UNDERSTANDING THE NIGERIAN FINANCIAL REGULATORY ARCHITECTURE

INTRODUCTION

The financial sector - banking, capital markets and securities, insurance, as with any other sector of the economy, is vital to Nigeria's growth and development, thus it is crucial to properly safeguard it by means of laws, adequate supervision and monitoring. This is especially important as it ensures that a balance is maintained because failure to do so may have a ripple effect on all other sectors of the economy. This then explains the role regulation plays in preserving the economy of any society or state. Regulation in this regard, comprises of the various laws, rules and institutions which exist to ensure that the financial ecosystem of a society is protected with a view to preventing and or absorbing financial risks as they may arise, as well as protect the investing public, and ensuring financial stability of the economy.[1]In other words, it is the body of rules which govern the product and services offered by financial institutions. These laws establish agencies which oversee the functioning and compliance of financial service firms through a series of policies and regulations, and with the aim of protecting investors/consumers from exploitative practices and promoting financial stability.[2]For example, the Central Bank of Nigeria (CBN) is the primary regulatory body tasked with the role of supervising and monitoring banks and other financial institutions in Nigeria through its oversight functions.

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1 O. Olanipekun, SAN., *Banking Regulation and Supervision: Concept, Theory & Rationale*(Aucourant Lagos, 2016) 5.

2 M. Schmidt, C. Stapleton and A. Courage, Financial Regulators: Who They Are and What They Do. <https: investopedia.com/articles/economics/09/financial-regulatory-body.asp>accessed on 23 July 2023.

However, irrespective of the measures put in place over the years, the financial sector has been severally plagued with distress since the inception of banking business in Nigeria. In carrying out its functions, the CBN has severally stepped in to rescue financial institutions from failing e.g., revocation of the licenses of failed banks and through its recapitalization policy for distressed banks which was occasioned by a decline in their capital base largely due to bad loans given by these institutions.[3]

Historically, Nigeria's financial regulatory system has made no small amount of progress, coupled with innovations, which have become necessary in preventing or at best, managing economic crises as have been witnessed in the past.[4] It has been argued that regulations are generally ineffective and therefore, not necessary because it has failed to prevent re-occurrences of financial crises both in Nigeria and elsewhere resulting in rising costs of inflation and a decline in investments in general.[5] It must however be noted that regulatory laws and bodies cannot be dispensed with because of the sensitive position the financial sector holds and a resultant significant cost a lack of regulation can incur.This underscores the importance of regulating financial institutions because regulations seek to prevent and investigate fraudulent practices which occur in the sector through its objective of promoting efficiency and transparency which

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3 C. Didigu et al, 'Monetary Policy and Banking Sector Stability in Nigeria'*CBN Journal of Applied Statistics*, 13 (1) 4.

4 Systemic banking failures have been resolved either through restructuring, bank bailouts etc, with the CBN bailing out as much as 14 indigenous banks in the last decade. See: Charles N.O. Mordi, The Nigerian Financial Crisis: Lessons, Prospects and Way Forward. <https://dc.cbn.gov.ng/bullion> accessed on 20 July 2023.

5 Proponents of deregulation argue that elaborate legislations reduce investment opportunities and stunt economic growth. Examples of the Stock Market Crash of 1929 and the Great Recession of 2008 have often been cited to buttress this point which all happened despite regulations which were in place. See: Deregulation: History, Effects, and Purpose <www.investopedia.com> accessed on 20 July 2023.

serves to build the confidence of the investing public in the sector and prevents panic.[6]

Ultimately, despite the arguments against regulating the sector, it would seem that the pros outweigh the cons. The need for standard regulatory laws, monitoring and supervision of the financial sector must continuously be emphasized such that in the advent of crises, it can be effectively managed and maybe prevented to a large extent. This essay considers the role and effectiveness of several regulatory agencies in light of their enabling laws in respect of the Nigerian financial sector vis-à-vis the banking sector.

