CENTRAL BANK OF NIGERIA
BANKING SUPERVISION
ANNUAL REPORT
1998

The Banking Supervision Annual Report is a publication of the Bank Examination and Banking Supervision Departments of the Central Bank of Nigeria. The publication reviews policy and operational issues affecting the financial sector and its supervisors, with the main objective of disseminating information on current issues.

Correspondence regarding the publication should be addressed to the Director of Banking Supervision, Central Bank of Nigeria, Zaria Street, Samuel Ladoke Akintola Boulevard, P.M.B. 0187, Garki, Abuja - Nigeria.

FOREWORD

The restoration of autonomy to the Central Bank of Nigeria (CBN or the Bank) could not have come at a more auspicious time than in 1998 when, in spite of the generally misunderstood role of the CBN, it lacked discretion in taking prompt action in dealing with the problem of distress without recourse to the political authorities. The granting in 1997, of co-ordinate supervisory powers to the CBN and the Nigeria Deposit Insurance Corporation (NDIC), in the management of distressed banks, not only constrained the Bank's activities, but also sent wrong signals to operators in the financial sector. The newly won autonomy, however, imposes a number of challenges on the Bank in the areas of monetary management, promotion of an efficient payment system and surveillance of banks and non-bank financial institutions.

The CBN will need to re-focus its attention on capacity building, especially in the quality of its human resources and the use of state-of-the art information and communications technology which will assist it in the effective performance of its statutory duties.

The management of liquidity in the banking system had posed serious challenges for the Bank in the past and has remained a major problem. Indeed, experience has clearly demonstrated the difficulty in trying to manage excess liquidity through discount window operations and regular changes in short-term interest rates. The challenge is for the Bank to cultivate and sustain consultations with the government, the money market operators and the private sector in order to enhance the effectiveness of the Bank's performance.

In the discharge of its statutory responsibility of promoting a safe and sound financial system in the country, the Bank, in 1998, took a variety of distress resolution measures including the liquidation of terminally distressed banks. The recent increase in the minimum paid-up capital requirement of both commercial and merchant banks to a uniform level of ₦500 million with the compliance deadline of December 1998 was aimed at stregthening the capital base of the banks and enhance their ability to compete with foreign banks. Consequently, in recognition of the challenges of creating a viable banking system, prompt attention will be given to the creation of the enabling legal and operational environments that will foster healthy competition among the banks as well as ensure their viability.

The publication of the Banking Supervision Annual Report will continue to serve as a forum to mirror and gauge the activities and performance of CBN's regulatory efforts in achieving its objective of promoting a stable and sound financial system in Nigeria. The annual publication has opened up the supervisory efforts of the Banking Supervision and Bank Examination Departments by bringing to the fore contemporary banking issues that are germane to the development of the financial system in Nigeria.

It is delightful to note the appreciable response that greeted the 1997 Report which was the maiden edition. In particular, commendations were received from both foreign supervisory bodies and practitioners at home. It is my wish therefore, that the standard and quality already established for the Report would not only be sustained but would continue to elicit reactions and discourse among operators and scholars alike.

DR. SHAMSUDDEEN USMAN
DEPUTY GOVERNOR
DOMESTIC MONETARY AND BANKING POLICY
CENTRAL BANK OF NIGERIA

PREFACE

In line with the outline adopted in the maiden edition, this issue reviews major developments in the areas of supervisory policy initiatives and the trends in the overall performance of the Nigerian banking industry. It is organised into five chapters for ease of presentation. Chapter one, on recent developments in the Nigerian financial services industry reviews, among others, the issues of concession to merchant and discount houses on branch network, conversion of merchant to commercial banks, lifting of embargo on licensing of new banks, supervision of other financial institutions and the 1998 Bank Examiners' Conference.

Chapter two on current issues in supervision covers a wide range of new issues, including the criteria for approving financial statements of banks and other financial institutions, the cash reserve requirement as a tool of monetary policy, the examination of banks - the role and focus of regulatory authorities, an update on electronic banking, farming out of the CBN's supervisory functions and self-regulation.

Chapter three on legal framework and supervision highlights the major changes introduced in the 1998 Bankers Tariff and amendments to the Banks and Other Financial Institutions Decree (BOFID) 1998 while chapters four and five dwell on performance trends in the banking sector and capacity building for supervisors, respectively.

The Acting Directors of Bank Examination and Banking Supervision Departments express their gratitude to the Governor, the Deputy Governor, Domestic Monetary and Banking Policy and the entire Management of CBN for their strong support on this project. Also commended are the efforts of the members of the Banking Supervision Annual Report Committee drawn from the twin departments and other staff who either contributed inputs or provided secretarial assistance towards the successful preparation of this Report.

CHIEF M. O. EJINIMA
AG. DIRECTOR OF BANK EXAMINATION DEPARTMENT

CONTENTS

CHAPTER TWO

CHAPTER THREE

CHAPTER 1

1.00 RECENT DEVELOPMENTS IN THE FINANCIAL SERVICES INDUSTRY

1.01 CBN Involvement in the Activities of Regional Supervisory Bodies

In its continued efforts towards achieving its objectives, the Committee of Bank Supervisors in West and Central Africa held its 4th Annual Meeting in Yaounde, Republic of Cameroon, between 4 and 6 February, 1998.

