial institution specialized in the provision of certain services such as acceptance of bills of exchange, corporate finance, portfolio, management, equipment leasing, etc. Merchant Banks, unlike commercial banks, concentrate on wholesale banking. They carter for the need of corporate institutional customers and as such, accept only relatively large deposits of N25,000 and above. Since commercial banks concentrate more on short – term lending, merchant banks are expected to bridge this gap by providing medium and long- term loans. In other words, the principal function of a merchant bank is the provision of medium and long –term lending as against short – term lending which is regarded as the sacred domain of commercial banking.

In Nigeria, the Bank and other financial institutions Decree No. 25 of 1991, legally defines a merchant bank as “a bank whose business includes receiving deposits on deposit account, provision of finance, consultancy and advisory services relating to corporate and investment matters, making or managing investments on behalf of any person". Merchant Banks are best known in the U. K as "acceptance houses" and as "investment banks in the U.S.A".

Self-Assessment Exercise1

What do you understand by Merchant Banking?

3.2. Functions of Merchant Banks

Merchant banking services comprise primarily corporate finance services and banking services. Corporate finance services range from the management of the issue of private and public equity shares to corporate debt securities. Merchant banks provide expertise in the arrangement of syndicated loans for the financing of large-scale industrial projects, general financial and investment advisory services, company floatation, mergers and reconstructions, financial planning and portfolio management. Banking services are essentially loans and advances, deposits, acceptances, foreign exchange transactions, international trade and equipment leasing.

3.2.1. **Banking Services**

Loans and advances: Merchant banks provide loans and advances to industry and commerce. The merchant banks like commercial banks, provided loans and advances of short-medium and long-term nature. The central bank directs that a minimum of 4% of merchant banks' total loans and advances shall be of a medium and long-term nature while a maximum of 20% shall be of short-term nature.

Deposits: Merchant bank's deposits are provided in the forum of fixed term deposits, usually form corporate and non-corporate customers. The deposits are only in large blocks with a minimum of N50,000 at present. The deposits are not withdrawable with cheques. Certificates of deposits are used for inter-banks transactions.

Acceptances: Merchant banks accept bills of exchange from importers and exporters which are easily rediscountable.

Foreign exchange services: Merchant banks as authorized dealers perform foreign exchange services. This include the provision of service for opening letters of credit and handling direct remittances for both importers and exporters, arrangement of confirming lines for the letter of credit of clients, and liaising with the Central Bank on behalf of client. They also sell foreign exchange to customers obtained from bidding sessions at the Foreign Exchange Market (FEM).

Equipment Leasing: Leasing is a method of financing which enables a company to "rent" industrial equipment instead of buying it out rightly. Leasing involves the purchase of equipment by a bank for a client who is unable to pay for the cost of the equipment at a time, but takes the possession of the equipment in installmental basis over a period of time. The equipment becomes that of the client on the completion of the payment for its cost. In this way, merchant banks help to promote the activities of their clients. Merchant banks lease equipments to farmers and industrialist.

Portfolio management: Most merchant banks in Nigeria have investment departments set up to manage the portfolios of customers. This includes arranging purchases and sales of securities (and offering advice on when and what to buy and sell) as well as attending to registrations, rights or bonus issues.

3.2.2. Corporate Finance Services

Issuing House Services: Merchant Bank acts as issuing House in the capital market. In this role they provide financial services to corporate entities including governments, government parastatals and companies seeking to raise long-term or permanent finance for their operations. They do this by sponsoring their capital issues and sales of their securities to the public. They provide advice on the current type of capital structure and determine the most appropriate time to make an issue. In addition, they advise on relevant government regulations, legislation and policies and in preparing all the necessary documents (e.g. the prospectus required for an application for quotation on the stock exchange) and give backing to an issue in the form of underwriting.

Project financing: "Project financing" (or project loans) are terms which describe the method that banks, especially merchant banks and other institutional lenders in Nigeria, use to finance the construction of new projects on a basis whereby repayment is anticipated from the revenue stream generated by the project. Project financing often involves a loan to a new entity formed specifically to own or operate the project. Merchant Banks are deeply involved in the provision of this service to both government and corporate organizations in Nigeria.

Investment and financial advisory services: Merchant banks assist trustees of staff pension, endowment and unit trust funds and institutional fund managers in developing overall investment, strategies; they also provide advisory services with respect to privatization, mergers and acquisitions; and debt rescheduling.

Self-Assessment Exercise 2

Discuss the main functions of merchant bank

3.3. Major Differences between Merchant Banks and Commercial Banks

Some of the major differences between the merchant banks and the commercial banks include the following:-

i. Merchant banks are wholesale bankers accepting deposits only in large blocks with a minimum of N50,000 while commercial banks act primarily as retail bankers. Thus, while commercial banks do business with individuals and companies, merchant banks concentrate on corporate customers.

ii. Merchant banks operate as wholesale bankers with only a few branches, while commercial banks, as retailers, need a wide network of branches.

iii. Merchant banks provide mainly medium and long-term finance, while commercial banks grant short-term loans and advances.

iv. While commercial banks accept deposits from all and sundry, merchant banks depend on public and private corporations. In their lending activities, commercial banks deal with a wide variety of customers, while merchant banks deal mainly in the acceptance and discounting of commercial bills to finance trade and corporate customers.

4.0. CONCLUSION

Though merchant banks are primarily concerned with the provision of medium and long – term loans in the economy, they are not a substitute to commercial banks in any way, but they compliment the efforts of the commercial banks in an economy. This unit highlights the functions of merchant banks. It also shows the difference between merchant banks and commercial banks terms of operations.

5.0. SUMMARY

You have learned that Merchant banking is any person who is engaged in wholesale banking, medium and long-term financing, equipment leasing, debt factoring, investment management, issue and acceptance of bills and the management of unit trust. In this unit, you have also learned about the major differences between the Merchant bank and the commercial bank.

6.0. TUTOR-MARKED ASSIGNMENT

Clearly differentiate between a merchant bank and a commercial bank.

7.0. REFERENCES

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UNIT 6: DEVELOPMENT AND SPECIALIZED BANKS

CONTENT

1.0. INTRODUCTION

In this unit, you shall be introduced to the concept of Development and Specialized banks. You shall be made to understand that apart from the other types of banks discussed in the previous units, there could be Development and specialized banks that could be established to purposely carter for some specific sectors in an economy. In Nigeria, some of these development banks include the Nigerian Bank for Commerce and Industry (NBCI), the Nigerian Agricultural, Co-operative and Rural Development Bank (NACRDB), the Federal Mortgage Bank of Nigeria (FMBN), and the Nigerian Industrial Development Bank (NIDB). The Specialized banks include the Federal Savings bank (now FSB International), the Peoples Bank, and the Community Banks.

2.0. OBJECTIVES

At the end of this unit, you should be able to;

Define a Development Bank;

Enumerate and explain the general functions of Development Bank;

Distinguish between the banking and development functions of a Development Bank; and

Differentiate between Development Banks and Specialized banks in Nigeria.

3.0. DEVELOPMENT AND SPECIALIZED BANKS

3.1. What is a Development Bank?

Development banks are specialized financial institutions providing medium and long – term credit for the creation or expansion of agriculture, commercial and industrial enterprises in developing countries such as Nigeria. They are mostly established by government. The main objective of development banks is the promotion of economic development in the economy. The idea of setting up development banks in Nigeria was mooted after the establishment of the CBN. It became apparent that there was an urgent need for banking institutions capable of providing medium and long-term finances, to fill the gaps in the economy which the merchant banks at that time were not well – equipped to service. The gaps were specifically made up of the priority sectors of the Federal Government such as the development of our agricultural and industrial sectors. Since these areas involve large expenditures which cannot be met by the commercial banks, because of the legal constraints and regulations by the CBN coupled with the rapid development within the economy, the need to establish development banks devoted primarily to stimulate these priority sectors of the economy and concerned with the promotion and finance of enterprises by the provision of long-term and intermediate finance was accepted. The development banks operating in Nigeria includes the Nigeria Bank for Commerce and Industries (NBCI), the Nigeria Agricultural, Co-operation and Rural Development Bank (NACRDB), the Federal Mortgage Bank of Nigeria (FMBN), and the Nigerian Industrial Development Bank (NIDB).

Self-Assessment Exercise1

1. What is a Development Bank?

3.2. General Functions of Development Banks

Development Banks are specialized banks which are established for specified purposes in the economy. Their functions are therefore aimed at developing those sectors which they are established for. However, they perform two broad functions which include the banking functions and the development functions.

3.2.1. Banking Functions

i. Development Banks Provide long-term and medium-term finance / loans for commerce, industry and agriculture as well as general development projects.

ii. Development Banks make funds available in the form of equity to development projects.

iii. They raise bilateral and multilateral loans from international aid agencies like the United States Agencies for International Development (USAID), from international donor agencies like the World Bank and from their own governments.

3.2.2. Development Functions

i. Development banks provide promotional activities such as identifying and properly articulating investment proposals.

ii. Development Bank facilitates the establishment of institutions and enterprises which fill specific gaps in the financial system.

iii. They help to stimulate their nations' capital markets (Market for long-term loans) by selling their own stocks and bonds and / or selling and using the proceeds to invest in new enterprises.

iv. Development Banks provide their clients with technical skill and advice at the preparatory and implementation stages of projects.

v. They provide managerial assistance to their clients in project preparation and evaluation.

vi. Development Banks ensure that allocations to projects are in line with the defined economic, social and political priorities of the government.

vii. Development banks ensure efficient allocation to scarce financial resources in the development planning projects.

viii. They thus help to quicken the pace of economic development.

3.3. Specialized Banks

Specialized banks are established in Nigeria to carter for the financial needs of some segments of the society. The banks in this category include the Federal Savings Bank (Now FSB International), People's bank of Nigeria (PBN) and Community Banks (CB).

3.3.1 The Federal Savings Bank (FSB International)

The Federal Savings Bank (FSB) evolved from the post office savings banks in 1974, backed by Decree No. 33 of 1973. The objective of setting up a Federal Saving Bank was to encourage the savings habit among the low- income group in the society. It was recognized in 1990, as FSB international Ltd.

3.3.2. Peoples Bank of Nigeria

People's Bank of Nigeria was established in 1989 to encourage savings and provide credit facilities for the underprivileged in both urban and rural areas. The Decree that set up the bank specified its functions as the provision of basic credit requirements normally demanded by banks' customers. The bank was thus set up to facilitate access to credit for those at the grass –roots and thereby increase their self – reliance.

3.3.3. Community Banks

A Community Bank (CB) is defined as a self – sustaining financial institution owned and managed by a community or group of communities to provide financial services to that country. Community Banks were established in Nigeria in 1990 to provide banking facilities for rural dwellers as well as to support micro-enterprises in urban areas.

Self-Assessment Exercise2

Name and explain the purpose of any Specialized bank in Nigeria.

4.0. CONCLUSION

This unit highlights the concept of development banks, and its functions. The unit also discusses specialised banks in Nigeria.

5.0. SUMMARY

In this unit, we have learned about:

i. The concept of development banks;

ii. Development functions of development banks;

iii. Banking functions of development banks; and

iv. The various specialized banks and their purposes in the Nigerian economy

6.0. TUTOR-MARKED ASSIGNMENT

Discuss the general functions of Development Banks in Nigeria

7.0. REFERENCES

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MODULE 2

UNIT 1: THE FORMS OF BANK REGULATIONS IN NIGERIA

1.0 Introduction

2.0 Objectives

3.0 Main Content

3.1 Forms of Bank Regulations in Nigeria

3.1.1 Companies and Allied Matters Act

3.1.2 Banks and Other Financial Institutions Act.

3.1.3 Central Bank of Nigeria

4.0 Conclusion

5.0 Summary

6.0 Tutor-Marked Assignment

7.0 Reference/Further Reading

1.0 INTRODUCTION

Laws are the legal mechanisms that are provided to guide the conduct of people in every aspect of human endeavours. Anything that is not governed by law is a free for all affairs and could be done to the detriment of other persons, society and of course the nation. The laws that are put in place for establishment of banks in Nigeria have set standard and requirements to be fulfilled by the operators. The establishment of banks in Nigeria involves several processes which are required by different laws. There is the process of incorporation, which is regulated by the Companies and Allied Matters Act. There is also the process of obtaining banking licence under the Banks and Other Financial Institutions Act which is finalized by the authority of the Central Bank Governor under the Central Bank Nigeria Act. Until all the necessary steps are undertaken before a bank could be said have been established.

2.0 OBJECTIVES

At the end of this unit, you should be in a position to:

1. Identify the principal laws for establishing a bank in Nigeria;
2. Know the Requirements under each of the Laws; and
3. Know the stages of establishing a bank as required by law.

3.0 MAIN CONTENT

3.1 **Forms of Bank Regulations in Nigeria.**

The Laws regulating the establishment of banks in Nigeria include principally the Companies and Allied Matters Act, Cap. C. 20 LFN 2004; Banks and Other Financial Institutions Act, Cap. B.3 LFN 2004; and Central Bank of Nigeria Cap C4 LFN 2004.

3.1.1 Companies and Allied Matters Act. (CAMA)

Banks operating in Nigeria are corporate bodies. They must firstly be incorporated as a company under the CAMA by complying with the requirements in respect of registration of such a company. See Sections 18, and 35 CAMA See also Section 2(1) BOFIA. Once a company is incorporated, it becomes a body corporate by the name contained in the memorandum of association to carry out business. See Sections 37 and 38 (1) CAMA.

3.1.2 Banks and other Financial Institutions Act.

Section 2(1) BOFIA states that no person shall carry on any banking business in Nigeria except if it is a company duly incorporated in Nigeria and holds a valid banking licence issued under the Act. The procedure for application for grant of licence to undertake banking business is contained under section 3(1) (2) of BOFIA.

The Central Bank Governor has unfettered discretion as to whether to issue or not to issue licence, however, any licence to be issued shall be with the prior approval of the Minister of Finance. See sections 3 (3) & (5) BOFIA.

3.1.3 Central Bank of Nigeria Act.

The Central Bank of Nigeria is established as a body corporate under S.1. CBN Act. It is constituted by a Board chaired by its Governor. The governor is very significant in the establishment of other banks because he issues them with banking licence.

Self – Assessment Exercise 3

1. State the statutory backing to the establishment of banks in Nigeria
2. What is the role of the CBN in the establishment of other banks in Nigeria?

4.0 CONCLUSION

The establishment banks in Nigeria involve compliance with different laws, and the requirements of those laws must be complied with before it can be said that a bank has been properly established.

5.0 SUMMARY

There are three principal laws that regulate the establishment of banks in Nigeria. The Companies and Allied Matters Act deals with incorporation of a bank as a body corporate, while, the Banks and Other Financial Institutions Act is concerned with application and issuance of banking licence, and the Central Bank of Nigeria Act deals with the authority to issue banking licence.

6.0 TUTOR-MARKED ASSIGNMENT

Explain the relationship between the under listed statues with regard to the establishment of Banks in Nigeria.

(a) Companies and Allied Matters Act

(b) Banks and Other Financial Institutions Act.

(c) Central Bank of Nigeria.

7.0 REFERENCES/FURTHER READINGS

1. Companies and Allied Matters Act, Cap. C. 20 LFN 2004.

(d) Banks and Other Financial Institutions Act, Cap. B2 LFN, 2004.

(e) Central Bank of Nigeria Act, Cap. C4 LFN, 2004.

UNIT 2: THE NEED FOR BANK REGULATIONS

1.0 INTRODUCTION

The Nigeria banking reforms is a product of global effort at revamping the world economy various approaches to economic and financial reforms include the millennium development goals (MDGs), the new partnership for Africa development (NEPAD) strategy and the national economic empowerment and development strategies (NEEDS) that are geared towards the economic development of the country. For a long term in the history of policy reforms in Nigeria the banking sectors was given priority attention such that directive by means of regulation were issued to the banking sector with the aim of development other sector and thus propelling the entire economy.

2.0 OBJECTIVES

At the end of this unit, you should be in a position to:

The need for bank regulations; and

The Objectives of Banking Regulations

3.0 MAIN CONTENT

3.1 The need for Banks Regulation

Economists have come to disagree on the level of government intervention in economic and financial activities over the world (Adam, 2005) while some believe that many regulations are necessary in order to protect the depositors funds other believe that the bank are overregulated (short and O'Driscroll Jr., 1983). For instance the economic theory of regulation postulates that regulation result from the desire of government to eliminate or correct market failure.

The public interest theory views that regulation come pressures brought to bear on the government multifarious interest group. Pressure groups in economy such as business, consumers, workers, environmental groups among others lobby government to pass legislation to protect such group. It seems that economy theory of regulation has gained more acceptance among economist as Llewellyn (1986) put it. Regulation is necessary in the case of bank specifically to maintain safe and sound banking system that can meet its obligation without difficulty, hence a high solvency and liquidity level is experience of individual banks than they would ordinarily maintain. Oloyode (1994) observed that the banking Industry is highly prone to volatility and fragility either arising from exogenous or endogenous shocks and are therefore amenable to regulation and supervision. Tougher capital requirements may have positive benefits—they may reduce the consequences of market freezes, they may encourage banks to become smaller to avoid "systemic" capital requirements, and they may reduce contagion—but they may not be relied on to reduce the risk of bank failure(Gale, 2010). This view is in line with Oke (2006) that observed the inconsistency in monetary and regulatory policies as major setback to banks stability as the surveillance and regulatory measures of the Central Bank of Nigeria (CBN) have unfortunately been unable to keep the pace with the rapidity of the charges in the financial system.

Mishkin (1997) viewed that forging a strong bank supervision system will be one why out of financial crisis while ogunleye (1999) summarized the rationale for banks regulation as efficiency, diversity of choice, competition stability of financial system, macroeconomic stability and development and social objective . This view is in line with the World Bank (1989) that good regulation and supervision will minimize the negative impact of moral hazard and price shocks on the financial system there by leading to a reduction in bank distress and failure. Llewellyn (1986) describes presidential regulation as a body of specific rules or agreed behavior, either imposed by the government or external agency or self imposed by explicit or implied agreement with the industries that constrains the activities in the industry.