OVERVIEW OF THE NIGERIAN FINANCIAL SECTOR

Before the enactment of the CBN Act in 1959, the development of banking business in Nigeria commenced with the establishment of the African Banking Corporation in 1883, and subsequently, the Bank of British West Africa in 1884 to meet the business demands and facilitate trade in the colonial era. Several indigenous banks were later set up from 1929,[7] however, a majority of these banks failed due to factors which include inadequate capital base, inexperienced management, etc.[8] These events necessitated the enactment of the Banking Ordinance of 1952 upon the recommendations made by the G.D. Paton commission of enquiry into banking activities in Nigeria which put forward

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6 Regulations seek to build the confidence of the public especially in the banking sector. This seeks to prevent panic or bank runs. For example, the earlier part of 2023 saw the collapse of the Silicon Valley Bank in the United States due to a bank run in March, and its subsequent takeover by First Citizens. See: The Week in Business: A Bank Takeover <www.nytimes.com/business> accessed 23 July 2023.

7 The Industrial and Commercial Bank was the first indigenous bank established in Nigeria in 1929, although it failed in 1930.

8 This is also referred to as the free era of banking where no sustainable framework for the supervision of banks existed. See: Central Bank of Nigeria/History. <www.cenbank.org/AboutCBN/history.asp> accessed 23 July 2023.

measures for controlling banking activities, and placed supervisory powers in the Financial Secretary. The Ordinance aimed to oversee the establishment of commercial banks and act as a check on unregulated banking activities.[9] This era also saw the formation of several specialized banks – community banks, development banks and merchant banks e.g., Nigerian Industrial Development Bank, Nigerian Bank for Commerce, and Nigerian Agricultural and Credit Bank.[10]

The enactment of the CBN Act in 1959 empowered the CBN with supervisory and regulatory powers previously vested in the Financial Secretary under the Banking Ordinance, with its objectives which includes issuing of a legal tender in Nigeria and safeguarding the value of the currency both in domestic and international markets, promoting stability and securing a sound financial system, advising the government on financial policies, and serving as a bank of last resort to other domestic banks.[11] These objectives are achieved through the formulation of policies and rules to which all financial institutions must comply. The decades after the enactment of the CBN Act saw an increase in indigenous banking activities to meet with the demands of the advancing sector.[12] The Nigeria Deposit Insurance Corporation (NDIC) was also established in 1988 by virtue of the Nigeria Deposit Insurance Corporation Act, with its core functions supplementing those of the CBN in carrying out and executing sound financial policies, supervising and ensuring safe banking services by monitoring actors in the financial sector through insuring financial institutions and paying out deposits

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9 T. Ajayi and M. Sosan, The Evolution of Nigerian Banking System, Supervision and Current Challenges <https://ssrn.com/abstract=2286200> accessed 23 July 2023.

10 Ibid.

11 Central Bank of Nigeria Act, 2007.

12 A push for deregularization and liberalization of the sector led to an exponential rise in commercial banking activities which promoted competition in the industry. See: Historical Development of Banking in Nigeria. <www.thelawlane.com>accessed 23 July 2023.

of failed insured financial institutions.[13] Other bodies such as the Asset Management Corporation of Nigeria, Corporate Affairs Commission, The Securities and Exchange Commission, The Financial Reporting Council of Nigeria etc., all work to check unsafe practices in the financial sector.[14]

Over the years, studies have identified several factors which are responsible for banking failures such as poor management and weak internal structures of banks, poor regulation, monitoring and supervision etc., resulted in banking failures in the 1950's and 1980's.[15] Other economic factors including inflation and exchange rate, capital inadequacy, lack of transparency and a high volume of non-performing loans, also contribute to the fragility of the sector, with as much as 53 Deposit Money Banks being closed down by the CBN following a revocation of their operating licenses between 1994 and 2018, while 51 other banks were in the process of being wound up with the NDIC appointed as liquidator.[16] Thus, regulations seek to put in place several measures to mitigate the effects of such occurrences. The CBN carries out this function through its committees e.g., the Monetary Policy Committee, Monetary Policy Forum etc., which are tasked with evaluating economic and financial conditions, and determining economic conditions both in the long and short run.[17]

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13 NDIC: Mandate, Powers and Functions<www.ndic.gov.ng> accessed 23 July 2023.

14 Financial Reporting Council of Nigeria Act 2011, s. 1.

15 B. Adeyemi, 'Bank Failure in Nigeria: A Consequence of Capital Inadequacy, Lack of Transparency and Non-Performing Loans?'(2011)6 (1) Banks and Banks Systems, 99.