During the meeting, the Committee deliberated on contemporary issues which included the resolution of financial sector distress, cross-border supervision, deposit-protection schemes and money laundering activities. The out-going Chairman of the Committee, Mr. G. A. Ogunleye, Director of Banking Supervision, Central Bank of Nigeria reviewed the activities of the Committee during his tenure before he handed over to his successor, Mr. Adam Madji, Secretary-General of Commission Bancaire de L'Afrique Centrale (COBAC).

After the election of Mr. Adam Madji, member countries presented papers on developments in their banking systems. A representative from the French Banking Commission, Mr. Henry De Ganay, presented a paper on the French experience in the supervision of decentralised institutions and discussed the following issues, among others:

- Improvement of the legal environment for each country in order to enhance supervision;

- Implementation of the Basle Committee Core Principles For Effective Supervision;
- The need to protect depositors through the creation and improvement of the deposit insurance scheme;
- The need to reflect on the terms/conditions for the supervision of off-shore banks which have started to emerge in the sub-region (Cape Verde and Burundi are examples);
- The supervisory challenges posed by the proliferation of savings and loans co-operatives and other decentralized financial institutions;
- Socio-political instability as a destabilizing factor in supervision;
- The need to strengthen co-operation with other sub-regional groups such as the East and South African Supervisors Forum (ESAF);

Beyond the discussion of various papers, the following action plan for 1998/99 was adopted:

i] Organisation of a seminar for Heads of Banking Supervision with the themes, Corporate Governance and Bank Rating

ii] Organisation of an annual training seminar for junior/middle level supervisors.

Apart from the above, the Committee agreed on the following:

i) Re-definition of the Committee's territorial coverage

ii) Establishment of a permanent secretariat

iii) Adoption of the Core Principles For Effective Banking Supervision

iv) Sensitising the financial services industry on the Year 2000 problems, thereby complementing the efforts of the Basle Committee in that regard.

1.02 **Implementation of the Bank Analysis System (BAS)**

A test-run of the Bank Data Entry (BDE) of Bank Analysis System (BAS) was carried out in 35 banks for further validation before its final installation and parallel run in banks.

As a result of the observations from the test-run the system was fine-tuned by CBN/NDIC technical staff and the consultants in order to enhance performance and following the request by banks, a refresher course was organised for their staff in October 1998.

After fine-tuning the system, the installation of Bank Data Entry (BDE) was effected in 84 out of 89 banks. The five (5) banks that could not provide the machine for installation were all distressed.

Following the successful installation of the BDE software in banks, Help Desks were established in both Lagos and Abuja offices of the CBN to assist banks in solving any problems that might arise during the parallel run which commenced with the November 1998 returns. During the parallel run, banks were required to submit their returns in hard copies and diskettes.

Overall, downloading into diskettes was 96% and 93% successful with November and December 1998 returns respectively. The diskettes were also successfully uploaded into BAS and reports were generated for comparison with manual operations.

1.03 **Developments in Money Laundering Surveillance in Nigeria**

In May, 1998, the Central Bank of Nigeria, in collaboration with the Financial Institutions Training Centre (FITC), organised a workshop on Money Laundering Surveillance for banks' Chief Compliance Officers. The programme represented Central Bank of Nigeria's continuing effort toward sensitizing operators in the Nigerian financial services industry to the issues involved in money laundering as well as keeping them abreast of the expectations of the regulatory and enforcement authorities in respect of the fight against the scourge.

In addition to the above efforts, the West African Institute for Financial and Economic Management (WAIFEM) hosted a "Regional Workshop on Money Laundering and Other Financial Crimes". Resource persons were drawn mainly from the Department of Treasury, U.S.A., while participants came from countries in the West African sub-region.

The Central Bank of Nigeria actively participated in the workshop which produced a draft money laundering law for West Africa.

The Money Laundering Surveillance Unit in the Bank Examination Department (BED) of the CBN carried out money laundering surveillance on 20 commercial banks, 18 merchant banks, five discount houses and five bureaux de change as part of its routine duties.

The exercise revealed the following:

i) the absence of adequate systems and procedures for preventing money laundering, e.g. continuous training of staff, effective Audit Unit, appointment of Chief Compliance Officers;

ii) failure to render monthly returns to CBN on all inflows and outflows of foreign exchange or securities in excess of $10,000 or its equivalent;

iii) inability to render accurate and prompt reports on any single transaction, lodgement or transfer of funds in excess of N500,000 and N2,000,000 for individuals and corporate bodies respectively, to the CBN and NDLEA; and

iv) failure to obtain adequate customer identification before entering into business relationships.

While appropriate sanctions were imposed on erring banks, the CBN will intensify its efforts in ensuring that banks comply with the guidelines on money laundering.

1.04 **<u>Concession to Merchant Banks and Discount Houses on Branch</u>**

Network

Merchant Banks, by the nature of their activities, were not allowed to establish many branches in one location or have large branch network like commercial banks. They are wholesale bankers which engage in specialised transactions with corporate or big customers, hence the restriction that they take deposits of not less than ₦10,000. The reduction of the minimum deposit from ₦50,000 to ₦10,000 in 1994 was due to the changes in the economy and the keen competition among merchant and commercial banks.