In terms of policy thrust therefore the banking sectors reforms are expected to build and foster a competitive and healthy financial system to support development and avoid systemic distress (Soludo, 2007). Thus Balogun (2007) averred that banking sector reforms is interpreted to mean embarking on comprehensive process aimed at substantially improving the financial infrastructure, strengthening the regulatory and supervisory framework to address the issue of low capitalization and a structured financing for cheap credit to the real sector and financial accommodation for small and rural credit schemes. Studies have shown that the objectives of financial sector reforms are broadly the same in most countries of sub-saharan Africa (Omoruyi 1991, CBN 2004, Balogun, 2007, Ray, 1986). These are summarized to include market liberalization for promotion of more efficient resource allocation, expansion of savings mobilization base, promotion of investment and growth through market base interest rates. It also means the improvement of the regulatory and surveillance framework, fostering healthy competition in the provision of service and above all
laying the basis for inflation control and economic growth (Balogun, 2007).

Self – Assessment Exercise 1

What is the Need for Bank Regulation?

3.2 The Objectives of Banking Regulations

The following were the objectives of Banking Regulation:

(a) Confidence of Depositors

One of the primary objectives of the bank regulations enacted following the Great Depression was to ensure the confidence of depositors. One of the catalysts of the Great Depression was fear over the security of money deposited in banks. The lack of confidence led to runs on banks, which quickly ran out of financial reserves. By regulating the management of bank finances and the level of reserves a bank has on hand, the government seeks to ensure depositor confidence, avoid similar runs on banks and encourage active participation in the national financial system.

(b) Prevention of Risky Behaviors

Banks make money by investing deposited funds in various activities, typically loans to businesses and individuals. Every loan carries some level of risk. The more risk involved in a financial transaction, the greater the potential reward. Those rewards can be very tempting for banks, and one objective of banking regulations is to restrict the level of risk to which a bank may expose itself. If a bank were to become involved in too many risky investments, it would endanger the money of depositors.

(c) Prevention of Criminal Activity

Many bank regulations require banks to notify the government of deposits over a certain dollar amount or of any suspicious banking activity by the bank's customers. Money is a means and an end to many criminal activities, such as drug trafficking and international terrorism. By restricting the financial freedom of criminal and terrorist organizations, the government seeks to reduce the strength of such groups. Regulating banks to ensure they are not knowingly or unknowingly helping criminal groups hide or distribute money is one way of doing this.

(d) Directing Credit

Many bank regulations require or encourage extension of credit to certain industries or classes of loans that are deemed socially desirable. For example, a bank regulation might provide incentives to encourage loans to minority-owned businesses or students pursuing higher education. Just as the tax code promotes social policy with preferential tax treatment of certain activities, bank regulations promote social policies that have certain requirements and incentives.

4.0 CONCLUSION

In this unit you have studied some of the needs and objectives of banking regulation. For much of the unit we have placed these issues in the context of the banking regulations, it highlights the character of bank regulation and it has stimulated renewed interest in reform of regulation. However, regulation is important in 'normal' times when banks are operating smoothly and the difficult questions about regulation are relevant whether or not the system is in crisis.

5.0 SUMMARY

At the end of this unit, the students were able to:

Evaluate the need for bank regulations; and

Examine the Objectives of Banking Regulations

6.0 TUTOR-MARKED ASSIGNMENT

Explain the Objectives of Banking Regulation

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UNIT 3: LAW REGULATING THE OPERATIONS OF BANKING IN NIGERIA

CONTENT

1.0 INTRODUCTION

The conduct of banking business in Nigeria as in other countries is regulated by several laws. These laws are put in place to provide some set of standards and establish Government agencies to be responsible for ensuring that banks comply with the requirements of all relevant laws. The operation of banking includes its internal control system, conduct of business, relationship with customers, and other banks, the Central Bank, and dealings in banking instruments. All these are covered by laws such as the Banks and Other Financial Institutions Act which majorly sets criteria for all banks. The CBN Act establishes the CBN as the apex regulatory government agency to oversee the operation of other banks while the Bills of Exchange Act deals with negotiable instruments that are used by banks in their relationship with customers.

2.0 OBECTIVE

At the conclusion of this unit you should be able to:

1. Identify the relevant laws that regulate banking operation in Nigeria.
2. Distinguish between the requirements of each of the laws.
3. Identify the regulatory significance of each of the laws.

3.0 MAIN CONTENT

3.1 Laws regulating the operation of Banking in Nigeria.

After the establishment and licensing of a bank in Nigeria, it can legally commence business, however, in doing business it has to operate within the purview of the applicable laws in Nigeria. These laws include the BOFIA, CBN, and the Bills of Exchange Act. Cap B8 LFN 2004.

3.1.1 Banks and Other Financial Institution Act (BOFIA)

- The opening and closing of branches requires a written consent of the CBN. Section 6 BOFIA likewise the operation of foreign branches. Section 8 BOFIA.
- Every reconstruction, reorganization, mergers and disposal including acquisitions requires prior approval of the Governor of the CBN.
- Every bank must at all material times maintain the minimum paid-up share capital as may be determined by the C.B.N. Section 9, and 61 BOFIA.
- Every bank is required to maintain a reserve fund which a proportion of the annual profit is transferred into for the purpose of its business and adequacy in relation to its liabilities. Section 16 BOFIA.
- The BOFIA restricts certain banking activities except with prior approval of in writing of the CBN. See Section 20
- Every bank is required to keep proper books of account with respect to all the transactions of the bank. Section 24.
- The control and management of failing banks is done by the CBN in conjunction with the Nigerian Deposit Insurance Company (NDIC). See Sections 35, 36 & 38 BOFIA.
- The name which a bank should bear is also regulated, e.g. names that appear Government patronage are restricted or depict religious connotation. Section 43.
- The appointment of directors, chief executives is done with the approval of the CBN. Section 48

3.1.2 Central Bank of Nigeria Act.

- The CBN operates within the Act establishing it. The Act provides for the powers of the Bank to print currency notes and coins and the monopoly of issuing them. See Section 16 & 17 CBN Act.
- The general operation powers of the CBN are contained elaborately under Section 26 while the activities it is prohibited from undertaking are stipulated under S. 28.
- The CBN is entrusted with certain services which it renders to the Federal Government. Section 30
- It is also mandated to act as banker to other banks in Nigeria and outside Nigeria, Section 36 and 37.
- Very importantly, it has power to make and alter rules and regulations for the good order and management of its activities. S. 47.

3.1.3 Bills of Exchange Act. (BEA)

This Act deals with cheques, which is a bill of exchange that is commonly used by commercial banks, ("whose business includes the acceptance of deposits withdrawable by cheques") S. 66 BOFIA. By virtue of Section 73 BEA " A cheque is a bill of exchange drawn on a banker payable on demand" See also UBN Plc V. Okubama (2000) 14 NWLR Pt 688, 573; Trade Bank Plc v. Barilux (Nig.) Ltd (supra). Therefore, the provisions of the BEA apply to a cheque.

There are specific provisions in respect of cheques under the BEA such as presentment of cheque for payment S. 74, crossed cheques. S. 78-84. In Addition, other provisions of the BEA in respect of bills of exchange generally apply to cheques, so banks are bound by them.

Self – Assessment Exercise 4

1. State at least 5 aspects that law regulates in the operation of banking in Nigeria.
2. What is the relevance of Bills of Exchange Act to the regulation of banking operation in Nigerian.

4.0 CONCLUSION

The conduct or operation of banking in Nigeria is regulated by three principal statutes. These laws provide operational standard to be conformed with by banks. They also provide the legal basis for their activities. Consequently, every bank is mandated to operate within the ambit of the laws. Any activity outside the law might be illegal.

5.0 SUMMARY

The Banks and other Financial Institutions Act regulates the activities of all banks apart from the Central of Nigeria. The BOFIA regulates banking business and management of banks while the CBN Act establishes the CBN as the apex regulator of the banking sub-sector with functions and powers under the Act. The Bills of Exchange Act deals with the negotiable instruments, which are used by banks in the conduct of their business, especially cheques.

6.0 TUTOR MARKED ASSIGNMENT

What is the relevance of Bills of Exchange Act to the conduct of banking business in Nigeria?

7.0 REFERENCES/FURTHER READINGS

1. Banks and Other Financial Institution Act (supra)
2. Central bank of Nigeria Act (supra)
3. Bills of Exchange Act, Cap. B8, LFN 2004.

UNIT 4: REGULATORY AGENCIES; EVOLUTION & FUNCTIONS

CONTENT

1.0. INTRODUCTION

In this unit, you shall be introduced to regulatory agencies of financial sectors.

You shall be made to understand the Nigerian financial system which comprises of bank and non-bank financial institutions which are regulated by the Federal Ministry of Finance (FMF), Central Bank of Nigeria (CBN), Nigeria Deposit Insurance Corporation (NDIC), Securities and Exchange Commission (SEC), National Insurance Commission (NAICOM), Federal Mortgage Bank of Nigeria (FMBN), and the National Board for Community Banks.

2.0. OBJECTIVES

At the end of this unit, you should be able to;

Know the structure of the Nigeria financial system; and
Enumerate and explain the types of financial regulatory agencies in the economy

3.0 MAIN CONTENT

3.1 The Structure of the Nigerian Financial System

3.2 Regulatory Agencies

3.2.1 The Federal Ministry of Finance (FMF)

The Federal Ministry of Finance advises the Federal Government on its fiscal operation and co-operates with CBN on monetary matters.

3.2.2 The Central Bank of Nigeria (CBN)

The CBN is the apex regulatory authority of the financial system. It was established by the Central Bank of Nigeria Act of 1958 and commenced operations on 1st July 1959. Among its primary functions, the Bank promotes monetary stability and a sound financial system, and acts as banker and financial adviser to the Federal Government, as well as banker of last resort to the banks. The Bank also encourages the growth and development of financial institutions. Enabling laws made in 1991 gave the Bank more flexibility in regulating and overseeing the banking sector and licensing finance companies, which hitherto operated outside any regulatory framework.

3.2.3 The Nigerian Deposit Insurance Corporation (NDIC)

The NDIC complements the regulatory and supervisory role of the CBN. It is however autonomous of the CBN and reports to Federal Ministry of Finance. NDIC effectively took off in 1989 and was set up to provide deposit insurance and related services for banks in order to promote confidence in the banking industry. The NDIC is empowered to examine the books and affairs of insured banks and other deposit taking financial institutions. Licensed banks are mandated to pay 15/16 of 1 per cent of their total deposit liabilities as insurance premium to the

NDIC. A depositor's claim is limited to a maximum of N50, 000.00 in the event of a bank failure. The Nigerian Deposit Insurance Corporation (NDIC) has concluded plans to hike the insured deposit of banks to N200, 000.

3.2.4 The Securities and Exchange Commission (SEC)

This is formerly called the Capital Issues Commission, the SEC was established by the SEC Act of 27th September 1979, which was further strengthened by the SEC Decree of 1988. It is the apex regulatory organ of the capital market. The Commission approves and regulates mergers and acquisitions and authorises the establishment of unit trusts. In the course of deregulation of the capital market, the function of price determination has been transferred to the issuing houses. The SEC maintains surveillance over the market to enhance efficiency. It issues guidelines on the establishment of Stock Exchanges in furtherance of the deregulation of the capital market. Following the enactment of the Nigerian Investment Promotion Commission Decree and the Foreign Exchange (Monitoring and Miscellaneous Provisions) Decree in 1995, SEC released guidelines on foreign investment in the Nigerian capital market.

3.3.5. Debt Management Office (DMO)

The Federal Government of Nigeria took a major step in addressing the debt problems recently by establishing an autonomous Debt Management Office (DMO). The creation of the DMO consolidates debt management functions in a single agency, thereby ensuring proper coordination. The DMO centralizes and coordinates the country's debt recording and management activities, including debt service forecasts; debt service payments; and advising on debt negotiations as well as new borrowings.

3.2.6 National Insurance Commission (NAICOM)

The National Insurance Commission (NAICOM) replaced the Nigerian Insurance Supervisory Board (NISB). The NAICOM is charged with effective administration, supervision, regulation and control of the business of insurance in Nigeria. Its specific functions include the establishment of standards for the conduct of insurance business, protection of insurance policy holders and establishment of a bureau to which complaints may be submitted against insurance companies and their intermediaries by members of the public. NAICOM ensures adequate capitalization and reserve, good management, high technical expertise and judicious fund placement in the insurance industry.

3.2.7 The Federal Mortgage Bank of Nigeria (FMBN)

The FMBN took over the assets and liabilities of the Nigerian Building Society. The FMBN provides banking and advisory services, and undertakes research activities pertaining to housing. Following the adoption of the National Housing Policy in 1990, FMBN is empowered to licence and regulate primary mortgage institutions in Nigeria and act as the apex regulatory body for the Mortgage Finance Industry. The financing function of the Federal Mortgage Bank of Nigeria was carved out and transferred to the Federal Mortgage Finance, while the FMBN retains its regulatory role. FMBN is under the control of the Central Bank of Nigeria.

3.2.8 Financial Services Co-ordinating Committee (FSCC)

The Committee was established in 1998 and charged with the primary responsibility to promote safe, sound and efficient financial sector in the country. It’s membership is drawn from the key regulatory and supervisory institutions in the nation’s financial system, namely, Central bank of Nigeria (CBN), Security and Exchange Commission (SEC), National Insurance Commission (NAICOM), Corporate Affairs Commission (CAC) and the Federal Ministry of Finance. This committee chaired by the Ministry of Finance co-ordinates the activities of all regulatory institutions in the financial system.

3.4 The Money Market and its Institutions

This is a market for short-term debt instruments. The major function of the money market is to facilitate the raising of short-term funds from the surplus sectors to the deficit sectors of the economy. The deficit units, which could be public or private, obtain funds from the market to bridge budgetary gaps by either engaging in inter-bank taking or trading in short-term securities such as Treasury Bills, Treasury Certificates, Call Money, Certificates of Deposit (CD), and Commercial Papers (CP). With the commencement of Open Market Operations (OMO) by the CBN, the scope of the money market has been expanded. The number of participants in the market also increased with the establishment of five discount houses. Money market institutions constitute the hub of the financial system. These institutions include discount houses, commercial and merchant banks, and special purpose banks, like the Nigerian Agricultural Co-operative and Rural Development and Community banks.

3.4.1 Discount Houses

A discount house is a special, non-bank financial institution intervenes in mobilizing funds for investments in securities in response to the liquidity of the system. It does this by providing discount/rediscounting facilities in government short-term securities. In the process of shifting the financial system from direct market-based monetary control, discount houses were established to serve as financial intermediaries between the CBN, licensed banks and other financial institutions. Some of the discount houses currently in operation in Nigeria include First Securities Discount House Limited, Express Discount House Limited, Associated Discount House Limited, Kakawa Discount House Limited and Consolidated Discount House Limited.

3.4.2 Universal Banking

CBN has approved the introduction of Universal Banking in Nigeria. Since the release of the guidelines, more than ten banks have converted to universal banking status. Thus, such banks operate Commercial and Merchant functions.

3.4.3 Commercial and Merchant Banks

Comercial and Merchant Banks operate under the legal framework of the Banks and other Financial Institutions (BOFI) Act 25 of 1991 (as amended). Commercial banks perform three major functions, namely, acceptance of deposits, granting of loans and the operation of the payment and settlement mechanism. Since the Government commenced active deregulation of the economy in September 1986, the commercial banking sector has continued to witness rapid growth, especially in terms of the number of institutions and product innovations in the market.

Merchant banks take deposit and cater for the needs of corporate and institutional customers by way of providing medium and long-term loan financing and engaging in activities such as equipment leasing, loan syndication, debt factoring and project advisers to clients sourcing funds in the market. The first merchant bank in Nigeria, Nigerian Acceptance Limited (NAL), started operations in 1960. Currently, there is a general banking operation. With this banks performs multiple operations whether commercial or merchant operation

Community Banks

A community bank in Nigeria is a self-sustaining financial institution owned and managed within a community to provide financial services to that community. The National Board for Community Banks (NBCB) processes applications for the establishment of community banks. The first community bank commenced operation in December 1990. Since then, NBCB has issued provisional licences to

1,366 community banks and are expected to be issued final licences by the CBN after operating for two years.

4.0 CONLUSIONS

From the above discussion, we observed that, Regulatory Agencies, such as the Federal Ministry of Finance (FMS), The Central Bank of Nigeria (CBN), The Nigeria Deposit Insurance Corporation (NDIC), The Nigeria Securities & Exchange Commission (SEC), The Debt Management Office (DMO), National Insurance Commission (NAICOM) and the Money Market and its Institutions plays an important role on the success of the financial structure. Under this, it should define, explicitly, workable goals that are well understood.

5.0 SUMMARY

In this unit, the students were enlightened on:

The structure of the Nigeria financial system;

Regulatory Agencies;

The Federal Ministry of Finance (FMS);

The Central Bank of Nigeria (CBN);

The Nigeria Deposit Insurance Corporation (NDIC);

The Nigeria Securities & Exchange Commission (SEC);

The Debt Management Office (DMO);

National Insurance Commission (NAICOM); and

The Money Market and its Institutions.

6.0 TUTOR MARKED ASSIGNMENT

Elaborate on different types of Regulatory Agencies in the Nigeria economy.

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UNIT 5: PROCEDURES FOR ESTABLISHING A BANK IN NIGERIA

CONTENT

1.0. INTRODUCTION

This unit would examine the procedures for establishing a bank in Nigeria.