16 Closed Financial Institutions/NDIC <www.ndic.gov.ng/failureresolution> accessed 23 July 2023. This is in addition to CBN interventions. It was reported that the CBN and AMCON have spent about N3.83 trillion in bailing out distressed banks since 2009 <https://businessday.ng/exclusives/article/cbn-amcon_spendn38-trillion-rescuing-sick-banks-since-2009/> accessed 23 July 2023.

17 <www.cbn.gov.ng> accessed 23 July 2023. The CBN also released regulatory and supervisory guidelines for Development Financial Institutions in 2015 in order to encourage and maintain the overall socio-economic atmosphere.

LEGAL AND REGULATOR FRAMEWORK OF THE NIGERIAN FINANCIAL SECTOR

Central Bank of Nigeria (CBN) ACT 2007– It established the Central Bank of Nigeria (CBN), which is the apex regulator of banks in Nigeria. The CBN is the primary regulatory body tasked with the role of supervising and monitoring banks and other financial institutions in Nigeria through its oversight functions. The CBN is managed by the board of directors, and its members are appointed by the government. The Bank and Other Financial Institutions Act (BOFIA) 2020, is another important legislation that regulates banks and other financial institutions. The powers, duties and functions of the CBN are also derived from BOFIA.

Mandates/Objectives of the CBN –

The following objectives of CBN are derived from Section 2 of the CBN Act, 2007:

a. To ensure monetary and price stability[18]- The CBN watches and controls government spending to ensure that there is no high budget deficit. In order to attain price stability and support the economic policy of the Federal Government, Section 12 of the CBN Act established a committee of known as Monetary Policy Committee.

   The functions[19] of the committee are:

   i. To review the economic and financial situation in the Nigerian economy.

   ii. To take a stance of policy in the short to medium term.

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18 CBN Act 2007, s. 2(a).

19 Central Bank of Nigeria, Monetary Policy Committee. <https://www.cbn.gov.ng/monetarypolicy/Committees.asp#:~:text=The%20Monetary%20Policy%20Committee%20is,and%20adopt%20changes%20when%20necessary> accessed 21 July 2023.

iii. Regularly review the framework of the CBN monetary policy and make changes whenever it becomes necessary.

iv. To ensure effective communication of monetary or financial policy decisions to the public as well the credibility of the transmission mechanism.

Some monetary policy instruments used by government are:

i. Reserve Requirements - The CBN necessitate Deposit Money Banks to reserve a fraction of the deposit in their banks as vault cash.

ii. Open Market Operations - The CBN sells or buys securities to both banking and non-banking public. By selling, the supply of reserves is reduced and by buying, it increases supply.

iii. Direct Credit Control - The CBN can mandate Deposit Money Banks on the maximum percentage to give different sectors of the economy, interest rates.

b. Issue legal tender currency in Nigeria[20] - The CBN is solely empowered to issue legal tender in Nigeria. The issuance relates to the design, volume, format and denominations, composition and standard weights.

c. Maintain external reserves to safeguard the international value of the legal tender currency[21] - The CBN is tasked with maintaining a good level of reserve in order to minimise volatility that can affect the country. External reserves are also called foreign exchange reserve. They are assets such as treasury bills, foreign banknotes, bonds, government securities held on

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[20] Ibid (14) s 2(b).

[21] Ibid (14)s 2(c).

reserve by a monetary authority in foreign countries. They act as a backup fund for a nation that can be easily converted to cash if there is devaluation of the currency. The maintenance and management of Nigeria's external reserves lies in the CBN. The objective of the reserve management includes ensuring the safety and preservation of capital.

d. Promote a sound financial system in Nigeria[22] - One of the core objectives of the CBN is to promote a sound financial system. It can achieve this by formulating and implementing policies that will attain monetary stability.

e. Act as banker and provide economic and financial advice to the Federal Government.[23]

Investment and Securities Act 2007 - It regulates the business of investment and securities in Nigeria. It performs this function through the bodies created under it as listed below;

Securities and Exchange Commission (SEC) – The Securities and Exchange Commission is the apex regulator of the Nigerian capital market. The capital market is the market in charge of the investments and securities business. Just as anyone would go to a food market to either buy or sell, it is the same way anyone interested in investment and securities business would carry out his trade in the capital market. According to Omojola,[24] 'the capital market is a framework of institutions that arrange for the sale and purchase of long-term financial assets, such as share, government stocks debentures, etc.'