The nature of merchant banking accounted for a wide disparity in the branch network between commercial and merchant banks. The total number of bank branches was 2220 as at December 31, 1998 and out of this, merchant banks had 113 or 5.1% while commercial banks accounted for 2107 or 94.9%. Approvals were granted for nine (9) merchant and forty (40) commercial bank branches in 1998, a ratio of 1:4.5

However, as a result of the increasingly difficult terrain in which merchant banks operated and the subsequent representations made by them, the CBN approved, in 1998, that merchant banks can, on a case-by-case basis, open a maximum of three branches in a city. This concession was expected to engender fair competition among

banks (merchant and commercial), closer banker-customer relationship, faster transactions and, more importantly, increased deposits and higher profits for merchant banks. Similarly, Discount Houses (DHs) were allowed to open branches in the new capital, Abuja. This concession was informed by the fact that since DHs operate between the CBN and the banks' head office, the movement of CBN and some banks' head offices to Abuja signalled that the DHs could have presence in the new Federal Capital.

1.05 **The Operation of the Credit Risk Management System (Credit Bureau) - Problems and Prospects**

The Credit Risk Management System (Credit Bureau) took off effectively on 1st January, 1998 following the CBN circular No. BSD/PA/7/97 dated 31st December, 1997. The circular stipulated, amongst others, that banks must:

[a] obtain a CRMS's borrower code for all their customers enjoying any form of credit facilities of N1 million and above;

[b] render, mandatorily, monthly credit returns to the Credit Bureau stating the current balances and the repayment status of the facility(ies); and

[c] request for and obtain a credit report in respect of each prospective borrower before granting any facility of N1 million and above.

During the year, the CRMS witnessed a lot of activities by way of training, system enhancements and wider acceptance by the financial system.

As a result of training requests from banks, the Banking Supervision Department, in conjunction with the Financial Institutions Training Centre, organised a two-day workshop for all operators of the CRMS with the aim of:

[a] familiarising them with the guidelines and modalities of the operation of the CRMS ;

[b] demonstrating the process and procedure for rendering and retrieving information from the system; and

[c] providing a forum for the exchange of views between the Bureau and the banks.

In addition, a one-day Executive seminar was organised for top executive officers of banks and other financial institutions to provide them with an overview of the aims and operational modalities of the Credit Bureau.

While banks generally accepted the concept of the Credit Bureau, they were opposed to its mandatory nature. This affected their compliance with the requirement of the Credit Bureau and consequently, by the end of March, 1998, the total borrower codes issued to 89 banks was 18,270 while monthly credit returns were rendered for only 8,715 borrowers from 71 banks. During this period, only 1020 requests for credit status were received from 39 banks.

After a lot of moral suasion and workshops/seminars, the Credit Bureau became widely accepted as a very useful input in the credit appraisal process of banks. As at December, 31st 1998, the total issued borrowers codes increased to 21,933, while credit returns were received in respect of 9,143 borrowers from 86 banks. The total credit status requests was 5,397.

In July, 1998, there was an enhancement of the CRMS which made it possible for automatic dropping from the data base of all borrowers that have fallen out of scope (i.e. either those who had liquidated their facilities or brought them below the N1 million benchmark).

The major problems encountered on the CRMS included low level of returns from banks. Credit returns from commercial and merchant banks represented only 31% and 55% respectively of the total adjusted credits as against the expected 85% - 90% returns during the review period.

A machinery was however put in place to monitor and ensure full compliance from banks while arrangements were on to ensure that the returns from liquidated banks were received and the debtors to the banks fed into the database of the CRMS in order to preclude them from obtaining fresh loans from other banks.

1.06 **Conversion of Merchant to Commercial Banks**

Prior to the liberalization of the Nigerian Financial System, there was a clear distinction between merchant and commercial banking activities. For example, while merchant banks had lower minimum paid-up capital and were allowed to engage in equipment leasing and issuing house activities, they were restricted to dealing with corporate clients and accepting a minimum deposit of N10,000. They were also required to comply with a specified asset maturity structure.

As a result of liberalization, some of the distinctions between merchant and commercial banks were removed. However, merchant banks were still subjected to the following regulatory restrictions which put them at a competitive disadvantage vis-a-vis commercial banks:

i) preclusion from the provision of chequing account services;

ii) non-participation in the clearing house activities; and

iii) preclusion from accepting deposits below N10,000.00

As a result of the above and the upward review of the statutory minimum paid-up capital to a uniform level of N500 million for both categories of banks, merchant banks intensified their clamour for conversion to commercial banks.

In pursuance of its policy of promoting a level playing field for the operators in the banking system and also in the context of the philosophy of guided deregulation, the Central Bank of Nigeria approved the conversion of merchant to commercial banks subject to the fulfilment of the following requirements:

(1) Submission of business plan or feasibility report in support of the proposed change of status.

(2) A track record of good management reflected in the financial condition during the last three years as well as a culture of compliance with banking laws, rules, and regulations.

(3) Employment of experienced, competent and credible commercial bankers to strengthen the top Management team of the bank.

(4) Compliance with prudential requirements such as the prescribed capital adequacy and liquidity ratios.

(5) Compliance with the new minimum paid-up capital requirement of N500 million.

(6) Submission of Board approval authorizing the conversion.

(7) Payment of application and licence fees of N50,000.00 and N500,000 respectively.

(8) Surrender of current merchant banking licence for cancellation before new commercial banking licence would be issued.

It was further stated that the new dispensation to allow merchant banks which met the above requirements to convert to commercial banks did not amount to the adoption of the universal or multi-purpose banking model in Nigeria. Accordingly, banks were required to observe the restrictions imposed by the Banks and Other Financial Institutions Decree of 1991 (as amended) and other guidelines on each class of banking licence with respect to the types and scope of business they may engage in.