2.0. OBJECTIVES

The objectives of this unit, were as follows:

To evaluate the procedures for establishing a bank in Nigeria;

To examine the major participants in the Nigeria Capital Market;

To access the Nigeria Capital Market;

To understand the Nigeria Deposit Insurance Corporation (NDIC);

To understand the Nigeria Securities & Exchange Commission (SEC);

To understand the Debt Management Office (DMO);

To understand the National Insurance Commission (NAICOM); and

The Money Market and its Institutions

3.1 Procedures for Establishing a Bank in Nigeria

1. Any person desiring to undertake banking business in Nigeria shall apply in writing to the Governor for the grant of a licence and shall accompany the application with the following:

- A feasibility report of the proposed bank;
- A draft copy of the memorandum and articles of association of the proposed bank;
- A list of the shareholders, directors and principal officers of the proposed bank and their particulars;
- The prescribed application fee and
- Other information, documents and reports as the bank may, from time to time, specify

2. After the applicant has provided all such information, documents and reports as the bank may require

   the shareholders of the proposed bank to deposit with the bank a sum equal to the minimum paid-up capital that may be applicable.

3. Upon the payment of the 25billion Naira paid-up capital, the Governor may issue a license with or without conditions or refuse to issue a licence and the Governor need not give any reason for the refusal.
4. Where an application for a licence is granted, the bank shall give written notice of that fact to the applicant and the licence fee shall be paid.

Self – Assessment Exercise1

What are the procedures for establishing a bank in Nigeria?

3.2 The Capital Market

The Nigerian Capital Market is a channel for mobilising long-term funds. The main institutions in the market include the Securities and Exchange Commission (SEC), which is at the apex and serves as the regulatory authority of the market, the Nigerian Stock Exchange (NSE), the issuing houses and the stock-broking firms. To encourage small as well as large-scale enterprises gain access to public listing, the NSF operates the main exchange for relatively large enterprises and the Second-Securities Market (SSM), where listing requirements are less stringent, for small and medium scale enterprises. Given its operations both in the primary and secondary markets, the **Nigerian Capital Market** has recorded phenomenal growth in the first twenty years of its formal existence. The equity market capitalisation of N1.70 billion and listed equities of 92 in 1980, have risen to N472.9 billion and 196 listed equities at the end of 2000. 21 new issues valued at N16.71 billion were raised from the market to fund various expansion and developmental projects in the country in the year 2000.

Unit Trusts Scheme also operates on the market for the purpose of mobilising the financial resources of small and big savers and managing such funds to achieve maximum returns with minimum risk. Currently, there are 14 Unit Trust operations in the market.

3.2.1 The Major Participant in the Nigerian Capital Market

- The Securities and Exchange Commission (SEC), which is responsible for the overall regulation of the entire market.
- The Nigerian Stock Exchange (NSE), a self-regulatory organization in NCM that supervises the operations of the formal quoted market.
- Market Operators, this consists of the Issuing Houses (Merchant Banks and Stock broking firms), Stockbrokers, Trustees, Registrars, etc.

- Investors, Insurance Companies, Pension Fund, Unit Trusts (Institutional Investors) and Individuals.
- The Central Bank of Nigeria (CBN).
- The Federal Ministry of Finance

Self – Assessment Exercise 2

Who are the major participants in the Nigeria Capital Market?

3.2.2 How to Access the Nigerian Capital Market

When a company or government wants to use the Capital Market to raise long-term funds, it must consult an issuing house or stockbroker. These specialists provide the company/government with financial advisory services. It is their duty to study the company's performance over the years in order to determine its financial needs. More so, they do not only advise on the best option, they undertake total financial restructuring of the company before introducing the facility to the company.

The issuing house and the stockbroker liaise with the other parties – Registrars, Trustees, Auditors, Reporting Accountant, and Solicitors etc. to produce a marketing document known as the **PROSPECTUS.** The Prospectus is the document the public relies on for making investment decision. Necessary approvals from SEC and other bodies are obtained. If the financial option involves listing on the Stock Exchange, the brokers to the issues ensures that all necessary approval with the Exchange are also obtained since only stockbrokers can introduce issues to the Exchange.

On the completion of the offer, the proceeds of the issue are handed over to the company for executing the proposed business programme on long-term investment and the securities is listed on the Daily Official list of the Exchange. For individuals wishing to invest in the Capital Market in form of buying shares, what they need do is to consult a Stock broking firm and register with the broking firm.

DEVELOPMENT FINANCE INSTITUTIONS (DFIs)

Specialised banks or development finance institutions (DFIs) were established to contribute to the development of specific sectors of the economy. In order to enhance their operations and make their efforts felt in the economy, most of the former DFIs in the country have been merged and restructured. The DFIs from the merger and restructuring are the Bank of Industry (BOI) and the Nigerian Agricultural Co-operative and Rural Development Bank (NACRDB). The two banks provide soft loans to industrialists and those engaged in agro-allied ventures. Other existing DFI's are Federal Mortgage Bank (FMB), Urban Development Bank (UDB) and Education Bank (EB) to cater for the sectors reflected in their names.

OTHER FINANCIAL INSTITUTIONS AND FUNDS

There are other institutions and funds within the financial system that play important intermediating roles. The institutions include:

Insurance Companies

There are many insurance companies, consisting of life and non-life as well as those, which engage in both activities, and reinsurance firms. They mobilize relatively long-term funds and act as financial intermediaries. Their investments are mainly in government securities and mortgage industry. The Nigerian insurance industry has grown tremendously over the years. The funds were sourced mainly through reduction in outgoing and other assets which together account for 80.8 per cent of total funds. The National Insurance Commission was established to provide insurance cover for insurance companies. In addition, the Commission is expected to assist the government in achieving its economic and social objectives in the field of insurance and re-insurance. All registered insurance companies in Nigeria are required to reinsure 20% of premium collected with the National Insurance

Commission. The potential investors in insurance business should contact Nigerian Insurance Commission (NAICOM) for the licensing procedures.

Finance Companies

Finance companies are institutions that specialise in short-term, non-bank financial intermediation. They mobilise funds from the investing public in form of borrowing and provide, among others, facilities for Local Purchase Order (LPO) and project financing, equipment leasing and debt factoring. The BOFI Act brought finance companies under the direct control and supervision of the CBN.

Bureaux de Change

In order to broaden the foreign exchange market and improve access to foreign exchange, especially for small users, bureaux de change have been authorised since 1989. A total of 240-bureau de changes have been licensed and they are supervised by CBN.

Exchange Control Regulations

Unconditional repatriation of Capital, profit and dividends is allowed, while technical fees and royalties on imported technical services and technologies are payable. Repatriation of proceeds from disposal of assets is allowed. Foreign Exchange transactions are carried out at the Autonomous Foreign Exchange Market.

Primary Mortgage Institutions (PMIs)

Primary mortgage institutions operate within the framework of Act No. 53 of 1989. PMIs mobilize savings for the development of the housing sector. Their total assets/liabilities rose to N7248.2 million in 1999. In reaction to distress in the sector, the Federal Mortgage Bank of Nigeria tightened its surveillance of the institutions by issuing “clean bill of health” to 116 mortgage institutions. The share capital requirement for new primary mortgage institutions in Nigeria has been raised to N20 million (Twenty Million Naira), by the Central Bank of Nigeria (CBN).

Nigerian Social Insurance Trust Fund (NSITF)

The main objective of the Fund is to adopt a more comprehensive social security scheme for Nigerian private sector employees. The scheme was established to replace the defunct National Provident Fund (NPF) as a compulsory pension scheme for non-pensionable public servants and employees in the organised private sector. Nigerian private sector employees are required to contribute 2.5 percent, while their employers are to contribute 5 per cent of the gross monthly emolument to NSTIF. Workers in enterprises employing more than 25 persons are to be automatically registered by their employers.

4.0 CONLUSIONS

The Nigerian financial System has undergone some remarkable changes in recent times. Some of these developments include the promulgation of the Failed Banks (Recovery of Debt) and Financial Malpractice in Banks Decree No. 18 of 1994. This is to facilitate the prosecution of those who contributed to the failure of banks and to recover the debt owed to the failed banks. Another major development was the inauguration of a Financial Services Regulatory Coordinating Committee (FSRCC) by the CBN in 1994. The aim is to coordinate and standardize the regulatory policies of all financial institutions in the system with a view to evolving coherence and comprehensiveness. The CBN also granted forbearance to finance companies operating in Nigeria whereby they were given a maximum of four years to amortize their classified assets portfolio against their current profits.

5.0 SUMMARY

In this unit, the students were able to:

To evaluate the procedures for establishing a bank in Nigeria;

To examine the major participants in the Nigeria Capital Market;

To access the Nigeria Capital Market;

To understand the Nigeria Deposit Insurance Corporation (NDIC);

To understand the Nigeria Securities & Exchange Commission (SEC);

To understand the Debt Management Office (DMO);

To understand the National Insurance Commission (NAICOM); and

The Money Market and its Institutions

6.0 TUTOR MARKED ASSIGNMENT

Discuss the other institutions and funds within the financial system that play important intermediating roles.

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MODULE 3

UNIT 1: THE CONCEPT OF CAPIATAL BASE

CONTENT

1.0. INTRODUCTION

Capitalization is an important component of reforms in the banking industry, owing to the fact that a bank with a strong capital base has the ability to absorb losses arising from non-performing liabilities. Attaining capitalization requirement is achieved through consolidation, convergence as well as the capital market. This unit will also help you to actually understand the Approval under Mergers and Acquisitions, the Procedures for obtaining Approval for Mergers and Acquisitions, the Roles of SEC, CBN, NSE & CAC as Regulatory Authorities in Mergers and Acquisitions, Challenges of Bank Consolidation, the Implication of Consolidation on the Banking Industry and Prospect of Banks after Consolidation

2.0. OBJECTIVES

At the end of this unit, you should be able to:

Explain the Concept of Capital Base;

The position of the Banking Sector before Consolidation for Banks;

The Reform Agenda before Consolidation; and

Benefits of Consolidation and so on.

3.1 The Concept of Capital Base

The recent call for recapitalization in the banking industry has raised much argument among the bank regulators, promoters and depositors as if shoring up of bank's capital base is a new phenomenon in Nigeria. Historically, the failure of Pioneer Z, 1930's and 1940's brought about the enactment of banking ordinance of 1952. Banking ordinance of 1952 prescribed an operating licence and emphasized on minimum equity capital for all banks. Since then, raising of bank capital has become the hallmark response policy of the Nigerian monetary authorities. Capitalization is an important component of reforms in the banking industry, owing to the fact that a bank with a strong capital base has the ability to absorb losses arising from non-performing liabilities (NPL). Attaining capitalization requirement is achieved through consolidation, convergence as well as the capital market. Thus, banking reforms are primarily driven by the need to achieve the objectives of consolidation, competition and convergence.

3.2 The Position of the Banking Sector before Consolidation

There was existence of eighty-nine (89) banks predominantly in the urban centres as at June 2004, Characterized by structural and operational weakness of low capital base. Dominance of a few banks insolvency, and illiquidity over dependence on public sector deposits, and foreign exchange, trading. Poor asset quality, weak co-operate governance, a system with low depositor confidence. Banks that could not effectively support the real sector of the economy at 24 percent of GDP compared to African average of 87 and 272 percent for developed countries.

Furthermore the vision of consolidation amongst others includes becoming Africa's financial centre and CBN as one of the best in the world. Within ten years, Nigerian bank(s) should be among the top 50 0f the 100 banks in the world. Facilitate evolution of a strong of a save and strong banking system. Improve transparency and accountability in the sector. Drive down the cost structure of banks and make them more competitive and development oriented. A new banking system that depositors can trust and investors can rely upon to usher in a new economy.

3.2.1 The Reform Agenda for Consolidation for Banks

- Recapitalization of banks to 25 billion naira share holders fund by December 31 2005.
    - Zero tolerance on misreporting and infarctions.
    - Stricter enforcement of corporate governance principles.
    - Policy framework on Risk Management systems.
    - Strengthening risk management systems in banks.
    - Risk based supervision.
    - Payment system Reforms.
    - Closer collaboration with the Economic and Financial Crimes Commission (EFCC) in the establishment of the Financial

Intelligence Unit (FIU) and enforcement of anti money laundering measures.

- Some element of reform, to strengthened, Universal, banks.

Self – Assessment Exercise 1

Explain the Reform Agenda before Consolidation

3.2.2 Benefits of Consolidation

The consolidation program has fundamentally changed the nature of competition, in the banking industry, in Nigeria. Through the new minimum capital requirement, the number of banks in the country has been successfully reduced from eighty-nine to twenty-five. The policy has also effectively raised entry barriers for those wishing to start banking business.

There are many benefits attached to the consolidation of the Nigerian banking sector, and the Nigerian banks stand to gain a lot from them. Some of the benefits are:

- Emergence of 25 banks through consolidation (compare to 89 banks before consolidation). Successful banks accounted for about 93.5% of aggregate deposit liabilities
- More effective supervision focus on fewer (25) banks rather than 89 mostly sick banks. No more wholly regionally/ ethnically based banks
- Strong capital is a basic indication of solvency, and it will take a while along with careless risk for any of the newly capitalized banks to walk its way into insolvency
- The consolidation provides a vehicle for taking out the weak banks in the system in an orderly manner
- The consolidation will improve profitability and operational efficiency of banks.

- The expansion of the shareholding base of Nigeria banks, thus eliminating the phenomenon of 'family banks' and the tendency for poor corporate governance.
- The Nigeria economy will be stronger and better capitalized to finance the long term development projects in different spheres of the economy and businesses.
- Banks will also invest in infrastructure development, good business enterprises and moreover, support entrepreneurship.
- Banks will invest heavily in training and development of manpower.
- Enhanced liquidity and capitalisation of stock market
- Aggregate capitalisation of banks as a share capitalisation rose from 24% to 38%.

Self – Assessment Exercise 2

Discuss the Benefit of Consolidation

3.2.3 The Concept of Consolidation

Consolidation is view as the reduction in the number of banks and other deposit taking institution with a simultaneous increase in the size and concentration of the consolidation entities in the sector. It is mostly motivated by technology innovation, deregulation of financial services, enhancing intermediation and increased emphasis on shareholder value, privatization and international competition.

The process of consolidation has been argued to enhance bank efficiency through cost reduction revenue in the long run. It also reduces industry's risk by elimination weaker banks and acquiring the smaller ones by bigger and stronger banks as well as creates opportunities for greater diversification and financial intermediation.

The pattern of banking system consolidation could be view in two different perspectives, namely; market-driven and government-led consolidation. The market-driven consolidation which is more pronounced in the developed countries sees consolidation as a way of broadening competitiveness with added comparative advantage in the global context and eliminating excess capacity more efficiently than bankruptcy or other means of exit.

On the other hand, government-led consolidation stems from the need to resolve problem of financial distress in order to avoid systematic crises as well as to restrict inefficient banks. One of the general effects of consolidation is to the reduction in the number of players, moving the industry more toward an oligopolistic market.

3.2.4 The Reason for Consolidation

The inability of the Nigeria banking system to voluntarily embark on consolidation in line with global trend has necessitated the need to consider the adoption of appropriate legal and supervisory framework as well as a comprehensive incentive package to facilitate to consolidation in the banking industry, both as a crisis resolution option and to promote soundness, stability and efficiency of the system by the apex regulatory body of the banks in Nigeria, (Soludo, 2004:4).

The major objective of the banking system is to ensure price stability and facilitate rapid economic development. Regrettably, these objectives have remained largely unattained in Nigeria as a result of some deficiencies.

These include:

- Technological drive: A bank desirous of enhancing its operations but constrained by its inability to easily access the needed technology may be driven into merging with another which has the technological advantage over it

- Desire for growth: A merger arrangement may be entered into by a bank with a view to harnessing the other bank to achieve the desire growth.
- Poor rating of number of banks: though the banking system in Nigeria is, on the average, rated satisfactory, a detailed analysis of the condition of individual banks, as at December, 2004, showed that no bank was rated very sound only 10 were adjudged sound 51 satisfactory, 61 marginal and 10 unsound.
- Low capital Base: The average capital base of Nigeria banks is US$10milion, which is very low compare to that of banks in other developing countries like Malaysia where the capital base of the smallest bank is US$526million. Similarly the aggregate capitalisation if the Nigeria banking system at 311million naira (US$2.4million) is grossly low in relation to the size of the Nigeria economy and in relation to the capital base of US$688billion for a single banking group in France US$541billion for a bank in Germany. (CBN 2004: 17)
- Stock Exchange Quotation: Business combination could be motivated by the desire for stock exchange listing. In this case, a bank unable to meet the requirement of the stock exchange, but desirous of public quotation may integrate with another bank in order to realize its goal.
- Increased Market Share: Consolidation (Mergers and Acquisition) may be compelled by the desire banks that have similar line of product to enlarge its market share after the merger.

In addition to the above inadequacies, the Nigeria banking system suffers the following operational problems:

- Weak corporate governance, evidence in inaccurate and non-compliance with regulatory requirement, declining ethics and gross insider abuse resulting in huge non-performing insider related credits.

- Over-dependence on public sector deposits and foreign exchange trading and neglect of small and medium scale private savers.

Self – Assessment Exercise 3

Elaborate on the Reasons behind Banking Consolidation

3.3. Bank Consolidation through Merger & Acquisition

Consolidation is achieved through merger and acquisition. A merger is the combination of two or more separate firms into a single firm. The firm that results from the process could take any of the following identities: Acquirer target or new identity.

Acquisition on the other hand, takes place where a company takes over the controlling shareholding interest of another company. Usually, at the end of the process, there exist two separate entities or companies. The target company becomes either a division or a subsidiary of the acquiring company (Pandey, 2005:885).

While consolidation involves merger and acquisition of banks, convergence involves the consolidation of banking and other types of financial services like securities and insurance.

Anecdotal evidence indicates that the commonest form of mergers and acquisitions found in the financial services industry involves domestic firms competing in the same segment (for instance, bank to bank). The second most common type of merger and acquisition transactions involves domestic firms in different segments (e.g. bank-insurance firms). Cross-border merger and acquisition are less frequents particularly those involving firms in different industry segments.

3.3.1 Approval under Merger and Acquisition

Before any bank can be said to consolidate through merger and acquisition in the Nigeria industry, it must first seek and obtain the approval of the following regulatory and supervisory authorities in the industry. They include the Securities and Exchange Commission (SEC), Central Bank of Nigeria (CBN), Nigeria Stock Exchange (NSE) and the Corporate Affairs Commission (CAC).(CBN 2004).