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22 Ibid (14) s 2(d).

23 Ibid (14) s 2 (e).

24 A. Omojola, *Capital market operations* (Credible associates limited, Nigeria, 2006) 16.

A healthy capital market cannot be underestimated by any economy which seeks growth. According to Olajide,[25] 'the capital market is considered the bedrock of growth and development of modern national economy because it can attract investors to invest in the economy.' The effect of a good capital market is felt by the economy as it attracts a great number of investors, both national and foreign investors, which in turn is good for the economy. However, investors will only invest in an economy where they have confidence and security of their investment. It is for this reason that effective regulations cannot be undermined.

Objectives of the Securities and Exchange Commission

All of the different activities are utilised by SEC is to meet the following objectives:

a. to ensure that investors are protected,
b. to ensure market operators are protected,
c. to ensure and uphold integrity of the market as well as ensure organized and equitable transactions in securities business.

Functions of the Securities and Exchange Commission[26]

a. It regulates investment and securities business in Nigeria
b. Register and regulate corporate and individual capital market operators
c. Keep and maintain a register of foreign portfolio investments
d. Protect the integrity of the securities market against all forms of abuse including insider dealing

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25 David Ademola Olajide, 'Capital Markets and Law: Nigeria As a Case Study' (2020) < https://ssrn.com/abstract=3744995> accessed 21 July 2023

26 Investment and Securities Act 2007, s 13.

e. Review, approve and regulate mergers, acquisitions, takeovers and all forms of business combinations and effected transactions of companies

f. Authorize and regulate cross-border securities transactions

g. Enter and seal up the premises of persons illegally carrying on capital market operations

h. Conduct research into all or any aspect of the securities industry

i. Prevent fraudulent and unfair trade practices relating to the securities industry

j. Disqualify persons considered unfit from being employed in any arm of the securities industry

k. It registers securities and capital market intermediaries (these are entities such as commercial bank, mutual fund or investment that provide assistance to both the issuing companies and the investors in carrion out transactions) to ensure that only individual who are fit can operate in the capital market

l. It performs inspection on market operators to ensure compliance to common practices and non-involvement in activities that are fraudulent

m. It ensures their operation are efficient and within the ambit/scope of the law by requesting information from the market operators at regular intervals

Administrative Proceedings Committee (APC)

It is a quasi-judicial committee of the SEC which engages in fact finding. One of the functions of the SEC is to sanction operators or regulated entities who act contrary to the regulations. The Investment and Securities Act empowers the Securities and Exchange Commission to appoint one or more committees to execute such function on its behalf. An example of the committee is the Administrative Proceedings Committee (APC) that was set up to enforce the regulation of the Nigerian capital market. In case of any disputes between the market operators and institutions, it hears such matter and considers if there has been any violation or attempted violation of the Act.

It hears complaints made by investors against capital market operators. Because it is a committee of the SEC its decision will be regarded as decision of the SEC. An appeal can be made to the IST.

Investment and Securities Tribunal (IST)

It is another body established under ISA[27]to resolve disputes relating to the Nigerian Capital market. It has exclusive jurisdiction to hear and determine disputes involving the Commission as it relates to disputes between capital market operators, capital market operators and their clients, investors and clearing and settlement agency, SEC and self-regulatory organization, SEC and capital market operators, investors and SEC.[28] Decisions made will be enforced in the same manner in which a decision of the Federal High Court will be.

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27 Ibid s 274.
28 Ibid s 284.

Nigeria Deposit Insurance Corporation (NDIC) Act, 2006

It established the Nigeria Deposit Insurance Corporation (NDIC), which is the body that regulates deposit insurance scheme in Nigeria. Deposit Insurance is a financial structure put in place to protect the deposit of depositors in the event of bank failure, which makes it difficult for the bank to meet its obligation owed to depositors. In essence, it is a financial guarantee to depositors that when a bank fails, all of their funds are not lost. According to Garcia, 'deposit insurance is the protection offered under a system which provides a guarantee that all, or a limited amount of the principal and the interests accrued on protected accounts will be paid.'[29]

Deposit insurance aims to achieve the following:

a. In the event that there is bank failure (which is the risk insured against), deposit insurance indemnifies the depositor.
b. Deposit insurance promotes confidence in banks by ensuring that specific problems in one bank does not spread to the entire banking sector.