1.07 **Lifting of embargo on licensing of new banks**

Before 1991, the Federal Executive Council was charged with the responsibility for licensing banks. However, in 1991 the Bank and Other Financial Institutions Decree (BOFID) transferred the responsibility for licensing banks to CBN. In that year, the number of licensed banks stood at 121. Between 1991 and 1998 no banking licence was issued because of the Federal Government's embargo on the establishment of new banks.

During this period, concerted efforts were made by both the government and the regulatory authorities to improve the investment environment and strengthen the financial services industry. These efforts included the promulgation of a new investment promotion decree to encourage greater inflow of foreign investment, increase in the statutory minimum paid-up capital for banks and liquidation of terminally distressed banks. Consequently, the authorities, in view of the improved environment, lifted the embargo on bank licensing with effect from January 1999. In line with this decision, new guidelines were put in place as contained in Appendix I.

1.08 **Supervision of Other Financial Institutions**

CBN's authority to supervise Other Financial Institutions (OFIs) was based on the provisions of the Banks and Other Financial Institutions Decree (BOFID) of 1991 (as amended). The OFIs include finance companies, primary mortgage institutions, discount houses, community banks, bureaux de change, specialised banks (Nigeria Agricultural and Credit Bank (NACB), Federal Mortgage Bank of Nigeria (FMBN), Nigeria Export and Import Bank (NEXIM), Nigerian Industrial Development Bank (NIDB), Nigerian Bank for Commerce and Industry (NBCI), Education & Urban Development banks).

The following overview highlights the status of the various subsectors vis-a-vis the supervisory efforts.

a. **Finance Companies:**

A total of 279 finance companies were licensed as at the end of 1998 while additional three applications for licence were received during the year thus bringing the cumulative applications received to date to 1808. No new licence was issued during the period. Finance companies also continued to render quarterly returns to the

CBN as well as submit annual audited financial statements for approval by CBN prior to publication as required by the operating guidelines. In 1998, ten [10] cases of defaults amounting to N10.1 million were reported by investors/creditors of finance companies as against ninety-two [92] cases of default totalling N224.5 million recorded in 1997.

During the year, errant directors of failed finance companies were referred to the various tribunals for prosecution and recovery of debts. The Failed Banks Inquiry [FBI] unit of the Nigeria Police Force made a total recovery of N80.9 million from the Managers/ Debtors of failed finance companies. New tribunals were created in 1998 to ensure speedy dispensation of justice.

In an effort to provide a comprehensive supervisory framework for the subsector, spot checks were carried out to determine the financial condition as well as the actual number of finance companies in the system.

b. **Primary Mortgage Institutions [PMIs]:**

The Federal Mortgage Bank of Nigeria [FMBN] formally transferred the responsibility for the supervision of the Primary Mortgage Institutions [PMIs] to CBN in 1998.

Out of 195 PMIs which were reported by the FMBN to be in operation, 63 or 32% rendered monthly returns to the CBN as at 31st December, 1998. Of the 63, only fifteen [15] rendered up-to-date returns for the period.

During the same period, 17 PMIs representing 9% submitted audited financial statements for approval by CBN. As at 31st December, 1998, total reported cases of default in meeting financial obligations amounted to N32.7 million while three PMIs applied for voluntary winding-up.

c. **Discount Houses:**

The number of Discount Houses in operation remained at five during the period. All the discount houses rendered statutory returns regularly and submitted their audited financial statements for approval prior to publication as required. The overall performance of the discount houses appeared satisfactory during the period apart from a few recorded cases of contraventions.

The Nigerian Discount Market Association [NDMA] complained of unfavourable operating environment characterised by regulated interest rates on treasury instruments and restricted access to activities in the other segments of the money market. In response, the CBN set up a committee during the period, to review the existing operating guidelines for discount houses. The report of the committee was submitted to the CBN Management for consideration towards the end of the year.

d. **Bureaux De Change:**

In 1998, 11 [eleven] applications were received for the establishment of bureaux de change business, thus bringing the cumulative number of applications so far received to 647 [Six hundred and forty seven]. Six applications for voluntary withdrawal were approved and this brought the total number of withdrawals to ten [10] as at 31st December, 1998, while four new licences were issued during the period. Overall, the total number of bureaux de change in operation was reduced from 250 as at December 1997 to 244 as at 31st December, 1998 although not more than 25% of the total rendered statistical returns to CBN.

e. **Community Banks:**

The number of community banks remained at 1015 in 1998, out of which only 580 rendered returns to the National Board for Community Banks [NBCB].

The distress scourge which had ravaged the community banking sub-sector over the years continued unabated during the period under review. The incidence of trapped placements in other financial institutions, incompetent Boards and Managements, poor record keeping, illiquidity, negative shareholders funds and inadequate earnings still persisted in most of the community banks.

Sequel to the above, the following actions were taken:

- Pre-licensing inspection of those adjudged healthy by NBCB, CBN and NDIC.
- Verification exercise in respect of those suspected to have closed down.

Reports were thereafter forwarded to the CBN Management Committee for its consideration.

f. **Specialised Banks/Development Finance Institutions [DFIs]:**

Off-site and on-site supervision of DFIs continued during the year. The reports on those examined revealed problems of poor asset quality and under-capitalisation. The Federal Government of Nigeria constituted a committee to examine the operations of all the DFIs and the committee had concluded its assignment and had submitted a comprehensive report with recommendations on the strategies for restructuring the institutions.

As part of efforts to restructure some of the DFI's, the CBN and the Federal Ministry of Finance (MOFI) injected additional capital into NBCI and NIDB, while other proposals were being appraised.