3.3.2 Procedures for obtaining Approval for Mergers and Acquisitions

The Company and Allied Matter Act (CAMA 1990) and The Investments and Securities Act (ISA 1999) provide the primary legal provision for effecting Merger and Acquisitions in Nigeria. This provision vested the power to review and give approval to Securities and Exchange Commission (SEC). Before granting its approval, SEC considers the effect of the proposed transaction on the competitive environment, with a view to ensure that the transaction does not restrain competition or create a monopoly. The procedure or process for obtaining approval for mergers and acquisitions entail four (4) basic steps:

- Filling a Pre-Merger/Acquisition notification
- Filling a formal application for approval of the

Proposed Merger/Acquisition.

- Hold a Court Order Meetings
- Complying with post-approval requirements

3.3.3 The Role of SEC, CBN, NSE, and CAC as Regulatory Authorities in Mergers and Acquisitions

Securities and Exchange Commission (SEC):

The Nigeria law provides that every merger, acquisition or business combination between or among companies shall be subject to the prior review and approval of the Security and Exchange Commission (SEC), (ISA 1999:599(2). Subsection 3 of the said section 99 provides that the commission shall approve any application made under that section if and if only the commission finds that "it is not likely to cause a substantial competition or trend to create a monopoly in any line of business enterprise" or "use of such shares by voting or granting of proxies". It should be noted that both mergers and acquisitions requires SEC approval on monopoly. Worthy of note is that monopoly consideration is a pre-merger issue. There is no need to commerce the merger process if at the end or in the middle of the process SEC will refuse approval on the basis that the combination will inhibit competition. It is therefore important to seek a pre-merger approval should SEC. The application for pre-merger approval should include information on history and business of the combing companies as well as their market.

Apart from pre-merger approval on issues relating to monopoly, SEC has to approve the scheme after a court session and holding of court- sanctioned meetings. The role of SEC in this regard is quite different from the pre-merger approval. At this stages SEC will play its traditional role of regulation to ensure compliance by the parties with disclosure and good corporate governance requirement of the law. The role of SEC is not to be a participant but to create the enabling environment for parties to play in affair market situation.

Central Bank of Nigeria (CBN) Approval:

Banks and other financial institutions Act (Bofid) 1991 and the CBN Act of 1991, the CBN has enormous powers to regulate banks including approval of consolidation of banks and changes in the structure and management of any bank. It follows that in view of the world powers of the CBN, it is advisable that pre-merger approval of CBN be obtained prior to commencement of the process consolidation. The pre-merger approval for merger and acquisition would be required to undergo three stages of approval namely, pre-merger consent from the CBN, approval – in- principle and final approval. Also, it is imperative that CBN approval be sought and obtained to the scheme document, shareholders agreement, new memorandum and articles of association implementing shareholders agreements, if any.

During implementation process, every structural management action would be subject to CBN approval. These would include reorganization, staff rationalization, name approval, branch rationalization, head office etc.

Nigeria Stock Exchange (NSE) Approval:

The approval of the Nigeria stock exchange is necessary if the merged company is to be a public limited liability company and desires listing on the exchange or some of the merging companies are listed on the exchange. During the merger period the NSE is like place of listed parties to the merger or technical suspension to prevent unfair trading and protect those companies.

Corporate Affairs Commission (CAC) Approval:

Essentially from the legal point of view the CAC has merely a ministerial role to play in mergers and acquisitions.

It is the custodian of company documents; therefore most of the processes end up with the CAC for proper custody. This is done through statutory returns. Certificates of incorporation will eventually be returned and a new one issued for the merged company. The share capital may have to be increased substantially. Also, returns of allotment will have to be filed. Some of these processes involve payment of substantial sums in stamp duties and filling fees. It is therefore imperative that these costs be anticipated.

Although the CAC has a purely ministerial role in regulation of mergers and acquisitions, improvement in its technology and some service delivery means that, it is more able to track defaulting companies and this can slow down the process for companies involved in the merger process whose returns at CAC is not up to date. Defaulting companies may have to pay substantial penalties.

3.4 Challenges of Bank Consolidation

The challenges identified in this research work cut across the banks, their shareholders, bank employees and other stakeholders in the banking industry.

It is an established fact that the route to improving efficiency in any industry is to foster competition among the operators. This is evident in two important growth sectors of the Nigeria economy- aviation and telecommunications over the last one decade. A major challenge of bank consolidation is how to foster competition with fewer mega banks.

Certainly, fewer cannot be more competitive. There is however, the other side to the argument, which considers the number and spread of bank branches. The fewer banks are likely to be pressured to expand further, seeking business opportunities through aggressive branding to hitherto unexplored territories.

There is ample evidence that this is the direction that the emerging banks in Nigeria are likely to follow, going by the indications in their capital raising information memorandum. International evidence in bank consolidation also confirms this except that it is more in the context of cross boarder acquisitions.

One of the supposed benefits of consolidation (Bigger Banks) is indeed and efficiency challenge. The argument has been that bigger banks might not necessarily be filter or more efficient, since they have no incentive to improve efficiency within the limited competitive field. Observers of Nigerian banking have noted that the big banks (perhaps because of the increase in the number of customers) have slipped back to their erstwhile habits before the advent of the new generation banks.

Another major challenge of consolidation is capacity building for risk management for both the regulators and operators. Both constituencies of the bank system need to enhance their risk management skills and indeed acquire new ones, covering the three plant of risk recognition, evaluation and monitoring.

3.4.1 The Implication of Consolidation on the Banking Industry

The directive by the Central Bank that, banks should raise their capital base to the tune of N25 billion several implications for both the banking industry and the Nigerian economy at large. These implications are as follows: with respect to the banking industry, the implications can be categorized into two parts namely; brand and structural implications.

(I) BRAND IMPLICATION: With regards to branch implications, the new entities that will come from the dust of consolidation will need to deal with brand-related issued such as:

- There will be a change of name if two or more banks come together and decide not to adopt any of the participating bank name.
- The logos which were formally used by each of these banks will be dropped and another one adopted.
- There will also be the evolution of a new brand culture for the emerging banks after consolidation.

- The brand message of the consolidated banks will also be changed.

- The place of information communication technology (ICT) in the bank will be changed, that is, banks software as the new banks will go for the best to meet up customers demand.

(II) STRUCTURE IMPLICATION: The recapitalization of banks will leave in its wake, a number of structural issues which will have direct impact on staff, customers and the entire banking sector. They include:

- The reduction in the number of banks in the country
- The closure of many small banks, especially those in the rural areas with poor capital deposit.
- Increased competition due to better incentives and rendering of banks services.
- Acquisition digestion issues which will include loss of jobs, consolidation of branch locations and tackling of inefficiencies and bureaucracies. Reconstitution of management and board of the banks.

3.4.2 Prospect of Banks after Consolidation

- The initial public offering by banks through the capital market when completed is likely to increase the level of financial deepening as evidenced in the upsurge in the volume and value of trading in stock market.
- The reform in the banking industry has been able to attract more foreign investment inflow, especially in the area of portfolio investment; this development if sustained will boost the level of economic activity especially toward non oil sector.

- The consolidation of banks is likely to attract a significant level of foreign banks entrance into Nigeria which will become a feature in the industry over time. This will bring about more confidence by the international community of the banking sector thereby attracting more foreign investment into the country. As the level of financial intermediation increase, interest rate is likely to fall and increase lending to the real sector that will generate employment and booster growth.

4.0. CONCLUSION

The vision of consolidation amongst others includes becoming Africa's financial centre and CBN as one of the best in the world. Within ten years, Nigerian bank(s) should be among the top 50 0f the 100 banks in the world. Facilitate evolution of a strong of a save and strong banking system. Improve transparency and accountability in the sector. Drive down the cost structure of banks and make them more competitive and development oriented. A new banking system that depositors can trust and investors can rely upon to usher in a new economy.

5.0. SUMMARY

In this unit, we have learned about;

i. The concept of Capital Base;

ii. The Benefit of Consolidation;

iii. The Reasons for Consolidation;

iv. The Challenges and Implication of Consolidation; and

v. The Prospects of Consolidation;

6.0. TUTOR-MARKED ASSIGNMENT

What are the Role of SEC, CBN, NSE, and CAC as Regulatory Authorities in Mergers and Acquisitions

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UNIT 2: BANKING REFORMS AND ITS IMPACT ON THE NIGERIA ECONOMY

CONTENT

1.0 INTRODUCTION

Banking Reforms in Nigeria and Its Impact on the Economy, As you may all be aware, the banking sector in Nigeria has recently witnessed significant reforms and hard choices have had to be made to tackle the lingering effects of the global financial crisis, which culminated in the contraction of some banks' balance sheets with the attendant economic losses. You are expected to note that these problems have been surmounted through series of reforms undertaken by the Central Bank of Nigeria.

2.0. OBJECTIVES

At the end of this unit, you should be able to:

Know the Banking Reforms and its impact on the Nigeria Economy;

Rationale for Banking Reforms in Nigeria;

Critical Elements of Banking Reform in Nigeria;

Impact of the Banking Reform; and so on.

3.0 MAIN CONTENT

3.1 Banking Reforms in Nigeria and Its Impact on the Economy

Generally, the financial system is more than just institutions that facilitate payments and extend credit. It encompasses all functions that direct real resources to their ultimate user. It is the central nervous system of a market economy and contains a number of separate, yet co-dependent, components all of which are essential to its effective and efficient functioning. These components include financial intermediaries such as banks and insurance companies which act as principal agents for assuming liabilities and acquiring claims. The second component is the markets in which financial assets are exchanged, while the third is the infrastructural component, which is necessary for the effective interaction of intermediaries and markets.

The three components are inextricably intertwined. Banks need payments system infrastructure to exchange claims securely and markets in which to hedge the risks arising from their intermediation activities. The banking system therefore functions more efficiently and effectively when there is a robust and efficient payments systems infrastructure. Moreover the concern to ensure a sound banking system by the Central Bank is underscored by the critical role of banks in national economic development. Banks for instance, mobilizes savings for investment purposes which further generates growth and employment. The real sector, which is the productive sector of the economy, relies heavily on the banking sector for credit. Government also raises funds through the banking system to finance its developmental programmes and strategic objectives. It is in view of these strategic roles of the banking system to national economic development that the issue of a sound banking system, through proactive reforms becomes imperative.

Self – Assessment Exercise 1

Explain the Banking Reforms in Nigeria and Its Impact on the Economy

3.2 Rationale for Banking Reforms in Nigeria

Conceptually, economic reforms are undertaken to ensure that every part of the economy functions efficiently in order to ensure the achievement of macroeconomic goals of price stability, full employment, high economic growth and internal and external balances. Thus, banking reform in Nigeria is an integral part of the country-wide reform program undertaken to reposition the Nigerian economy to achieve the objective of becoming one of the 20 largest economies by the year 2020. As part of the vision, the banking sector is expected to effectively play its actual role in intermediation and for the banks to be among global players in the international financial markets. However, the various reforms we undertook in Nigeria were targeted at making the system more effective and strengthening its growth potentials. In view of the fact that banks take deposits from the public, there is a need for periodic reforms in order to foster financial stability and confidence in the system. The recent experience from the global financial crisis has further underscored the imperatives of countries to embark on banking reforms on a regular basis. As you are all aware, the world economy was hit by an unprecedented financial and economic crisis in 2007-2009 that resulted in a global recession. This crisis led to the collapse of many world-renowned financial institutions and even caused an entire nation to be rendered bankrupt.

In Nigeria, the economy faltered and was hit by the second round effect of the crisis as the stock market collapsed by 70 per cent in 2008-2009 and many Nigerian banks sustained huge losses, particularly as a result of their exposure to the capital market and downstream oil and gas sector. Therefore, the CBN had to rescue 8 of the banks through capital and liquidity injections, as well as removal of their top executives and consequent prosecution of those who committed some infractions.

These actions became necessary to restore confidence and sanity in the banking system. A holistic investigation into what went wrong in Nigeria leading up to the banking crisis in 2008 found eight interrelated factors responsible. These were macroeconomic instability caused by large and sudden capital inflows, major failures in corporate governance at banks, lack of investor and consumer sophistication, inadequate disclosure and transparency about the financial position of banks, critical gaps in the regulatory framework and regulations, uneven supervision and enforcement, unstructured governance & management processes at the CBN/ and weaknesses in the business environment. Each of these factors is serious in its own right. Acted together they brought the entire Nigerian financial system to the brink of collapse.

We all know that a well-functioning financial system matters to everyone and to the economy at large. The Nigerian economy has huge potential for growth. To realize this potential, it is imperative that we learn lessons from the crisis and take steps to not only fix the problems, but to also introduce measures to establish financial stability, a healthy evolution of the financial sector and ensure the banking sector contributes to the development of the real economy. As a result, the Nigerian banking system has steadily evolved, following wide and far-reaching reforms embarked upon by the regulatory authorities. Following the banking crisis of 2008, the Central Bank of Nigeria articulated a blue print known as ***"The Project Alpha Initiative"*** for reforming the Nigerian financial system in general and the banking sector in particular. The reforms aimed at removing the inherent weaknesses and fragmentation of the financial system, integrating the various ad-hoc and piecemeal reforms and unleashing of the huge potential of the economy.

Self – Assessment Exercise 2

What is the Rationale for Banking Reforms in Nigeria?

3.2.1 Critical Elements of Banking Reform in Nigeria

The current reforms which began in 2004 with the consolidation programme were necessitated by the need to strengthen the banks. The policy thrust at inception, was to grow the banks and position them to play pivotal roles in driving development across the sectors of the economy. As a result, banks were consolidated through mergers and acquisitions, raising the capital base from N2 billion to a minimum of N25 billion, which reduced the number of banks from 89 to 25 in 2005, and later to 24.

Beyond the need to recapitalize the banks, the regulatory reforms also focused on the following:

- Risk-focused and rule-based regulatory framework;
- Zero tolerance in regulatory framework in data/information rendition/reporting and infractions;
- Strict enforcement of corporate governance principles in banking;
- Expeditious process for rendition of returns by banks and other financial institutions through e-FASS;
- Revision and updating of relevant laws for effective corporate governance and ensuring greater transparency and accountability in the implementation of banking laws and regulations, as well as;
- The introduction of a flexible interest rate based framework that made the monetary policy rate the operating target. The new framework has enabled the bank to be proactive in countering inflationary pressures. The corridor regime has helped to check wide fluctuations in the interbank rates and also engendered orderly development of the money market segment and payments system reforms, among others.

The Bank has over the years identified key priority sectors and developed tailored interventions to support and promote their growth. Some of the key interventions in the real sector include:

- N200 Billion Refinancing/Restructuring of SME/Manufacturing Fund
- N300 billion for long term funding of Power and Aviation
- Commercial Agricultural Credit Scheme (CACS)
- The Small and Medium Enterprises (SME) Credit Guarantee Scheme (SMECGS)
- In addition the Nigerian Incentive-Based Risk Sharing System for Agricultural Lending (NIRSAL) was established. The programme is a demand-driven credit facility that would build the capacity of banks to engage and deliver loans to agriculture by providing technical assistance and reducing counterparty risks facing banks. It also seeks to pool the current resources under the CBN agricultural financing schemes into different components of the programme.

Furthermore, the Bank has been collaborating with the Securities and Exchange Commission (SEC) and the Nigerian Stock Exchange (NSE), to reduce the cost of transactions, particularly bond issues, so as to diversify funding sources away from banks as well as attract more foreign portfolio investors into the sector. In 2010, the Asset Management Corporation of Nigeria (AMCON) was established following the promulgation of its enabling Act by the National Assembly. It is a special purpose vehicle aimed at addressing the problem of non-performing loans in the Nigerian banking industry, among others. In line with its mandate, AMCON recently acquired the non-performing risk assets of some banks worth over N1.7 trillion, which is expected to boost their liquidity as well as enhance their safety and soundness. With the intervention of AMCON, the banking industry ratio of non-performing loans to total credit has significantly reduced from 34.4 per cent in November 2010 to 4.95 per cent as at December 2011.

In order to ensure that AMCON achieves its mandate, the CBN and all the deposit money banks have signed an MOU on the financing of AMCON. The CBN shall contribute N50 billion annually to AMCON, while each of the participating banks shall contribute an amount equivalent to 0.3 per cent of its total assets annually into a sinking fund as at the date of their audited financial statement for the immediate preceding financial year. Therefore, the cost of the resolution to the Nigerian taxpayer is significantly minimized. To further engender public confidence in the banking system and enhance customer protection, the CBN established the Consumer and Financial Protection Division to provide a platform through which consumers can seek redress. In the first three months of its operation, the Division received over 600 consumer complaints, which was a manifestation of the absence of an effective consumer complaints resolution mechanism in the banks. The CBN has also issued a directive to banks to establish Customer Help Desks at their head offices and branches.

In addition, the CBN has commenced a comprehensive review of the Guide to Bank Charges with a view to making the charges realistic and consumer friendly. The CBN has taken steps to integrate the banking system into global best practice in financial reporting and disclosure through the adoption of the International Financial Reporting Standards (IFRS) in the Nigerian banking sector by end-2010. This should help to enhance market discipline, and reduce uncertainties, which limit the risk of unwarranted contagion.

The Universal Banking (UB) model adopted in 2001, allowed banks to diversify into non-bank financial businesses. Following the consolidation programme, banks became awash with capital. Some operators abused the laudable objectives of the UB Model with banks operating as private equity and venture capital funds to the detriment of core banking practices. To address the observed challenges, the CBN reviewed the UB Model with a view to directing banks to focus on their core banking business only.

Under the new model, licensed banks will be authorized to carry the following types of business:

i. Commercial banking (with either regional, national and international authorization);

ii. Merchant (investment) banking;

iii. Specialized banking (microfinance, mortgage, non-interest banking (regional and national); and

iv. Development finance institutions.