Forms of Deposit Insurance Protection

a. **Implicit Deposit Protection Scheme -** The protection of bank depositors is implied, as there is no formal arrangement to the effect. There is no legal obligation which offers protection to depositors, there are no set rules which determines the limit that compensation would cover, neither are there any designated funds set aside for the purpose. Rather the

[29] G Garcia, 'Deposit Insurance: Obtaining the Benefits and Avoiding the Pitfalls' (1996) *IMF Working Paper WP96,* 83.

government decides whether to offer relief or compensation to depositors. It is a discretionary assistance offered by the government.

Three basic ways the government provide assistance to depositors of failed banks are:

I. The government pays the depositor directly or arranges for the deposits of a failed bank to be handled by another bank.

II. Government provides support for another solvent bank to acquire the failing bank or emerge with it.

III. Direct rehabilitation of the bank by government.

b. **Explicit Deposit Insurance Scheme -** The deposit insurance is protected through a legal instrument. For example, The Nigeria Deposit Insurance Corporation (NDIC Act, 2006), Canadian Deposit Insurance Corporation (CIDIC Act, 1976).

Mandates of the NDIC

The main goal of the NDIC is to maintain stability and public confidence in banking system. It achieves this by ensuring payments of deposits to depositors where there is bank failure and also by promoting safe practices through effective supervision.

Functions of the NDIC

Section 2 of the NDIC Act states the following as it functions:

a. insuring all deposit liabilities of licensed banks and such other deposit-taking financial institutions operating in Nigeria to engender confidence in the banking system

b. giving assistance in the interest of depositors and also avoiding damage to public confidence in the banking system;

c. guaranteeing payments to depositors, in case of imminent or actual suspension of payments by insured financial institution up to a maximum insured amount (as stated in Section 20 of the Act)

d. assisting monetary authorities in the formulation & implementation of banking policies to ensure sound banking practice and fair competition among banks operating in the country

e. pursuing any other measures necessary to achieve NDIC functions provided such actions are not repugnant to its objective.

Powers of the NDIC

To carryout its objectives and functions, the NDIC has the following powers:

a. Powers to appoint examiners for the periodic examination of banks

b. Where the board believes that the insured bank is carrying business which is detrimental to the depositors and creditors interest, it can carryout special examination into the insured bank

c. It has the power to remove any officer in violation of its obligations or of the Act.

d. Power to act as liquidator.

e. Power to require information that relates to the interest of the depositors.

EFFECTIVENESS OF REGULATIONS IN LIGHT OF RECENT POLICY CONSIDERATIONS IN THE NIGERIAN FINANCIAL SECTOR

In light of the current state of the Nigerian economy, it is important to consider the effectiveness or otherwise of the various regulatory structures which are in place, and the extent of implementation of financial policies. First, the CBN has put several measures in place to ensure a smooth working of the financial system. One of the identified causes of bank failures in the past has been attributed to improper management and fraudulent activities in financial institutions. A prime example of such measures is the issuance of various Codes of Corporate Governance across the financial sector,[30] in a bid to stifle rampant occurrences of mismanagement of banks and other financial institutions. These Codes seek to establish management and stability in the tenure of office, composition of boards etc., in order to ensure good corporate governance in these institutions as well as transparency. In a recent study of several banks, there was shown to be a significant relationship in terms of board size, board composition and audit committee and their financial performance.[31] This is important because financial institutions in Nigeria holds great economic implications and the confidence of stakeholders who invest in these institutions must be adequately protected.[32] However, it must be noted that one loophole in this regard, is that some Codes do not have provisions for sanctions upon failure to implement them e.g. The SEC

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30 For example; The Code of Corporate Governance for Banks and Discount Houses in Nigeria, 2014 and Code of Corporate Governance for Other Financial Institutions in Nigeria, 2018. Section 11 (c) and 51 (c) of the Financial Reporting Council of Nigeria Act, No. 6, 2011, also gives the Financial Reporting Council the power to ensure good corporate governance in both the public and private sectors of the economy.