Although the transfer of the responsibility for the supervision of OFIs to CBN was a step in the right direction, there were problems which constituted hinderances to effective supervision of these institutions. These included institutional, legal, operational and personnel [manpower requirements] problems. Steps were however being taken to address the identified problems.

1.09 **Update on Distress in Banks**

The Governor of CBN, in exercise of his powers under Section 12 of the Banks and Other Financial Institutions Decree (BOFID) No. 25 of 1991 as amended, revoked the banking licences of twenty-six (26) terminally distressed banks (13 commercial and 13 merchant) in 1998 and appointed the Nigeria Deposit Insurance Corporation (NDIC) as the liquidator. Thus, the total number of banks under liquidation increased from 5 to 31 during the review period.

The above action together with the lifting of the holding actions imposed on three distressed banks reduced the number of distressed banks from 47 in 1997 to 22 as at 31st December, 1998.

The analysis of monthly returns from banks revealed that distressed banks held N36.13 billion or 4.77% of the banking system's net total assets of N757.88 billion as at December, 1998, compared with N62.09 billion or 10.38% of the total of N597.94 billion as at 31st December, 1997. Their share of the banking system's deposit liabilities was N24.4

billion or 6.61% as at 31st December, 1998 as against N46.07 billion or 14.04% as at 31st December, 1997.

Furthermore, their aggregate under -capitalisation was N15.65 billion as at December, 1998 compared to N16.2 billion as at 31st December, 1997. The improvement was a reflection of the efforts made by some of them to recapitalise. In addition, out of the banking system's total non-performing credits of N59.7 billion as at December, 1998, the distressed banks' share amounted to N16.3 billion. The corresponding figures for December, 1997 were N68.35 billion and N17.56 billion for the banking system and distressed banks respectively.

The quantum of distressed banks overdrawn balances with the CBN stood at N7.29 billion as at December, 1998 compared to N7.1 billion as at December, 1997.

1.10 **Compliance with the Statutory Minimum Paid-up Capital**

With the approval of the Federal Government of Nigeria and in consonance with the provision of Section 9(1) of the Banks and Other Financial Institutions Decree, 1991, as amended, the minimum paid-up capital requirement of commercial/profit and loss sharing and merchant banks was raised to a uniform level of N500 million with effect from 1st January, 1997, with compliance deadline of December 31, 1998.

In line with the directives of CBN, banks adopted the following approaches to shore up their paid-up capital:

i. Fresh injection of funds through rights issues, private placements and public issues;

II. Capitalization of reserves; and

III. Conversion of deposits, long term loans and debentures into equity.

The procedure adopted by Banking Supervision Department to process banks' recapitalisation claims included scrutiny of documents and authentication in line with the procedure approved by the Management of the Bank.

As at the deadline, 64 banks comprising 41 commercial and 23 merchant banks met the prescribed minimum while 8 banks (comprising 2 commercial and 6 merchant banks) had submitted evidence of compliance which were yet to be verified by CBN. The remaining 17 (8 commercial and 9 merchant banks) were yet to comply. It is, however, pertinent to note that interested investors in some of the 17 banks had deposited various amounts in escrow accounts in other banks and the Central Bank of Nigeria towards their re-capitalization.

In summary, a total of 19 banks (11 commercial and 8 merchant) capitalised fully through reserves while 29 banks (16 commercial and 13 merchant) capitalised fully through fresh injection of funds. In 16 banks capitalisation was through combinations of reserves, fresh injection of capital and conversion of debts/deposits.

1.11 Implementation of the Failed Banks Decree

During the year, considerable progress was made in the implementation of the Decree with respect to the number of cases disposed of as well as recoveries made. The success recorded was made possible through the substantial increase in the number of tribunals from 8 to 17.

The records of the NDIC revealed that the various tribunals disposed of 19 cases involving 70 persons (individuals and organisations) while a recovery of N186 million was made during the year thus bringing the cumulative recoveries on both criminal and civil cases to ₦3.603 billion from inception to December 1998.

While the amount of recoveries stated above did not reflect the recoveries made by the Police as well as amounts paid directly to the banks by debtors for fear of prosecution, it is pertinent to mention that as at 31st December, 1998, the NDIC had also assisted some distressed banks (not those under liquidation) to make recoveries of N2.5 billion from various customers. A general assessment of the activities of the Tribunals as at 31st December, 1998 showed the following:-

1.	Cases filed at the Tribunals	-	2,407

2.	Cases disposed of by the various zones of the Tribunal	-	574
3.	Cases struck out	-	17
4.	(a) Convicted persons	-	91
	(b) Discharged persons	-	33

The implementation of the Decree had not been without its share of problems. The major constraints which hampered the execution of judgement and recovery of debts included the following:

i. Lack of adequate and up-to-date information on debtor customers and their assets.

ii. Inability to locate customers by the NDIC-appointed solicitors due to poor documentation.

iii. Inadequacy of NDIC approved scale of fees for commission on debt recoveries to motivate the appointed solicitors.

iv. Initial congestion of the tribunals until the number was increased to 17 in the second half of the year 1998.

v. Distressed banks' inability to fund the execution of judgement due to their illiquidity, thereby preventing early execution.

vi. Appeals to the Special Appeal Tribunals by defendants/convicts resulting in stay of execution of judgement debts.

vii. Limited number of Special Appeal Tribunals to cope with the volume of appeals emanating from the lower Tribunals. Two Special Appeal Tribunals dealt with appeals from 17 lower Tribunals.

viii. Injunctions and other forms of delay tactics resorted to by the defence counsels/solicitors against pending cases.