The introduction of the non-interest banking in Nigeria is expected to herald the entry of new markets and institutional players thus deepening the nation's financial markets and further the quest for financial inclusion. In fact, the first fully licensed non-interest bank in the country (Jaiz Bank Plc.) started business on Friday, January 6, 2012. Similarly, the importance of Microfinance in a growing economy cannot be over-emphasized, given its potential in addressing the challenges of excluding a large population from full participation in economic activities. As at December 2011 there were 24 deposit money banks with 5,789 branches and 816 microfinance banks bringing the total bank branches to 6,605. The ratio of bank branch to total population is 24,224 persons, indicating a high level of financial exclusion. This is further substantiated by the 2010 Enhancing Financial Innovation and Access (EFInA) survey, which observed that 46.3 per cent of Nigeria's population is still financially excluded compared to South Africa, Kenya, Botswana with 26.0 per cent, 32.7 per cent and 33.0 per cent, respectively. Thus, in 2012 the Bank is looking to establish a Microfinance Development Fund (MDF) aimed at improving access to affordable and sustainable sources of finance by Microfinance Institutions (MFIs) and Microfinance Banks (MFBs). It would have both commercial and social components. This would enhance their operations and outreach and support the capacity building activities of the MFBs/MFIs.

The Bankers' Committee has declared 2012 the year of "Women Empowerment" in the banking industry. A sub-committee on Women Empowerment has been formed, with the CEO of Standard Chartered Bank Nigeria as Chairperson. The CBN is working on establishing a special fund by the end of the year that would provide credit facilities to women at a single digit interest rate. The CBN is also working with banks to ensure that a certain percentage of senior management and board seats are reserved for women. The Bank recently introduced a new policy "Cash less Policy" as part of ongoing reforms to address currency management challenges in Nigeria, as well as enhance the national payments system. As may be aware the Nigerian economy is heavily cash-oriented in the transaction of goods and services. This huge cash transaction increases the operational costs of the banking sector, which is passed on to the customers in the form of higher service charges and high lending rates. These operational costs are significant due to the high cost incurred in cash management, currency sorting, cash movements and frequent printing of currency notes.

The direct cost of cash management to the banking industry is estimated to be about N192 billion by 2012. Research has shown that about 90 per cent of withdrawals by bank customers' are typically below N150,000 whereas, only 10 per cent of bank customers who withdraw over N150,000 were responsible for the rise in cost of cash management being incurred by the generality of bank customers. There are also risks involved in keeping or moving large amounts of cash, namely the high incidence of robberies, encouraging corrupt practices and the public's propensity to abuse and mishandle currency notes.

The CBN, in collaboration with the Bankers' Committee, aims to achieve an environment where a higher and increasing proportion of transactions are carried out through cheques and electronic payments in line with global trends. The enforcement of the T+2 cheque clearing cycle is being stepped up and efforts are on-going to reduce the cycle to T+1. Anybody can now make payments of up to N10 million through the clearing system with a cheque.

The CBN recognizes the need to balance the objectives of meeting genuine currency transaction demand and combating speculative market behavior that may negatively affect economic growth and stabilization measures. The new cash withdrawal policy will ensure that a larger proportion of currency in circulation is captured within the banking system, thereby enhancing the efficacy of monetary policy operations and economic stabilization measures.

The policy does NOT in any way stop account holders from withdrawing any amount of money they desire from their accounts. The policy simply recognizes that banking is a business and, as with any business, there are costs that are sometimes shared between the business and the customers. The policy stipulates that to withdraw more than N150,000 (for individual account holders) and more than N1,000,000 (for corporate account holders), there will be a transaction cost.

The various measures notwithstanding, there was need for some intervened banks to merge in order to strengthen their capital base and to remain competitive in the market. Accordingly, five Transactions Implementation Agreements (TIAs) were signed among the banks, and the CBN issued a letter of no objection to the banks being acquired to proceed with the merger of the entities. The signing of legally binding TIAs for the five (5) banks and the full capitalization of the 3 new banks by AMCON had resolved the issue of the combined negative asset value of the eight

CBN intervened banks. Similarly, the recapitalization of all the five banks that signed TIAs was completed in 2011.

Self – Assessment Exercise 3

Discuss the Critical Elements of Banking Reform in Nigeria

3.3 Impact of the Banking Reform

The current banking reforms have yielded the following results among others:

i. The reforms have brought about a new mindset to the industry as banks are putting in place best practices in the areas of corporate governance and risk management. Transparency and public disclosure of transactions have remarkably improved.

ii. A number of banks have returned to the profit-making path and improved their balance sheets, as the recent results of their financial statements have shown.

iii. Banks are gradually resuming lending to the private sector with the additional liquidity of more than N1.7 trillion injected into the banking system through the issuance of AMCON bonds, and significant progress in re-directing credit to the power sector and SMEs at single digit interest rates. These initiatives have saved and helped create thousands of jobs in the economy.

iv. A new code of corporate governance has been issued by the Bank. The CEO of banks shall serve a maximum tenure of 10 years. Furthermore, all CEOs who would have served for 10 years by July 31, 2010 ceased to function in that capacity and have handed over to their successors.

v. Nigerian Banks are now key players in the global financial market with many of them falling within the Top 20 banks in Africa and among Top 1000 banks in the world.

vi. The reform has culminated in moderating the spread between the lending and deposit rates to 9.7 per cent as at end-December 2011, from 12.2 per cent in 2010. This has contributed to the existing macroeconomic stability in the economy with inflation moderating to 10.3 per cent as at end-December 2011.

vii. The hitherto volatility in the exchange rate witnessed in the foreign exchange market has been brought under control. The premium is within the international standard of 5.0 per cent.

4.0 CONCLUSION

In conclusion, the banking system functions more efficiently and effectively when there is a robust and efficient payments systems infrastructure. Moreover the concern to ensure a sound banking system by the Central Bank is underscored by the critical role of banks in national economic development. Banks for instance, mobilizes savings for investment purposes which further generates growth and employment. The real sector, which is the productive sector of the economy, relies heavily on the banking sector for credit. Government also raises funds through the banking system to finance its developmental programmes and strategic objectives.

5.0. SUMMARY

In this unit, we have learned about;

The Banking Reforms and its impact on the Nigeria Economy;

Rationale for Banking Reforms in Nigeria;

Critical Elements of Banking Reform in Nigeria;

Impact of the Banking Reform; and so on.

6.0. TUTOR-MARKED ASSIGNMENT

What are the Impacts of the Banking Reforms

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UNIT 3: PHASE OF BANKING SECTORS REFORMS

CONTENT

1.0 INTRODUCTION

This unit would focused more emphasizes on the Phase of Banking Sectors Reforms, by looking at the four (4) phases. Also addresses the bank's capital adequacy regulation, that further evaluate a quantum of fund, which a financial institution should have and plan to maintain in order to conduct its business in a prudent manner and the amount of capital that can effectively discharge the primary function of preventing banking industries failure by absorbing losses and other approaches to re – capitalization and bank capital profitability.

2.0. OBJECTIVES

At the end of this unit, you should be able to:

Examine the Phase of Banking Sectors Reforms;
Evaluate the Banks Capital Adequacy Regulation;
Identify approaches to Re-capitalization; and
Understand Banks Capital and Profitability.

3.0 MAIN CONTENT

3.1 Phase of Banking Sectors Reforms

A review of development in the Nigeria banking sector indicate some remarkable changes over the years, in term of the number of institutions, ownership structure, as well as the scale of operation driven largely by deregulation of the financial sectors in line with the global trend (Ogunleye, 2005). Four phase have of financial reforms have been identified in the literatures (see Balogun, 2007, Ogunleye, 2005 for review).

(1) The first is the financial system reforms of 1986 to 1993 which lead to the deregulation of the banking industry that hitherto was dominated by indigenized bank that had over sixty percent federal and state government stakes in addition to credit interest rate and foreign exchange policy reforms.

(2) The second phase began in the late 1993-1998 with reintroduction of regulation. During this regime the banking sectors suffered deep. Financial distress which called for another round of reform designed to manage the distress.

(3) The third phase began with the advent of civilian democracy in 1999 which saw the return ton liberalization of the financial sector accompanied with the adoption of distress resolution programmers. This era also saw the introduction of universal banking which empowered the bank to operate in all aspect of retail banking and nonbanks financial market.

(4) The fourth phase usually regarded as consolidation phase began in 2004 to date and it is informed by the Nigeria monetary authorities

who asserted that financial system was characterized by structural and operational weaknesses and that their catalytic role in promoting private sector driven growth could be further enhanced through a more pragmatic reforms.

According to Ogunleye (2005) the consolidation of the banking forms as follow up to the recommendation policy involves either a combination of exiting banks or exit from the weak bank. The consolidation take the form of merger and acquisition which became necessary because of the fundamental problem in the industry which includes among other significant asset quality problem, under capitalization of a number of industry players ,significant corporate governance issues, delay in or non publication of annual account, inadequate risk management practice ,over dependence on public sectors deposit and neglect of small and medium scale enterprises by the system.

Self – Assessment Exercise 1

Discuss the Phase of Banking Sectors Reforms

3.2 Banks Capital Adequacy Regulation

The imposition by regulators of minimum capital standards on financial institution was one important development in the 20th century. Most banks regulators see capital adequacy regulation as a means of strengthening the safety and soundness of the banking industry. There are three arguments for capital adequacy regulation. The first is that capital adequacy regulation is needed for prudential reasons, but most advocates of this position take the argument no further to explain why prudential "need" is there in the first place (Patricial and Jackson,1999). The second argument is that capital adequacy regulation is needed to counter moral hazard problems created by the regulator themselves (Benston and Kaufman, 1996). The third and final argument is that capital adequacy regulation is needed to protect small depositors.

Capital adequacy by definition is seen as a quantum of fund, which a financial institution should have and plan to maintain in order to conduct its business in a prudent manner (Kishore 2005; Pandey 2005). Adequate capital is regarded as the amount of capital that can effectively discharge the primary function of preventing banking industries failure by absorbing losses. It is seen as a way of providing the ultimate protection against insolvency arising from the risk in banking sector. It is the least amount necessary to inspire and sustain confidence in the banks, keep it open and operating so that time and earnings can absorb losses without being forced into costly liquidation and enable banking industry to take full advantage of its profitable growth opportunities (Akintoye and Somoye 2008). It is to be expected that firm value can be enhanced by judicious use of equity and borrowed capital. Thus, the enhanced capitalization of insurance industry been called for by regulatory authorities provides an opportunities for banks to attain desired optimal structure for the purpose of increasing market value and shareholders wealth. Their efforts are geared towards protecting depositors from banks and insurance industry fragility and failure (NDIC, 2006). It should be borne in mind that the type of recapitalisation envisaged should improve banks performance by ensuring solvency and profitability as well as enhancing financial intermediation capacity.

Self – Assessment Exercise 2

Explain the Banks Capital Adequacy Regulation

3.2.1 Approaches to Re-capitalization

The various approaches to recapitalization have been identified to be raising additional capital from existing or new owners that it's:

1. Using laundered financial resources (capital market) or raising capital using insurance fund;
2. Reduce liabilities (write down certain debt);

3. Book value of an asset; and
4. Right issues for existing shareholders and capitalisatioin of profits;
5. Public offer through the capital market and /or private placement, Merger & Acquisition, and a combination of the identified strategies Adeyemi (2006).

Banks Capital and Liquidity

The study of relationship between banks capital and liquidity level is becoming more relevant because many organizations in the recent past had fallen a victim of premature liquidation as a result of inadequate attention to the management of insurance capital from the management of the affected firm.

Jennings (1993) explained liquidity as the ease with which a firm can turn its current asset into cash. Pandey (2005) defined liquidity as the ability to realize value in money, the most liquid of asset. Every business firm requires capital though they differ in their degree of requirement. Hence, it can be said that capital is vital for business survival (Oke 2006) and Gale (2010) described it as the effective blood of any business. Somoye (2008) opined that linear relationship subsists between liquidity and profitability of a firm in timely disbursements to the various stakeholders before they can enjoy smooth operation needed to reach the desired goals.

Akinshulire (2005) explained that there must be trade-off between how a firm maintains its liquidity position and its profitability position as well. He opined that to make more profit, an organization is likely to be short of liquid assets. Conversely, in order to retain more liquid fund in the company’s capital structure, the profitability objective might be impaired. The financial statement coming out as output from the accounting process needs to be analyzed by the management of the firm or by outsiders in order to make certain deduction about the strengths, weakness and potential of the insurance industry. The key to management of capital, as explained by Kihore (2005), Pandey (2005) is striking a balance between risk and profitability.

They opined that when cash comes into a business and it actually leaves the business is not a matter of interpretation but a matter of fact notwithstanding the records or accounting system in operation. All items of expenditure including those that are ultimately profitable reduce the company's liquidity in the short term. Akinshulire (2005) explained that analysis of liquidity needs the preparation of cash budget and cash flow statement to facilitate establishment of relationship between cash and other current assets to current obligations thus providing a quick measure of liquidity. The most common ratio, which indicate the extent of liquidity or lack of it are current ratio and quick asset ratio. Current ratio measures the relationship between current asset and current liabilities and is designated as current asset/ current liabilities. On the other hand, quick asset ratio indicates the relative amount of cash and assets that can be quickly converted into cash available to meet short term liabilities. For these purpose, only liquid asset are considered. Therefore, stocks are deducted from the current assets. It is formulated as: current asset – stock / current liabilities (Jennings 1993, Akinsulire 2005, Soyode 2008).

3.2.2 Banks Capital and Profitability

Contrary to the propositions that in a frictionless world of full information and complete markets, a firm capital structure cannot affect its values (Modigliani &Miller, 1958), banks operates in a highly regulated and volatile world, hence lack any rational in the functionless world of M&M. Banks capital has a direct relationship with profitability, as more and more money is pump into the business, more profit will be recorded. Available statistics shows that arising from the consolidation, the capital market received a boost with a total of N406 Billion raised, out of which the apex bank has verified and cleared only N306 Billion as at December 2005. The consolidation drive has also brought a staggering $3

Billon into the sector, $500 Million of which represent Foreign Direct Investment (FDI).This is the highest inflow of FDI into the non-oil sector within one year. (Adeyemi 2006).

4.0 CONCLUSION

In conclusion, banking industry should ensure that it does not suffer from lack of liquidity and also that it is not too much highly liquid. It was argued that the failure of a company to meet its obligation due to lack of sufficient liquidity will result in bad credit image, loss of creditors' confidence or even in lawsuits resulting in the closure of the company. A very high degree of liquidity is also bad because the assets earn nothing. It is therefore, necessary to strike a proper balance between liquidity and profitability ratio, which is sometimes described as efficient ratio, indicate the relative efficiency of the business taking into account all revenue expenses.

5.0. SUMMARY

In this unit, we have learned about:

Phase of Banking Sectors Reforms;

Banks Capital Adequacy Regulation;

Approaches to Re-capitalization; and

Banks Capital and Profitability.

6.0. TUTOR-MARKED ASSIGNMENT

What are the approaches to Re-capitalization?

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UNIT 4: CENTRAL BANKING

CONTENT

1.0. INTRODUCTION

The Central Bank is one of the most important institutions in the financial system of a country. In this unit, you shall learn about what a central bank is and its functions in an economy. You shall equally learn about Credit Control in an economy by the central bank, objectives of credit control and methods of credit control by the central bank. This unit will also help you to actually understand the major differences between central bank and commercial bank.

2.0. OBJECTIVES

At the end of this unit, you should be able to;

Explain what a central bank is;

Enumerate and explain the functions of a central bank;

State and explain the objectives of credit control in an economy;

List and discuss methods of credit control;and

Explain the major differences between commercial banks and central banks

3.0. MAIN CONTENT

3.1. The concept of Central Bank

Central Bank is a government owned bank and each country owns only one Central Bank. A Central Bank is therefore government's representative in the banking system and acts mainly as a banker to the government. It is the apex bank in a country which controls its monetary and banking structures. It is usually owned by the government of the country and operates in national interest.

It regulates and issues currency, performs banking and agency services for the country, keeps cash reserves of commercial banks, keeps and manages international currency, acts as the lender of the last resort to commercial banks in the country, acts as clearing house, and controls of credit. Therefore, a Central Bank can be briefly and functionally defined as " a national (financial) institution that traditionally possess the monopoly of issuance of legal tender money in a country, is entrusted with the custody of the cash reserves of the banking system (that is function as a banker to banks), and acts as lender of last resort". It usually acts as banker and financial adviser to government, and the custodian and manager of the nation's foreign exchange reserves.

A Central bank is very different in both its organization and functions compared to other types of banking institutions. Since it is said to be at the apex of any banking system, the law or charter that establishes a central bank is normally very different from those other laws or legislations establishing other types of banks. The Central Bank of Nigeria (CBN) was established on March 17th, 1958 by the Central Bank Ordinance of 1958. The bank effectively came into existence and fully operational on 1st July, 1959.

3.2. Functions of Central Bank

Issuance of legal tender currency: The CBN is the sole authority vested with the power to issue legal tender currency in the country. Because of the primary importance of legal tender currency (Notes and Coins) in the smooth functioning and development of the economy, the issuance of legal tender money is the foremost responsibility of all central banks the world over. Also, it is the central banks' responsibility to safeguard the internal and international values of that currency. So, to service the economy with legal tender currency, the central bank organizes not only its production, but also its distribution and the periodic replacement of old or damaged ones.

It is also the sole responsibility of the central bank to withdraw notes. By this function, it is able to maintain the financial stability of the economy.

Banker to the government: The central bank serves as banker and financial adviser to the Federal Government and other state Governments. In its capacity as Banker to Government, the bank receives deposits and makes payments on behalf of the Federal Government. It also provides banking services to State Government – owned institutions.

Bankers' Bank: The Central Bank acts as banker to commercial, merchant, development banks and other financial institutions in that they keep part of their deposit with the Central Bank of Nigeria. Every bank in Nigeria is therefore required by law to keep an account with the Central Bank of Nigeria, not only as a statutory requirement, but rather also as a necessity in order to meet interbank transactions best handled through the CBN; for example, through the clearing system. To this end, the CBN established a number of clearing houses in the country to facilitate the clearing of cheques among commercial banks and further improve the payment system in the economy.