31 U. M. Joshua, E.J. Effiong and N.R. Imong, *Effect of Corporate Governance on Financial Performance of Listed Deposit Money Banks in Nigeria* (Global Journal of Social Sciences Vol. 18, 2019) 116.

32 The Codes aim to supervise and control the management of banks and other financial institutions based on ethical considerations. See: T. Ajayi and M. Sosan, The Evolution of Nigerian Banking System, Supervision and Current Challenges<https://ssrn.com/abstract=2286200> accessed 23 July 2023.

Code of Corporate Governance for Public Companies in Nigeria, 2011. This then means that compliance is not obligatory and institutions may choose to flout them.[33]

Second, in a bid to ensure soundness in the financial ecosystem and reduce systemic risks, the CBN has introduced various monetary policies in order to maintain stability and an efficient financial system in Nigeria. An example of this is the recent unification of the exchange rate to be determined by market rates in order to achieve market stability. Various economic experts have lauded this move by the CBN to make the Naira freely floating,[34] however, some concerns have been raised in its implementation majorly citing an unconducive environment for doing business in Nigeria, in order to avoid adverse consequences especially when considered alongside the recent fuel subsidy removal. The effects of this will be more evident in the long run with advantages including a stabilization of the exchange rate thereby reducing uncertainty and enhancing investor confidence.[35]

Third, the CBN earlier this year, moved to implement the naira redesign policy for some denominations of the naira. This policy was met with a great number of hardships especially given that the economy had hardly recovered from the COVID-19 stint. The policy involved a removal of the old notes of the affected denominations from circulation while new notes were minted with the view to curbing banknote hoarding by the public and to combat the shortage of clean and fit banknotes, counterfeiting as well as the fact that the policy was long overdue

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33 B. Sodipo and V. Ekundayo, *Corporate Governance in Banking* (Aucourant Lagos, 2016) 98.

34 Nigeria Lets Market Set Currency Exchange Rate to Stabilize Economy and Woo Investors<www.independent.co.uk> accessed 23 July 2023.

35 Experts Laud the Unification of Exchange Rate<www.tribuneonlineng.com> accessed 20 July 2023.

given that redesign should ordinarily be carried out every 6 to 8 years interval. The public were encouraged to utilize e-banking options and other cashless channels in carrying out transactions such as Payment Service Banks. The objectives of the policy were to help check counterfeiting, enhance CBN's visibility of the money supply and to strengthen the economy.[36] However, implementation of the policy to a large extent left the economy vulnerable in that a limited access to physical cash meant that basic needs and businesses could not be transacted with ease. The cash crunch experienced earlier this year raises the pertinent question of the practicability and effectiveness of the cashless policy which was introduced earlier in 2012. Despite the move to make the economy less reliant on physical cash, it is evident that the opposite is the case. This greatly hampered the effective implementation of Naira redesign policy. The import of this is that monetary policies must be adequately implemented and must be carefully considered as a whole i.e., both long-term and short-term implications.

CONCLUSION

Against the backdrop of the above, a great emphasis must be placed on not only regulators, but on the institutions which are regulated. It is evident that implementation is as important as the regulations and policies themselves. While it cannot be stated categorically that occurrences of financial risks can be completely avoided due to the dynamic nature of the financial sector, regulatory bodies must consider better ways for preventing financial crisis or as far as possible, cushion their effects in the event of reoccurrence. It is important that regulations and policies are in tandem with current developments and demands

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[36] CBN Circular on Naira Redesign<www.cbn.gov.ng> accessed 23 July 2023.

of the economy while maintaining their basic objectives of maintaining financial stability and protection of the public interest. Scholars have suggested the adoption of a risk-based approach in regulating the financial sector.[37]

The importance of a solid legal and regulatory framework cannot be overemphasized and it is important that in making policies, regulatory bodies must consider the best approach in achieving their objectives either by consideration of models which have worked for other economies and adoption of international best practices and evaluating the implications of applying them in our jurisdiction. Strategic economic models and solutions must also be put in place for cushioning the effect of incompetent implementation of policies. Also, the major players in the financial sector and their management must recognize the important role they play and endeavor to maintain integrity and high ethical standards in complying with regulatory directives in order to boost growth and stability in the financial sector.

[37] O. Olanipekun (n 1) 52.