The implementation of some of the provisions of the Failed Banks Decree had been criticised, especially the aspect of long detention pending the trial of debtors. In order to address some of the criticisms in the implementation of the Decree, the Government, during the year, constituted an Inter-Agency Committee comprising the Office of the Secretary to the Government of the Federation, Federal Ministry of Justice, Central Bank of Nigeria, Nigeria Deposit Insurance Corporation, Office of the National Security Adviser and the Nigeria Police Force with the following terms of reference:

1. To examine the intendment of the Decree and determine if it should emphasize more of recovery of debts and less of prosecution and punishment or continue with both.
2. To identify what aspects of the Decree, if any, inhibited the Chairmen of the Tribunals in exercising judicial discretion that ordinarily would be available in other courts.

3. To determine what aspects of the Decree and its implementation may have affected the attitude of the detainees in not co-operating with the Police and the Tribunals by making repayment of debts while in custody.

4. To propose amendments to the Decree to:

   [a] ensure faster dispensation of justice; and

   [b] ensure that the bail provisions can be more widely applied.

5. To determine what the future of the tribunals should be in view of the transition to democratic governance.

6. To examine all other issues relevant to the speedy dispensation of justice under the Decree.

In line with its terms of reference, the Committee at its meetings deliberated on the various issues and made recommendations embracing, inter alia, amendments to the Decree, review of the procedures for filing cases with the police, investigation, detention, bail as well as trial of cases. The implementation of the recommendations which was awaiting the consideration of the Federal Government was expected to give the decree a human face.

1.12 **The 1998 Bank Examiners' Conference**

The 5th Annual Bank Examiners' Conference held at the CBN Training Centre on the 8th and 9th October, 1998 focused on the

"Challenges Facing Nigerian Banks in the Next Millennium and the Role of the Bank Examiner". Five papers were presented during the Conference.

The Deputy Governor in his keynote address observed that the Conference had not only grown in scope and sophistication but had attracted participation from other organisations as well as other countries. He also highlighted the following key issues:

(i) The challenges posed to the Nigerian banking system by the century date change and the need for it to be comprehensively and adequately addressed in order to avert impending disaster;

(ii) The need for Nigerian banks to be technology-driven, more efficient, restructured and repositioned in view of the current pace of globalization and increased sophistication;

(iii) The need for Nigerian banks to be adequately capitalized, competently managed and to observe high ethical standards;

(iv) The need for re-engineering in banks; and

(v) The need for the Bank Examiner to be empowered through effective training and adequate exposure as well as the provision of conducive working conditions.

The President of the Chartered Institute of Bankers of Nigeria (CIBN) focussed on preventing a recurrence of the distress in the financial sector, image laundering, the century date change and the global information highway while the Managing Director of Nigeria Deposit Insurance Corporation spoke on the challenges facing Nigerian banks which had made the harmonization of supervisory standards as well as cooperation and coordination amongst supervisory authorities world-wide imperative. The President of the Computer Association of Nigeria drew attention to the need to minimise the negative impact of the sudden upsurge of computerisation.

The following papers were presented:

a) In the theme paper "Challenges facing the Nigerian Banks in the next millennium and the role of the Bank Examiner", an Assistant Director in the Bank Examination Department, identified the greatest challenges facing Nigerian banks at the turn of the millennium as increased competition occasioned by greater deregulation, liberalisation, globalization and revolution in information technology and the engagement of technically sound professionals who would be capable of improving the quality of banks' service delivery. They would also face the temptation of undertaking every conceivable type of business including those they cannot properly manage.

He further opined that the Bank Examiner must be computer literate and well equipped to effectively examine banks while his work environment should be conducive for optimal performance.

b) In his paper, "Replacing a cash-driven economy with an effective cashless system" the Director of Banking Supervision Department, Bank of Ghana focussed on the evolution of the payment system and observed that the modern payment system depended on instruments, appropriate legal framework, and clear rules. He made reference to various payment systems in different parts of the world and stressed that payment systems reform in developing countries was a continuous process. The migration from cash to a cashless system called for more vigilant regulators and supervisors and to ensure a stable and efficient financial system, supervisory laws must constantly be reviewed in terms of:

- streamlining the authorisation procedures, screening of developments in technological systems and the ability to maintain proper standards, policies and procedures;
- periodic upgrading of capital and prudential requirements for financial institutions; and
- improved customer services.

The major steps forward were to intensify wide access to chequing facilities, improve the acceptance of cheques and other instruments in the promotion of effective cashless systems in developing countries.

c) "The implementation of the Core Principles for Effective Banking Supervision in Nigeria" delivered by the Director of Banking Supervision Department, CBN, explained that the core principles were a set of supervisory guidelines aimed at providing a general framework for effective banking supervision. He enumerated the pre-condition for effective banking supervision as enunciated in the core principles but emphasised that Nigeria did not have the enabling environment for the full implementation of the Core Principles for the following reasons:

- lack of a clear definition/delineation of responsibilities of the supervisory agencies (CBN/NDIC);
- lack of operational independence by supervisory agencies; and
- lack of power by CBN to revoke the licence granted by it without recourse to the political authorities.