Banks control and supervision: The Central Bank controls, supervises and assists the activities of commercial, merchant banks and other financial institutions in the economy. The CBN exercise surveillance over the operations of the banks with a view to ensuring sound banking practices. For instance, the CBN prescribes periodically the proportion of deposit liabilities which banks must hold in the form of liquid assets so as to foster public confidence in their ability to meet their customers' cash demand.

Lender of last resort: Commercial banks in financial difficulties have the central bank as the last place to run to, to borrow or to discount bill of exchange. This function helps to prevent a banking crisis which may have been disastrous. By granting accommodation in the form of rediscounts and collateral advances to commercial banks and other financial institutions, the CBN acts as a lender of last resort. The CBN lends to such institutions in order to help them in times of financial stress so as to save the financial structure of the country from collapse.

Formulation and implementation of monetary policy: A major responsibility of a modern Central Bank is the formulation and implementation of monetary policy in the economy. By this function, the CBN seeks to promote monetary stability with a view to ensuring a stable internal and external value of the national currency. It is important that the supply of credit and money are adequate to support desirable and sustainable growth without generating inflationary pressures and undue instability in the naira exchange rate. Thus, monetary policy is applied to influence the availability and cost of credit in order to regulate money supply.

Maintenance of External Reserve: To safe-guard the internal value of our legal tender currency, the CBN maintains the management of the country's debt and its foreign exchange. It manages the national debts, controls the foreign exchange as well as deals with the central banks of other nations. In managing the nation's external reserves as required, the central bank seeks to maintain an adequate volume of external reserves to preserve the international value of its domestic (the naira). To achieve this aim, the CBN therefore has the responsibility of managing the country's foreign exchange reserves. The bank not only manages external reserves but also manages the exchange rate.

In Nigeria, the major objectives of exchange rate policy in support of stable economic growth and development including deriving an appropriate exchange rate for the naira and ensuring stability of naira exchange rate. A viable and realistic exchange rate ensures efficient use of resources, widens the scope of legitimate foreign exchange transactions and facilitates the achievement of internal and external balance. Also, stability of the exchange rate ensures that economic agents can plan ahead without fear of escalating costs.

Foreign Exchange Management: The foreign exchange management activities of the central bank involve the acquisition and development of foreign exchange resources in order to reduce the destabilizing effects of short term Capital inflows. The CBN monitors the use of scarce foreign exchange resources to ensure that foreign exchange disbursement and utilization are in line with economic priorities and within the annual foreign exchange budget and thereby ensure a viable balance of payments position as well as the stability of the naira. The CBN also conducts routine examinations into the foreign exchange operations of the authorized dealers. The activities of some "Bureau De change" are also investigated to ensure compliance with foreign exchange market (FEM) regulations.

Self-Assessment Exercise 1

Discuss the functions of the Central Bank of Nigeria

3.3. Credit Control by the Central Bank

Credit control is the means to control the leading policy of commercial banks by the central bank.

3.3.1. Objectives of Credit Control

The Central Bank controls credit to achieve the following:

i. Maintenance of relative stability in domestic prices: One of the major objectives of controlling credit in the economy is to stabilize the price level in the country. Frequent changes in prices adversely affect the economy. This is because excessive increases or decreases in prices make it difficult for economic planning and decision making as a result of the uncertainty in the economy. Inflationary or deflationary trends can be prevented by judicious credit control policy in the economy.

ii. To stabilize the rate of foreign exchange: with the change in the internal price level, exports and imports of the country are affected when prices fall, export increase and decrease. Consequently, the demand for domestic currency increase in the foreign market and its exchange rate rises. On the contrary, a rise in domestic currency, increases in the foreign market and its exchange rate rises. On the contrary, a rise in domestic prices leads to a decline in export and an increase in imports. As a result, the demand for foreign currency increases and that of domestic currency increases and that of domestic currency falls, thereby lowering the exchange rate of the domestic currency. Since it is the volume of credit money that affects prices, the central bank can stabilize the value of foreign exchange by controlling bank credit.

iii. To protect the outflow of Gold: The Central Bank holds the gold reserves of the country in its values. Expansion of bank credit leads to rise in prices which reduce exports and increase imports, thereby creating an unfavourable balance of payments. This necessitates the export of gold to other countries. Central bank has to control credit in order to prevent such outflows of gold to other countries.

iv. To control business cycles: Business cycles is a common phenomena of market economies which lead to periodic fluctuations in production, employment, and prices. They are characterized by alternating periods of prosperity and depression. During prosperity, there is large expansion in the volume of credit, and production, employment and prices rise. During depression, credit contracts, and production, employment and prices fall. The central bank can counteract such cyclical fluctuations through contraction of bank credit during boom periods, and expansion of bank credit during depression.

v. To achieve growth with stability: In recent years, the principal objective of credit control is to achieve growth with stability. The other objectives, such as price stability, foreign exchange stability, etc, are regarded as secondary. The aim of credit control is to help in achieving full employment and accelerated growth with stability in the economy without inflationary pressures and balance of payments deficit.

3.3.2. Methods of Credit Control

The Central Bank of Nigeria adopts two methods of credit control. They are the quantitative and qualitative methods. Quantitative aim at controlling the cost and quantity of credit by adopting such techniques as variations in the bank rate, open market operations (OMO) and variation in the reserve ratios of commercial banks.
On the other hand, qualitative methods control the use and direction of credit.

These involve selective credit controls and direct action. The methods of credit control by the Central Bank of Nigeria (CBN) are discussed as below:

Bank Rate or Discount Rate Policy: The bank rate or discount rate is the rate fixed by the Central Bank at which it rediscounts first class bills of exchange and government securities held by the commercial banks. The bank rate is interest charged by the Central Bank of which it provides rediscount to banks through the discount widow. The Central Bank controls credit by making variations in the bank rate. If the need of the economy is to expand credit, the Central Bank lowers the bank rate. By this, borrowing from the Central Bank becomes cheap and easy.
So the Commercial Banks will borrow more from the CBN. The Commercial Banks in turn, will loan to customers at a lower rate. The market rate of interest

will then be reduced. This therefore encourages business activities, and expansion of credit follows which encourages the rise in price. The opposite happens when credit is to be contracted in the economy. The Central Bank raises the bank rate which makes borrowing costly from it. So the banks borrow less. They in turn raise their lending rate to customers. The market rate of interest also rises because of the tight money market. This discourages fresh loans. This also discourages business activities. There will also be a contraction of credit which depresses the rise in price. Thus lowering the bank rate offsets deflationary tendency and raises the bank rate which controls inflation.

Open Market Operations (OMO): Open Market Operations (OMO) is another method of quantitative credit control used by the Central Bank of Nigeria (CBN). This method refers to the sale and purchase of securities, bills and bonds of government as well as private financial institutions by the Central Bank. There are two principal motives of Open Market Operations. One, to influence the reserves of commercial banks in order to control their power of credit creation. Two, to affect the market rates of interest as so to control the commercial bank credit.

The effect is that when the central bank sells securities to the market, the commercial bank's reserves is reduced. In this way, open market operations reduce or enhance, respectively the banking system's ability to create credit and hence money supply.

The required Reserve Ratio: Every commercial bank is required by law to maintain a minimum percentage of its deposits with the central bank. The minimum amount of reserve with central bank may be either a percentage of its time and demand deposits separately or of total deposit. Whatever the amount of money remains with the commercial bank over and above these minimum reserves is known as excess reserves. It is on the basis of this excess reserves that the commercial bank is able o create credit. The larger the size of the excess reserves, the greater is the power of a bank to create credit, and vice versa. When the central bank raises the reserve ratio of commercial banks, it means that the latter are required to keep more money with the former. Consequently, the excess reserves with the commercial banks are reduced and they can lend less than before. On the contrary, if the central bank wants to expand credit, it lowers the reserve ratio so as to increase the credit creation power of commercial banks. Thus, by varying the reserve ratio of commercial banks, the CBN influences their power of credit creation and thereby controls credit in the economy.

Selective Credit Control: Selective or qualitative methods of credit control are meant to regulate and control the supply of credit among its possible suppliers and uses. They are different from quantitative or general methods which aim at controlling the cost and quantity of credit. Unlike the general instruments, selective instruments do not affect the total amount of credit but the amount that is put to use in a particular sector of the economy. This confers on the CBN the power to regulate the terms on which credit is granted in specific sectors. These powers or controls seek typically to regulate the demand for credit for specific uses and the period of time over which the loan is to be paid. This involves official interference with the volume and directions of credit into those sectors of the economy which planners believe are of crucial importance to economic development. These tools include Moral suasion and selective credit controls or guidelines.

Moral Suasion: This involves the employment of persuasions or friendly persuasive statements, public pronouncements or outright appeal on the part of the CBN to the banks requesting them to operate in a particular direction for the realization of specified government objectives. For examples, the CBN may appeal to the banks to exercise restraint on credit expansion by explaining to them how excess expansion of credit might involve serious consequences for both banking system and the economy as a whole.

Selective credit controls or guidelines: Selective credit controls or guidelines involves administrative orders whereby the CBN uses guidelines, instructs banks on the cost of and volume of credit to specified sectors depending on the degree of priority of each sector.

Self-Assessment Exercise 2

Enumerate and explain the major ways in which the Central bank of Nigeria controls Credit supply in the economy.

3.4. Difference between Central Bank and Commercial Bank

A Central bank is basically different from a commercial bank in the following ways:

i. The Central Bank is owned by government, whereas the commercial bank is owned by shareholders.

ii. The Central Bank is the apex financial institution and banking structure of the country. The commercial bank is one of the organs of the money market.

iii. The Central Bank is a non-profit institution which implements the economic policies of the government. But the commercial bank is a profit-making institution.

iv. The Central Bank is a banker to the government and does not engaged itself in ordinary banking activities. The commercial bank is a banker to the general public.

v. The Central Bank has the monopoly of issuing notes, while the commercial banks can issue only cheques. The notes are legal tender but cheques are in the nature of near money.

vi. The Central Bank is the bankers' bank. As such, it grants accommodations to commercial banks in the form of rediscount families, keeps their cash reserves, and clears their balances. On the other hand, the commercial bank advances loans to and accepts deposits from the public.

vii. The Central Bank is the custodian of foreign currency reserves of the country while the commercial bank is the dealer of foreign exchange.

4.0. CONCLUSION

The above analyses show that a Central bank is very important in the live wire of the financial sector of an economy. Therefore, government need to accord the Central Bank of Nigeria (CBN) the necessary support and backing to be able to take active in discharging its functions adequately and efficiently in an economy.

5.0. SUMMARY

In this unit, we have learned about;

i. The concept of Central Bank,

ii. The functions of the Central bank,

iii. Credit control by Central bank,

iv. Objectives of credit control,

v. Methods of credit control, and

vi. The difference between central bank and Commercial Bank

6.0. TUTOR-MARKED ASSIGNMENT

Why do you think in your own opinion the Central Bank of any Country controls its credit supply?

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UNIT 5: CENTRAL BANK OF NIGERIA CASH – LESS POLICY

CONTENT

1.0. INTRODUCTION

This unit would examines the implications of cashless banking, with a view to exposing the possible challenges and prospects it poses to the Nigerian economy whilst employing aggregated approach and overview the effectiveness of the cash-less policy of the CBN in Nigeria, which arises from the rising doubts as regards the effectiveness of various economic policies in achieving developmental goals of Nigeria. Moreover, the recent evolution of electronic money poses interesting questions of policy makers all over the world. This unit also seeks to evaluate policies of the Central Bank of Nigeria as well as proffer valuable recommendations on the execution of cashless banking in Nigeria.

2.0. OBJECTIVES

At the end of this unit, you should be able to:

Understand the Central Bank of Nigeria Cash Policy;

Know the Cash-less Lagos Project & Point of Sale (POS) Guidelines;

Understand the Reasons for Cash Policy;

Understand the Content of the Cash Policy;

Know the Expected Benefits of the New Cash Policy; and

Know the Key Components of Cash Policy Circular

3.0 MAIN CONTENT

3.1. Central Bank of Nigeria Cash Policy

What is the CBN Cash Policy?

The CBN cash policy stipulates a daily cumulative limit of N500, 000 and N3, 000,000 on free cash withdrawals and lodgments by individual and corporate customers respectively in the Lagos State with effect from March 30, 2012. Individuals and corporate organizations that make cash transactions above the limits will be charged a service fee for amounts above the cumulative limits. Furthermore, 3rd party cheques above N150, 000 shall not be eligible for encashment over the counter with effect from March 30, 2012. Value for such cheques shall be received through the clearing house. Banks will discontinue cash in transit lodgment services rendered to merchant-customers with effect from January 1, 2012.

Further Clarifications on Cash-Less Lagos Project

3.2 Cash-less Lagos Project and Point of Sale (POS) Guidelines

The Central Bank of Nigeria (CBN) has introduced a new policy on cash-based transactions which stipulates a ‘cash handling charge’ on daily cash withdrawals or cash deposits that exceed N500,000 for Individuals and N3,000,000 for Corporate bodies. The new policy on cash-based transactions (withdrawals & deposits) in banks, aims at reducing **(NOT ELIMINATING)** the amount of physical cash (coins and notes) circulating in the economy, and encouraging more electronic-based transactions (payments for goods, services, transfers, etc.)

3.3 Reasons for Cash Policy

The new cash policy was introduced for a number of key reasons, including:

1. To drive development and modernization of our payment system in line with Nigeria's vision 2020 goal of being amongst the top 20 economies by the year 2020. An efficient and modern payment system is positively correlated with economic development, and is a key enabler for economic growth.
2. To reduce the cost of banking services (including cost of credit) and drive financial inclusion by providing more efficient transaction options and greater reach.
3. To improve the effectiveness of monetary policy in managing inflation and driving economic growth.

In addition, the cash policy aims to curb some of the negative consequences associated with the high usage of physical cash in the economy, including:

- **High cost of cash:** There is a high cost of cash along the value chain - from the CBN & the banks, to corporations and traders; everyone bears the high costs associated with volume cash handling.
- **High risk of using cash:** Cash encourages robberies and other cash-related crimes. It also can lead to financial loss in the case of fire and flooding incidents.
- **High subsidy:** CBN analysis showed that only 10percent of daily banking transactions are above 150k, but the 10percent account for majority of the high value transactions. This suggests that the entire banking population subsidizes the costs that the tiny minority 10percent incur in terms of high cash usage.
- **Informal Economy:** High cash usage results in a lot of money outside the

formal economy, thus limiting the effectiveness of monetary policy in managing inflation and encouraging economic growth.

- **Inefficiency & Corruption:** High cash usage enables corruption, leakages and money laundering, amongst other cash-related fraudulent activities.

Self – Assessment Exercise 1

What are the reasons for Cash Policy?

3.4 Content of the Cash Policy

The following aspects of the policy shall apply from January 1st 2012 in Lagos State ("tagged Cash-less Lagos"):

- Only CIT licensed companies shall be allowed to provide cash pick-up services. Banks will cease cash in transit lodgment services rendered to merchant-customers in Lagos State from December 31st 2011. **Any Bank that continues to offer cash in transit lodgment services to merchants shall be sanctioned.**
- 3rd party cheques above N150, 000 shall not be eligible for encashment over the counter. Value for such cheques shall be received through the clearing house.

The service charges/fees will not apply until March 30th, 2012, in order to give people time to migrate to electronic channels and experience the infrastructure that has been put in place. Therefore, banks should continue to encourage their customers to migrate to available electronic channels, and where possible demonstrate the costs that will accrue to those that continue to transact high volumes of cash from March 30th, 2012 in Lagos State.

In addition, below are some detailed context and pertinent clarifications on the policy:

- **Location**
  - The pilot shall be run in Lagos State.
- **Account Application**
  - The cash-policy applies to all accounts, including COLLECTION accounts. Banks should therefore work with their corporate customers to arrange for suitable e-collection options.
- **Limits**
  - The limits are cumulative daily limits each for withdrawal, and for deposits (e.g. for Individuals, the daily free withdrawal limit is N500,000; while the daily free deposit limit is N500,000)
  - The limits apply to the account so far as it involves cash, irrespective of channel (e.g. over the counter, ATM, 3rd party cheques encashed over the counter, etc) in which cash is withdrawn or deposited (e.g. if an individual withdraws N450,000 over the counter, and N150,000 from the ATM on the same day, the total amount withdrawn by the customer is N600,000, and the service charge will apply on N100,000 - the amount above the daily free limit). The limit also applies to cash brought through CIT companies, as the CIT company only serves as a means of transportation.
- **Charges**
  - The charges shall apply from March 30th 2012 in Lagos.
  - The service charge for daily cumulative deposits above the limit into an account shall be borne by the account holder. However, during the pilot in Lagos, individuals paying money from Lagos, into an account outside Lagos, shall bear the charges for any single transaction above the daily limit.
  - The service charge for daily withdrawals above the limit into an account shall be borne by the account holder.

- **Interstate Transactions**
    - Charges/fees shall apply for all transactions in Lagos, and on Lagos State based accounts.
    - Transactions initiated out of Lagos State, and affecting a Lagos based account shall not attract charges/fees, and shall not be counted as part of the daily cumulative amount on that account since the policy has not been activated outside Lagos. (E.g. A deposit above the limit made from Onitsha into a Lagos state account shall not attract charges/fees).
    - Transactions initiated from Lagos State, and affecting an account outside Lagos, shall attract charges/fees (when the specific transaction is above the limit), since the policy has been activated in Lagos. (E.g. A deposit made from Lagos State above the limit, into an account in Abuja, shall result in the initiator paying the relevant charges/fees, while the account into which it is paid outside Lagos shall not be impacted).

The policy will eventually be rolled out to other regions across the country from January 1st 2013. Please note that the policy does not prohibit withdrawals or deposits above the stipulated amounts, but that such transactions will be subject to cash handling charge.