In his contribution, an Executive Director of Wema Bank Plc observed that the Nigeria banking system needed image laundering in addition to urgently creating the enabling environment for effective supervision and concluded that the grant of autonomy to CBN and

the urgent amendment of Nigeria banking laws would be steps in the right direction.

d) “Options for Banks capitalisation and the role of the capital market” by the Deputy Director-General of the Nigerian Stock Exchange enumerated the options for banks’ recapitalisation to include mergers and acquisitions, capitalisation of reserves, and capital market issues. He advocated graduating the share capital requirements of banks, using key measures such as risk assets and deposits.

e) “Enhancing efficiency of banks with information technology” by the Managing Director/Chief Executive, Zenith International Bank Ltd. viewed electronic banking as a means of enhancing the speed and quality of service delivery and added that the system had been enhanced by the introduction of internet banking, propelled by the advancement in information technology.

He observed that the automated clearing system, an information technology-driven project, spearheaded and coordinated by the CBN would:

- enhance effective and efficient clearing of instruments;
- significantly reduce the clearing float;
- maintain and enforce standard of clearing procedures, communication and quality of clearing items;
- promote effective control through tracking and reconciling physical items with related electronic data; and
- encourage development and integration of other electronic payment and settlement products.

In conclusion, he opined that information technology enhances the efficient provision of financial services and in effect demands strategic alignment with business goals, stressing that it was important for the regulatory authorities to upgrade their processing and monitoring systems to align with and support private sector innovation pace. He therefore urged the CBN to acquire and develop its website as a matter of urgency.

CHAPTER 2

2.00 CURRENT ISSUES IN SUPERVISION

2.01 Consolidated Supervision: Problems and Prospects

The benefits of consolidated supervision, including the prevention of supervisory gaps, elimination of double-leverage of capital and ensuring that banks measure their risks globally, underscore the desirability to embrace the concept of consolidated supervision. Bank supervisors are supposed to extend consolidated supervision to cover the parent bank, its subsidiaries and domestic and foreign branches through either full balance sheet consolidation i.e. preparation of group accounts or proportional consolidation based on percentage holdings or solo plus (in a situation where some subsidiary undertakings are to be excluded by virtue of the requirements of regulation).

In view of many Nigerian banks having branches or subsidiaries within and outside the country, the recent upsurge in banks' diversification into non-banking activities, the clamour for universal banking and increasing interest shown by foreign banks in extending their activities to the country, banking supervision can no longer be conducted only on solo basis as it has hitherto been done.

The Basle Committee on Banking Supervision, in an attempt to encourage consolidated supervision, carried out a survey in April 1998 on the core principles for effective banking supervision and from the survey it was observed that consolidated supervision still presented some problems which included the following:

(i) Despite the existence of legal provision to share information with foreign supervisors on the basis of reciprocity and confidentiality, a model information sharing agreement that could provide a more comprehensive and consistent approach to establishing contacts with other supervisors was yet to be developed.

(ii) The diverse nature of operations of some subsidiaries of banks which engaged in different areas of non-banking activities or operations such as real estate, insurance etc., could distort or present a misleading picture of the true financial position of the group on a consolidated basis.

(iii) The lack of trained and experienced staff was a critical reason for the limited consolidated supervision programme in many countries. Thus training would be needed to develop policies and procedures in order to improve the understanding of corporate structures.

(iv) There existed possible conflict among Regulatory Authorities resulting from activities of some subsidiaries of banks that were non-financial in nature such as real estate, insurance, stockbroking etc., the operations of which were regulated by separate bodies.

(v) The local operations of foreign banks would ordinarily follow domestic regulations. The only exception to this rule might be with respect to minimum capital base, as local branches of foreign banks might not be required to be separately capitalized and therefore, not subject to the same minimum capital requirements. It was therefore, certain that different legislations, rules and legal structures could exist that would require different interpretations when consolidating their activities.

(vi) Most countries had in place standardised reporting system for information collected from Institutions being supervised. However, the amount and type of information collected varied between countries, like the frequency of reporting amongst banks and their various subsidiaries. Consequently there arose the need to harmonise the divergent reporting systems to a single standardised reporting format that could sufficiently accommodate all the basic information requirements.

These problems are also some of the major constraints that have hampered the implementation of consolidated supervision in Nigeria.

However, the recent amendments to the CBN and BOFI Decrees widened the scope of the supervisory authority of the Central Bank of Nigeria by bringing all financial institutions including commercial, merchant, development and specialised banks, Primary Mortgage Institutions (PMIs), community banks, Peoples Bank, finance companies etc under its regulatory purview.

In the same vein, the Financial Services Regulation Co-ordinating Committee (FSRCC) was given legal backing in 1998 and charged with among others, the responsibility for co-ordinating the activities as well as encouraging co-operation among the various regulatory authorities. These actions are expected to facilitate the Bank's effort to implement consolidated supervision.

2.02 **Application of Core Principles for Effective Banking Supervision**

With the internationalisation of financial markets, a number of regulatory and supervisory initiatives were taken to promote the safety and soundness of financial markets and institutions. One of these initiatives was the issuance of the 25 Core Principles for Effective Banking Supervision by the Basle Committee in 1997.

Prior to the introduction of the core principles, the Central Bank of Nigeria had in place a supervisory arrangement that incorporated some of the substance of the principles. The introduction of the core principles, however has encourgaed the continued review of the arrangement to make it more effective and compliant with international standards as highlighted below:

Legal Framework

The enabling powers for the supervision of banks by the Central Bank of Nigeria are contained in the Central Bank of Nigeria Decree 24 of 1991 [as amended], the Banks and Other Financial Institutions Decree No. 25 of 1991 [as amended] and the Foreign Exchange [Monitoring And Miscellaneous Provisions] Decree 17 of 1995. These legislations vest the CBN with far-reaching powers to license as well as regulate and supervise all the activities of licensed banks and other financial institutions. While the Decrees did not initially embrace development banks, subsequent amendments have brought them under the supervisory purview of the Bank.