3.5 Expected Benefits of the New Cash Policy

A variety of benefits are expected to be derived by various stakeholders from an increased utilization of e-payment systems. These include:

- **For Consumers:** Increased convenience; more service options; reduced risk of cash-related crimes; cheaper access to (out-of-branch) banking services and access to credit.
- **For Corporations:** Faster access to capital; reduced revenue leakage; and reduced cash handling costs.
- **For Government:** Increased tax collections; greater financial inclusion;

increased economic development. Increased tax collections; greater financial inclusion; increased economic development.

Current Awareness/Engagement Status

The CBN has been running a set of targeted stakeholder engagement sessions as a first stage of its planned communication campaign. These have targeted key groups that will be most impacted by the cash policy, with the objective of creating awareness and providing an opportunity for them to raise issues and concerns. The stakeholders so far have included markets, associations, professional bodies, etc. These stakeholder sessions were concluded in November 2011. They are now implementing the phase 2 of the communication strategy, which is the Mass communication campaign, leveraging the inputs derived during the stakeholder sessions.

Self – Assessment Exercise 2

Discuss the expected benefits of the New Cash Policy Circular.

3.5.1 Key Components of Cash Policy Circular

•Commencing from January 1st, 2012, a daily cumulative limit of N500,000 and N3,000,000 on free cash withdrawals and lodgments by individual and corporate customers respectively in Lagos state.

•Commencing from January 1st, 2013, a daily cumulative limit of N500,000 and N3,000,000 on free cash withdrawals and lodgments by individual and corporate customers respectively nationwide .

•Individuals and corporate organizations that make cash transactions above the limits will be charged a penal fee of N20/thousand and N30/thousand respectively for deposit amounts above the cumulative limits , as well as N30/thousand and N50/thousand respectively for withdrawal amounts above the cumulative limits.

•Furthermore, 3rd party cheques above N150,000 shall not be eligible for encashment over the counter. Value for such cheques shall be received through the clearing house.

•Banks will cease cash in transit lodgment services rendered to merchant-customers from January1st, 2012 (to be replaced by CBN licensed CIT providers)

•No card scheme shall operate exclusive acquirer agreement or contract in Nigeria with effect from June 1, 2011

Implications & Priorities of the Cash Policy

•Increasing availability and reliability of alternative payment channels; as well as ensuring effective settlement cycles

•Ensuring appropriate options to enable addition of „new entrants‟ into the banking system (e.g. KYC requirements)

•Educating and creating awareness amongst consumers, merchants, other stakeholders

•Instituting a framework to ensure monitoring and compliance of policy; mitigate risks; as well as assess the impact on economy and industry cost-to-serve

“Cashless Lagos” is the cross-industry collaborative effort executing the payments transformation plan in Lagos state

GOALS:

•Implement new cash policy and demonstrate Feasibility/Benefits

•Significantly increase POS penetration and usage

•Significantly push awareness and usage of other electronic channels *(e.g. Direct Debit, Electronic Funds Transfer, Mobile payments, ATMs etc)*
Cashless Lagos: Alternatives to cash will be made available for both retail and wholesale cash users

Industry stakeholders are jointly working together to increase the alternative channel penetration, functionality, and ease-of-use
•Point-Of-Sale Systems: Card Neutral (Interoperability); Improved Connectivity; Greater reach/deployment, T+1 settlement

•Mobile Payments: Eleven players fully licensed; few others in pilot mode

•Multi-functional ATMs: Withdrawal, Cash-deposit, Bill payments, etc

•Internet Banking: Intra and Inter Bank funds transfer

•(Instant) Electronic Funds Transfer: Instant transfer option currently offered through NIBSS

• Direct Debits: Automated Direct Debit option being piloted with a few Banks and Billers

4.0 CONCLUSION

In conclusion, the Central Bank of Nigeria (CBN) introduced a new policy on cash-based transactions which stipulates a 'cash handling charge' on daily cash withdrawals or cash deposits that exceed N500,000 for Individuals and N3,000,000 for Corporate bodies. Some of the reasons for cash policy were to drive development and modernization of our payment system in line with Nigeria's vision 2020 goal of being amongst the top 20 economies by the year 2020, which is the key enabler for economic growth and to reduce the cost of banking services (including cost of credit) and drive financial inclusion by providing more efficient transaction options and greater reach.

5.0. SUMMARY

In this unit, we have learned about:

Understand the Central Bank of Nigeria Cash Policy;

Know the Cash-less Lagos Project & Point of Sale (POS) Guidelines;

Understand the Reasons for Cash Policy;

Understand the Content of the Cash Policy;

Know the Expected Benefits of the New Cash Policy; and

Know the Key Components of Cash Policy Circular

6.0 TUTOR – MARKED ASSISGNMENT

Explain the key components of Cash Policy Circular.

Discuss the GOALS of Cash Policy

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MODULE 4

UNIT 1: MEASURING THE EFFECT OF REGULATION ON PERFORMANCE OF BANKING

CONTENT

1.0 INTRODUCTION

The effect of banking sector reforms on corporate governance and concluded that to check abuses in the emerging consolidated banking system institutionalization of good corporate governance practice is both necessary and desirable. Some school of thought conducted a study that quantifies regulatory efforts to use capital requirements to control risk-shifting by U.S. banks during 1985 to 1994 and investigates how much risk-based capital requirements and other deposit insurance reforms improved this control. The result revealed that capital discipline did not prevent large banks from shifting risk onto the safety net. Banks with low capital and debt-to-deposits ratios overcame outside discipline better than other banks. Mandates introduced by 1991 legislation have improved but did not establish full regulatory control over bank risk-shifting incentives. That is why Scott (2010) regards Capital requirements as key element in containing systemic risk. Adams (2004) evaluated effect on bank regulation and supervision on the risk asset and income performance of banks in Nigeria and observed increase in banks distress as major reason for the various reforms. He argued that bank mismanagement and adverse ownership influence and other form of insiders' abuse couples with political consideration process especially as regard debt recovery created difficulties to reducing distress in the financial system as submitted by Sanusi (2002).

2.0. OBJECTIVES

At the end of this unit, you should be able to:

Measure the effect of Regulation on performance of banking; and

Evaluate the problems and challenges of bank regulation

3.0 MAIN CONTENT

3.1 Measuring the Effect of Regulation on Performance of Banking

The major purpose of the various financial sector reforms is to strengthen the banking industry and position it to meet the world standard. Bank supervision entails not only enforcement of rule and regulation, but also judgment concerning the soundness of bank asset, its capital adequate and management. Therefore effective supervision is expected to lead to a healthy banking industry that possesses the power to propel the economic growth (Ogunleye 2001, Adam 2005, Soludo 2007, Scott 2010).

The reform programme is expected to engender a diversified, strong and reliable banking sector in the country. In a view of the above, Balogun, 2007 opined that in order to give objective assessment of the outcome of the banking sector reforms there is the need to specify the evaluating criteria. He used descriptive statistics and economic methods to test the hypothesis that each phase of reform as identified in the literature culminated into improve incentives for the provision of better services to the economy as a whole. The assumption was that the post reform values of measure of institution and policy response performance represent significant improvement over the pre-reform value among these measures according to Balogun (2007) are branch network, increase supply and improved access to credit improvement in selected financial sectors and distress ratio, and above all increased profit earnings as well as increased ability to complete within the global economy. The empirical result confirms that eras of pursuit of market reform were characterized by improved incentive. However these did not translate to increased credit purvey to the real sector. Also while growth was suffered in eras of control the reform era was associated with rise in inflationary pressures. Among the pitfalls of the reforms identified by the study are faulty premise and wrong sequencing of reforms, frequent reversal and /or non sustainability of reforms.

3.2 Problems and Challenges of Bank Regulation

The various reforms have been acquired to be necessary but it is debatable if they yielded the anticipated result (Balogun 2007). The new policy initiative will no doubt pose some challenges to both the economy as well as the banking system as observed by Ogunleye (2005)that given the fury of activities that have attended effort of bank to comply with the new consolidation policy and the antecedent of some operators in the system, there are concerns on the need to strengthen corporate governance in banks in order to boost public confidence and ensure efficient and effective functioning of the banking system on the effect of small business. Emeria and Okafor (2008) identified merger and acquisition as one of the instrument of recent banking reforms in Nigeria, using cross sectional survey research and ordinary least square regression analysis the result observed two effect of merger and acquisition as static effect and dynamic effect. The static effect resulted in positive relationship between small businesses lending and bank size because for each N1 deposit received about N0.33k was given out to small business. However, dynamic effect of merger and acquisition in the Nigerian banking sectors which was reported as restructuring, direct and external effect gave on opposite result. The restructuring and direct effect shows that bank size is negatively related to small business lending and also there is a negatively relationship between external loan by institution like microfinance institution and small business lending.

Aminu (2004), identified human resources realignment, technology integration, stakeholders concern, monitoring and supervision problems as culminating from the consolidation of banks in Nigeria. Abati (2006) submitted that the biggest losers in the banking consolidation was the human element especially depositors in the liquidated banks and workers of the merged banks, observing conflicting conditions of service for workers within the same grade level in some emergent banks. The policies also have implication for the supervisory authorities in the country like the central bank of Nigeria (CBN) and Nigeria deposit insurance corporation (NDCI) most essentially. Though the number of bank has reduced drastically the need to cope with the complex system of the new mega banks require greater surveillance and monitoring by the CBN. The announcement of the new recapitalization policy as well as its implementation have induced a shake-out in the banking industry which pose a new set of challenges to the Nigeria deposit insurance corporation. According to Ogunleye (2005), following the announcement, the interbank market was adversely affected as interbank placements by the big players in the market were withdrawn from the smaller banks as precautionary measure. There was also a wave of flight to safety by depositors who were apprehensive of the survival of their bank, thus creating capital flight problem. The development complied with the planned phased withdrawal of public sectors funds from the universal banks made by the liquidity position of some banks precarious, this among other emerging challenges would put pressure on NDCI; both pre-consolidation and post consolidation challenges.

Ogunleye (2005), further identified the post consolidation challenges as possibility of bank failure where Merger and Acquisition (M&S) failed thus run the risk of liquidation. Other challenges are the inadequate executive capacity as to the need for NDIC to ensure the effective merging of information technology system, business lines, products, culture and people by the new mega banks, weak corporate governance that will put pressure NDIC and other regulators to ensure probity, transparency and accountability. There is also the supervisory approach that would need to be broadened, closing information gap between banks and investing public and the need to establish asset Management Company. Pressure would be on NDIC to put in place some specific insurance design feature that will ensure adequate deposit protection.

Aminu (2004), argued that the policy of recapitalization was a subtle way of compelling banks to merge with a submission that Merger and Acquisition are business imperatives that should not be forced or hurriedly conclude as was the case in Nigeria. In the bankers position paper presented to the Senate Committee on banking, insurance and other financial institutions, bankers argued that the Nigerian socio-political and macroeconomic environment is fraught with a lot of imperfections and inadequacies that make the comparison with other countries a mere theoretical postulations that while Malaysia with a population of 23 millions has a GDP of 104.6 billion and per capital GDP of $4,528.14, the Nigerian economy with a population of 125.8 million has GDP of 3.04 billion and per capita GDP of $24.2. It was also observed that in spite of the superior strength of the South African economy over that of Nigeria the minimum capital requirement of banks in South Africa is $39.06 million (N5 billion), while credit is 5.4% as against the Nigerian $192.3 million (N25 billion) and 32.25% credit extension to the Federal Government. It was also argued that the capital base of N25 billion will do more of harm than benefit to the banking industry and thus highlighted the major pitfalls to be crowding out other sectors, unethical practices like tactical money laundering, mass unemployment and neglect of micro lending to small businesses needed for growth of the economy.

4.0 CONCLUSION

In conclusion, the reform programme is expected to engender a diversified, strong and reliable banking sector in the country. In a view of the above, it was argued that in order to give objective assessment of the outcome of the banking sector reforms there is the need to specify the evaluating criteria. He used descriptive statistics and economic methods to test the hypothesis that each phase of reform as identified in the literature culminated into improve incentives for the provision of better services to the economy as a whole.

5.0. SUMMARY

In this unit, we have learned about:

Measure the effect of Regulation on performance of banking; and

Evaluate the problems and challenges of bank regulation.

6.0. TUTOR-MARKED ASSIGNMENT

Explain the problems and challenged of Bank regulations

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UNIT 2: ETHICS AND CODE OF BANKING PRACTICE IN NIGERIA

CONTENT

1.0 INTRODUCTION

An Ethics Committee of the General Assembly of Bank Chief Executives will consider and deliberate on matters of ethics referred to it. It will pronounce opinions and/or make recommendations to the General Assembly of Bank Chief Executives where appropriate. Matters may be referred to the Committee by a Bank or by an individual banker (through the Institute) or by the General Assembly of Bank Chief Executives. In the event that further action is indicated, the General Assembly may refer the matter to the Council of The Chartered Institute of Bankers of Nigeria to be considered by its Investigating Panel and, if necessary, a Tribunal in accordance with the provisions of The Chartered Institute of Bankers of Nigeria Decree 12 of 1990 or any amendment or re-enactment of same. The Ethics Committee has no legal status. It has no formal powers to compel appearance nor to impose any sanction. Its whole purpose is to provide rulings on the facts as presented to it in each instance. Its force is moral.

2.0. OBJECTIVES

The overall objectives of code of banking practice are to ensure the highest level of adherence to good banking practice and a strong commitment to high ethical standards in the banker-customer relationship.

3.0 MAIN CONTENT

3.1 General Standards Expected of Bankers & Banking Institutions

The following were the Standards expected of Bankers & banking Institutions:

a) Banks and bankers will operate within the legal framework

b) Banks and bankers will follow the best professional practice in the global industry.

c) Banks will always place their depositors' interest before all others.

d) Banks will always meet their commitments. Such commitments will not be lightly given, and should never be broken.

e) Banks will repay depositors at maturity on the agreed terms

f) Banks will meet their trade engagements

g) Banks will meet delivery on their trading contracts at maturity at agreed rates.

h) Banks will always lend on agreed terms.

i) The CBN or any arbitration body duly constituted should be invited to arbitrate, to resolve disputes among banks if such disputes cannot be resolved through the Institute.

j) Banks will deal only with respectable parties. They will take all reasonable steps to establish that all parties they deal with are bona-fide. Individual bankers should not ask for, nor even accept, any form of gratification, either in cash or in kind, *for* performing their normal services.

k) Banks should not pay brokerage to members of their staff

l) Banks and employers will follow only the best professional practice in their recruiting and employment policies.

m) Bankers (of either sex) should not harass (either sexually or otherwise) their staff or colleagues.

n) Banks should not undermine other banks' stability in the process of marketing so that competition is healthy..

3.2 Code of Conduct of the Banking Practices

1. GOVERNING PRINCIPLES

The governing principles of the Code are:

1. To set out the standards of good banking practice which banks will follow in their dealings with their customers;

2. To provide guidelines for banks to make them act fairly and reasonably in all their dealings with customers and other banks;

3. To cause banks to help customers to understand the operations of their accounts and to give them a good understanding of their banking services including known risks relating to the operations; and

4. To maintain confidence in the security and integrity of banking system. Banks must recognize that their systems and technology need to be reliable to protect their customers and themselves.

Self – Assessment Exercise 1

Discuss the Governing principles of the banking code

CUSTOMERS AND THEIR BANKS

2. OPENING AN ACCOUNT

1. Banks are required by law to satisfy themselves about the identity and address of a person seeking to open an account to assist in protecting their customers, members of the public and themselves against fraud and other misuse of the banking system. References on character and suitability for an account holder are imperative.

2. Banks will provide to prospective customers details of the identification needed.

3. Banks should educate customers on the proper handling of cheque

books and other security items.

3 TERMS AND CONDITIONS

i. Banks will provide written terms and conditions expressed in simple language, to customers, of the various types of financial services offered by them.

ii. Banks will ensure that adequate notice is given to customers about any change in such terms and conditions. For changes resulting from administrable or statutory action by authorities, notices as contained in the Monetary Policy circulars (or any other circulars from the Regulatory Authorities) should be considered adequate.

iii. Banks will give reasonable notice before closing a customer's account.

iv. Banks will send comprehensive statements of accounts to customers, at regular (agreed) intervals in order to enable customers to manage their accounts effectively and to check entries. Customers should in addition be at liberty to ask for their balances at any time.

v. All terms and conditions should be in line with the prevailing laws.

Self – Assessment Exercise 2

What are the Terms and Condition of the banking code?

4. CHARGES AND INTEREST PAYABLE BY CUSTOMERS

1. Banks will disclose to their customers in sufficient detail the basis of the charges incidental to the operation of their accounts. Such charges will be determined by the Bankers Tariff published by the Central Bank of Nigeria from time to time. based on the recommendations of the Bankers Committee. Such disclosures will be made to customers when new accounts are opened or upon request.

   Adequate information about changes in the tariffs will be made available or sent to customers.

2. Information on charges for services not covered by the tariff will be provided by the bank on request or at the point of rendering the service.

3. Banks will inform their customers about the interest that is applied to

debit balances on their accounts, the basis on which it is calculated and the timing of the debit. Banks will also inform their customers of the basis on which the interest rates may be varied.

5. INTEREST PAYABLE TO CUSTOMER

1. Banks will make information about the rates on all interest bearing accounts which they offer freely available and accessible to customers by one or more effective means, for example:

   i notices and/or leaflets at Head Office and all Branches;
   ii press advertisements, 5.1.3 personal notices; and
   iii a branch/central telephone service.

2. Banks will inform customers about the interest rates applicable to their accounts, the basis on which tile interest is calculated and when it will be paid to their accounts. Banks will also inform their customers of the basis on which they may vary interest rates.

3. When banks change interest rates wittt immediate effect they will effectively publicise those changes, for example by notices in their branches, if any, or in the press, or on statements of account or a combination of any or all of the methods.

6. HANDLING CUSTOMERS COMPLAINTS

1. Each bank will have its own internal procedures for handling customers' complaints fairly and expeditiously.

2. Banks will inform their customers that they have a complaints procedure. Details of that procedure will be made available at each office showing how complaints can be made and what further steps are available if they believe that the complaint has not been dealt with satisfactorily either at the branch or more senior level within the bank.

3. Banks will ensure that all their staff who deal directly with customers are made aware of their institution's internal complaints procedures and are able to help customers by giving correct information about it.

4. All banks should have public complaints/suggestion boxes displayed in their operational locations.

7. CONFIDENTIALITY OF CUSTOMER INFORMATION

1 Banks will observe a strict duty of confidentiality about their customers

(and former customers') affairs and will not disclose details of customers' accounts or their names and addresses to any third party, including other companies in the same group, other than in the four exceptional cases permitted by the law, namely:

i. Where a bank is legally compelled to do so;
ii. Where there is a duty to the public to disclose;
iii. Where the interests of the bank require disclosure; and
iv. Where disclosure is made at the request. or with the consent, (expressed or implied) of the customer.

2. Banks will not use exception iii above to justify the disclosure for marketing purposes of details of customers' accounts or their names and addresses to any third party, including other companies within the same group.

3. All banks should insist on their staff signing a "Declaration of Secrecy" to guarantee the confidentially of customer information.

Self – Assessment Exercise 3

Explain the Confidentiality of customer information

8. STATUS ENQUIRIES (BANKERS' REFERENCES)

Banks will on request:

1 advise other parties whether they provide bankers' references or bankers' opinions in reply to status enquiries made about their customers; and

2 explain how the system of Status Enquiries (Bankers' References) works.

9. MARKETING OF SERVICES

1 Except in response to a customer's specific written request or where a customer has given his express written consent, banks will not pass customers' names and addresses to other companies in the same group for marketing purposes. Banks will not make the provision of basic banking services conditional on customers giving such written consent. For this purpose, basic banking services' include the opening and the maintenance of accounts for money transmission by means of cheques and other debit instruments.

2 Banks will act responsibly and prudently in marketing. In particular,

banks will ensure that all advertising and promotional literature is fair and reasonable, does not contain misleading information and complies with all relevant legislation, whether relating to their own Bank or their competitors banks.

10 FOREIGN EXCHANGE SERVICES AND CROSS-BORDER PAYMENTS

1 Banks will provide customers with details of the exchange rate and the charges which will apply to foreign exchange transactions.

2 Banks will provide customers wishing to effect cross- border payments with details of the services they offer. In doing so, they will provide, as a minimum:

i. basic description of the appropriate services available and the manner in which they can be used;

ii. information as to when money sent abroad on customers' instructions will usually reach its destination or, when an exact date cannot be given, the latest date by which the money might be expected to arrive; and

iii. the details *of* any commission or charges payable by customers to their bank including a warning where agents' charges may also be incurred

Self – Assessment Exercise 4

Elaborate on the foreign exchange services and cross-border payment of the banking code.

11. GUARANTEES AND OTHER TYPES OF THIRD PARTY SECURITY

1. Banks will advise private individuals proposing to give them a guarantee or other security for another person’s liabilities:

i. that by giving the guarantee or their party security he or she might become liable instead of, as well as, that other person;

ii. that he or she should seek independent legal advise before entering

iii. into the guarantee or third part security.

2. Guarantees and other third party security documentation will be clear and prominent notice to the above effect.

12. INTER-BANK TRANSACTIONS

1 A bank should at all times and as expediently as possible seek adequate information about the credit-worthiness of any other bank before engaging in inter-bank transaction with it.

2 Banks should accord priority to inter-bank obligations.

4.0 CONCLUSION

In conclusion, banks are to provide basic information to customers on these codes conducts of the banking sectors. This will usually be at the time when an account is opened. Information, if any, will also be made available to customers from bank branches. Banks will provide additional information and guidelines about specific services at any time.

5.0. SUMMARY

In this unit, we have learned about:

General standard expected of Bankers and Banking Institutions;

Code of conduct of banking practices

6.0 TUTOR – MARKED ASSISGNMENT

Explain the General standard expected of Bankers and Banking Institutions

7.0 REFERENCES/FURTHER READINGS

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UNIT 3: CORPORATE GOVERNANCE CODE FOR MICROFINANCE BANKS IN NIGERIAN

CONTENT

1.0 INTRODUCTION

Recent disclosures by the Central Bank of Nigeria[CBN] of the large scale mismanagement and gross insider abuses in some of the universal banks taken over by the regulatory authority further strengthened the need for institutionalizing sound corporate governance in every financial institution. Given the large number of over 900 licensed microfinance banks, and the scanty but disturbing public information available on the governance practices in some of those banks, the need for the regulatory authority to establish and enforce implementation of effective guidelines for corporate governance code for this category of banks cannot be over-emphasised.

This paper examines the salient provisions in the operating guidelines on corporate governance issued by the CBN; suggest other issues that need to be addressed in the proposed guidelines; identify the major facilitators and expected deliverables for ensuring that the objectives of the guidelines are achieved; and also suggest appropriate sanctions for violations.

2.0. OBJECTIVES

At the end of this unit, you should be able to:

Issues in Microfinance Corporate Governance;

Objective of Corporate Governance Code;

Control of Insider – Related Activities; and

Sanctions for the Violations of the Code

3.0 MAIN CONTENT

3.1Issues In Microfinance Corporate Governance

The operational framework for microfinance banks issued by the Central Bank set a minimum of two and a maximum of seven directors for a microfinance bank. Two directors other than the executive management are required to have banking experience; and no person is to serve as a director in more than two institutions under the regulatory purview of the Central Bank ofNigeria. Directors must be "fit and proper'' persons; while the board is expected to add value, provide strategic direction and effective oversight through board committees for their respective bank.

The CBN requires each bank to have 'strong' organisation structure, set authorization limits, and possess appropriate management information system[MIS]. Management must be suitably qualified, experienced, competent, committed and certified microfinance practitioners and must also demonstrate high level of integrity and rofessionalism. Microfinance banks are expected to operate in line with commercial principles and best practices, and maintain high accounting and auditing standards. They are also expected to comply with the Code of good corporate governance. Among other prudential requirements, microfinance banks Portfolio at risk [PAR] shall not exceed 2.5% , while monetary penalties are specified for late, false and inaccurate returns.

The foregoing requirements are helpful in providing some guidance for microfinance banks in understanding some of the salient requirements in corporate governance code for the safety and soundness of the operation of the institutions. However the regulatory objectives will be better achieved if each bank is mandatorily required to articulate and faithfully implement corporate governance code based on a model to be provided by the CBN. We give below a specimen example of a code adopted by a microfinance bank, which could be modified to suit individual bank circumstances.

3.2 Objectives Of Corporate Governance Code

The cardinal objective for articulating and faithfully implementing a corporate governance code is to ensure that the bank's affairs are conducted in an orderly and responsible manner in order to ensure that the various stakeholders' expectations are met and indeed surpassed by the board and management who are entrusted with piloting the affairs of the bank.

The Code among other things defines the roles and responsibilities of the board, and also that of the management. In view of the need to ensure that insiders related activities are effectively monitored and controlled to guide against abuses, the code sets acceptable procedures and guidelines for the conduct of insiders related activities. In order to underscore the board members political will to enforce strictly the code provisions, appropriate sanctions are provided for its violations.

Board of Directors

Members of the board of directors are appointed by the shareholders and approved by the Central Bank of Nigeria. Except the Managing Director/Chief Executive who is also a member of the board, every other member is appointed in a non-executive capacity. Every board member is enjoined to recognise that in addition to the direct shareholding represented, he is also responsible for the collective interests of all the other stakeholders of the bank; including the depositors, the employees, the regulators etc. Accordingly the need to ensure that the operation of the bank is at all times conducted in a sound and professional manner is a joint and several responsibilities of all members. Accordingly the board shall have responsibilities, for the following:

- Enunciate and ensure implementation of sound policies on all matters affecting the bank.
- Appoint, remunerate, establish a competitive performance incentive schemes, and discipline all management and other staff of the bank.
- Consider, approve and monitor the implementation of the bank budget, and set budget expenditure limits for management and board committees.
- Consider and approve all credit facilities proposed by the management;
- Establish and monitor agreed performance targets for the management;
- Ensure strict compliance with laws, policies and guidelines issued by the supervisory and regulatory authorities, namely CBN and NDIC.

Carry out other functions and responsibilities as spelt out by the

.	relevant statutes, namely BOFIA, NDIC ACT CAMA.

Management

The Managing Director/ Chief Executive[MD/CE] is the head of the management team and he is responsible for the day to day operation of the bank. The appointment of the MD/CE shall be by the board for an initial period of two years commencing from the date of first appointment; and renewable for another two years subject to satisfactory measurable performance.

The MD/CE shall have primary responsibilities for recommending all credits presented to the board or its Credit Committee for consideration. Accordingly the disbursement and performance of all credits recommended and approved by the board or its Credit Committee is also the primary responsibility of the MD/CE.

The MD/CE shall propose for consideration to the Board Annual Budget for the bank, not later than two months before the commencement of the accounting year to which the budget applies. After approval by the board, the MD/CE shall have responsibility for its implementation. In furtherance to this responsibility, the MD/CE shall be responsible for the efficient management of the bank's resources with a view to ensure very competitive returns to all stakeholders. The MD/CE shall present at every board meeting the financial position of the bank, on monthly and cumulative basis, together with the comparative variance analyses which will show a true and reliable performance evaluation of the bank.

The MD/CE shall have responsibility to ensure that all information on the bank provided to the board or any of its committees are accurate and reliable for the purposes intended in order to provide reliable basis for decision making.

The performance of the MD/CE shall be periodically evaluated by the board based on among other things on the bank's competitive superior performance; impressive return on investment; effectiveness of cost-reduction measures; quantum of non-performing loans; level of frauds and forgeries; provision for losses incurred; level of infractions of statutory regulations; and other evaluation factors to be determined from time to time by the board.

3.3 Control of Insider-Related Activities

The IMFB is not averse to insiders, especially the directors obtaining or guaranteeing credit facilities or having interest in providing any remunerative services for the bank. However, the interests of the directors concerned must be fully disclosed as required by the CBN guidelines. Furthermore, such facilities must be granted without compromising the bank's established rules and procedures. It is however paramount that any such facility granted must fully comply with the CBN lending limits. Furthermore all insider-related facilities must be consistently performing.

Regarding award of remunerative services contracts to interested directors, the bank must ensure that the price is competitive. In this regard the board shall establish a uniform mark-up on the profit to be added to the realistic estimated cost of executing the project to guide the contract cost.

3.3.1Sanctions for Violations of the Code

In order to underscore the importance of effective compliance with the contents of the corporate governance code, the following sanctions shall apply for their violations:

- Where the MD/CE performance for consecutive two years fell below 50% of the budgeted target, his performance shall be adjudged not satisfactory, and appointment may not be renewed.
- Where a loan granted to or guaranteed by a director remains non-performing for a period exceeding six months and is classified doubtful or loss, the director concerned will be called upon to repay the loan, failing which his membership of the Board may be suspended. If the failure to repay persist for an additional period of six months, his removal from the board may be recommended to the shareholders at the annual general meeting.
- No director's related loan or any credit facilities nor the interest accrued thereon shall be written off without CBN written approval.
- Where a contract awarded to an interested director is unsatisfactorily executed, such a director will be compelled to refund the bank's fund disbursed for the contract, in addition to being blacklisted from enjoying the privilege of introducing or recommending anyone for future contracts

The Board of Directors may review the contents of this code from time to time as the need and developments warrant.

4.0 CONCLUSION

The importance of ensuring that every licensed microfinance bank in Nigeria articulates and implement sound corporate governance code cannot be over-emphasised. However given the realistic level of the technical and operational knowledge and competence of the members of the board that are in charge of most of the institutions, the CBN and NDIC will have to provide further necessary guidance and capacity building to assist them to put in place model code. More importantly, the authorities must ensure that violations of approved codes are sanctioned to minimise failure rates in those institutions.

5.0. SUMMARY

In this unit, we have learned about:

Issues in Microfinance Corporate Governance;

Objective of Corporate Governance Code;

Control of Insider – Related Activities; and

Sanctions for the Violations of the Code

6.0 TUTOR – MARKED ASSISGNMENT

Explain the sanctions, for the violations of the banking code

7.0 REFERENCES/FURTHER READINGS

Central Bank of Nigeria (CBN). (2008). Ethics of Professionalisms in the Banking Sectors. Abuja.

Chartered Institute of Bankers of Nigeria (CIBN) (2011). Banks Code of Conduct. Lagos

Chartered Institute of Bankers of Nigeria (CIBN) (2011). Reviews Code Of Conduct For Bankers, May 11.

Vanguard Newspaper (2012). CBN Mandates Banks to Establish Code of Conduct, August 09.

UNIT 4: CODE OF ETHICS & PROFESSIONALISM IN THE BANKING SECTORS

CONTENT

1.0. INTRODUCTION

This unit would examines

2.0. OBJECTIVES

At the end of this unit, you should be able to:

3.0. MAIN CONTENT

3.1. Chartered Institute of Bankers of Nigeria (CIBN) Review Code of Conduct for Bankers

The Chartered Institute of Bankers of Nigeria (CIBN) has reviewed professional code of conduct for bankers practicing in the country. The draft Code of Conduct has been sent to the Central Bank of Nigeria (CBN), Nigeria Deposit Insurance Corporation (NDIC) and the 24 deposit money banks for their input before final copy is endorsed by all the relevant bodies. The disciplinary organs of the Institute, the Investigating Panel and Tribunal have also been activated to ensure enforcement of the subsisting Code. The CIBN President, said action is part of the blueprint set by the body to restore bankers professional reputation in the country. The CIBN boss promised to increase and spread sound banking knowledge and practice to bankers, which he said can be achieved through improved corporate governance structures. The review of the Code of Conduct for bankers became exigent after series of corporate governance breaches and outright mismanagement of public funds that led to near collapse of some 10 banks rescued by the CBN with N620 billion tax payers funds.

3.2 Code of Ethics and Professionalism in the Banking Sectors

This is produced by the Sub-committee on Ethics and Professionalism of the Bankers Committee. The code contains a list of acts, conducts and omissions classified as unethical as well as the frame work for addressing these in the business of banking and finance in Nigeria. The code thus provides the procedure for dealing with complaints of unethical practices and the sanctions for infractions of the provisions.

Unethical practices/unprofessional conduct in banks include but are not limited to the following:

1. Conflict of interests.
2. Abuse of Trust / Office.
3. Misuse of information.
4. Insider Abuse.
5. Offer and Acceptance of Gratification.
6. Non-conformity with standards and Guidelines.

7. Associating with people of doubtful character.

8. Aiding and Abetting.

Sanctions

The Sub-Committee shall apply the following sanctions:

1. The fundamental principles of restoration, retribution, deterrent and equity will be given priority in the application of sanctions on all cases decided.

2. Where offences are clear and contradict existing regulatory guidelines e.g. CBN guidelines - CBN sanctions would apply.

3. For offences with no precedent, the Sub-committee would use its best judgement based on the principles enunciated above. In such cases, the Sub-committee will recommend specific sanctions to the appropriate regulatory body.

4. Individuals may be warned or advised by the Sub-committee where necessary.

5. In all cases of sanctions, specific time-frame shall be stated for compliance.

3.2 Central Bank of Nigeria Mandates Banks to establish Code of Conduct

The Central Bank of Nigeria, CBN, has directed banks in the country to set up codes of conduct that would guide their practices and detail their compliance to highest ethical and professional standards, even as it announced plans to review its code of corporate governance and issued new guidelines for whistle-blowing in banks.

The CBN, in a document posted on its website,titled, ‘Exposure Drafts of the Revised Code of Corporate Governance for Bank in Nigeria and the

Guidelines for Whistle-Blowing in the Nigerian Banking Industry,' signed by Chris Chukwu, Director, Financial Policy and Regulation Department, said the code shall commit the bank, its Board and management (and employees) to the highest standards of professional behaviour, business conduct and sustainable business practices.

In the proposed code, the CBN is also seeking to ensure that banks put in place a proper succession plan for its Chief Executive Officer, executive directors and top management staff. The CBN is also planning, through the revised code which is scheduled to come into effect soon, to ensure that no two members of the same extended family occupy sensitive position in any bank in the country. According to the document, no two members of the same extended family shall occupy the positions of Chairman and Managing Director/Chief Executive Officer or Executive Director of the bank and Chairman or MD/CEO of a bank's subsidiary at the same time. CBN further barred Board Chairmen from being members of Board committees of the various banks and their subsidiaries, except for the Governance and Nominations Committee, the various Board committees shall be headed by non-executive directors.

The apex bank further made it mandatory for all directors of banks to attend all meetings of the Board, saying that in order to qualify for re-election, a director must have attended at least two-thirds of all board meetings. As a means to regulate this, the revised code requires that, "The Board shall disclose, in the Corporate Governance section of the annual report, the total number of board meetings held in the financial year and attendance by each director. The CBN further reiterated its position on government's ownership of banks, pegging government's maximum direct and indirect equity holding in any bank at 10 per cent.

On banks establishing code of conduct, the CBN said, "Banks shall establish a code of conduct and disclose the code or a summary of the code as to: the practices necessary to maintain confidence in the bank's integrity; the practices necessary to take into account their legal obligations and the reasonable expectations of their stakeholders; the responsibility and accountability of individuals for reporting and investigating reports of unethical practices.

"The code shall commit the bank, its Board and management (and employees) to the highest standards of professional behaviour, business conduct and sustainable business practices.

"Be developed in association with management and employees; receive commitment for its implementation from the Board and the managing director/chief executive officer and individual directors of the company. Be sufficiently detailed as to give clear guidance to users including advisers, consultants and contractors."

5.0. SUMMARY

In this unit, we have learned about;

6.0 TUTOR – MARKED ASSISGNMENT

Explain the

7.0 REFERENCES/FURTHER READINGS

Adam, J.S (2005). Banking sector Reforms: The Policy challenges of banks consolidation in Nigeria, A paper presented at the 46th Nigerian Economic Society (NES0 annual conference, Lagos, 23-25 August.

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