Licensing Procedure

The licensing procedure for banks is designed to control entry into the banking system. It provides for the submission of an application with a set of specified documents to, among others, ascertain the fitness and properness of the promoters/shareholders and approval by the Governor of CBN.

Methods of Supervision

The supervisory arrangement adopted by the CBN is a combination of on-site examination and off-site supervision.

Cross-Border Supervision

The CBN periodically conducts on-site examination of overseas branches of Nigerian banks. In addition, banks are required to incorporate the results of their overseas operations in the statutory returns submitted to CBN for off-site supervision.

Prudential Requirements

Nigerian banks are required to maintain prescribed minimum standards in their operations in order to ensure safe and sound banking practices. These include minimum paid-up capital , risk-weighted asset (capital adequacy), liquidity/cash reserve, loan to deposit and adjusted capital to net credits ratios. Limits are also placed on credit exposure to a single borrower and investments by banks while special conditions are imposed on credits to directors and their related interests.

Furthermore, the Prudential Guidelines for licensed banks issued in 1990 [currently undergoing review to incorporate provisions for specialised banking institutions] require banks to classify their risk assets in accordance with a specified structure and make provisions against losses that may arise from such facilities. Finally, the annual Monetary, Credit, Foreign Trade and Exchange Policy Guidelines are issued by CBN to enunciate the role expected of the banks and other financial institutions and clarify certain requirements in line with the policy thrust for the year. Compliance with these and other supervisory regulations are monitored both on-site and off-site.

Formal Powers of Supervisors

The CBN is equipped to enforce compliance with all banking regulations and standards and to impose sanctions, where necessary, on erring institutions. The recent amendments to CBN and BOFI Decrees reinforced the position of the Bank to enforce the provisions without recourse to the courts, except on criminal issues which are within the jurisdiction of the courts.

In addition, the Failed Banks [Recovery of Debts] and Financial Malpractices in Banks Decree provides the needed avenue to prosecute delinquent borrowers as well as bank directors and officers involved in financial malpractices in banks.

The Bank also has powers in the case of a failing bank to take measures to protect the interest of depositors, creditors and other stakeholders. Where such options fail to resolve the problems of a bank, the CBN has the prerogative to revoke its licence, subject to the approval of the President. However, to further strengthen the supervisory/regulatory roles of the CBN, it is desirable that the Bank should be vested with the powers to revoke licences issued by it without recourse to the President.

In conclusion, while the Central Bank of Nigeria could be adjudged to have substantially complied with most of the requirements of the core principles, one of the areas in which much progress is yet to be made is in consolidated supervision. This is due mainly to the fact that some of the subsidiaries of banks, especially those in the insurance and securities business, fall under the supervisory purview of other regulatory bodies. However, the legal recognition recently accorded the Financial Services Regulation Co-ordinating Committee is expected to provide a more conducive atmostphere for co-peration and the setting up of procedures for the supervision of subsidiary companies.

The other area that is still to receive the Bank's attention is the application of capital allowance to accommodate market risks arising from dealings in currencies, securities, commodities, options and other derivatives. This is ostensibly due to the fact that Nigerian banks are not actively involved in trading on their own accounts and this is in turn due to the absence of most of the instruments in our financial system. Banks are therefore not yet exposed to the risks associated with such activities. However, as the financial market evolves and deepens with the introduction of these instruments, the supervisory arrangement will be reviewed to accommodate such developments.

2.03 **Mitigating Year 2000 Date Change Problems**

The year 2000 poses some significant challenges for financial institutions because many automated applications would cease to function as a result of the way the date fields were designed. Failure to address this issue in a timely manner would cause banking institutions to experience operational problems that could cause the disruption of financial markets. As a result, banking institutions must take the necessary steps to ensure that problems and disruptions are minimised.

Addressing the Year 2000 problem requires that every bank put in place a good action plan which should include the following:

a) Establishing Year 2000 as a strategic objective and assessing its resources at the highest levels within the bank and developing a process to communicate the strategic objective throughout the banking organization.

b) Making sure that the strategic importance of the Year 2000 as a business objective is understood and appreciated throughout the organization.

c) Detailing inventories of what must be done, covering centralized and decentralized hardware, software and networks as well as equipment with embedded computer chips.

d) Fixing of operating systems, applications, hardware and equipment which could be approached through field expansion, windowing, two-digit century field and data encoding.

Field expansion involves an expansion of the digits used to represent years from 2 to 4.

In windowing, the two-digit year code is converted to a present number called the “window boundary”, which enables the system to interpret the two-digit year as either a “19" century date or a “20" century date.

The two-digit century field technique creates a 2-digit field to indicate the century date (19, 20). It is, however, cumbersome since it requires a separate century field to be created for every date in the database and reprogramming to use those dates.

Data encoding involves designing a machine which can code and decode using the appropriate technique.

e) Developing detailed test schedules and co-ordinating same with correspondent banks and customers. To be considered compliant, a bank’s support system must pass the following internal tests as recommended by the Basle Committee on Banking Supervision:

I. ***Baseline Tests:*** To be performed before any changes are made to a computer programme or application. It compares performance of the system after changes are made to it in order to benchmark not only results but also operational efficiency.

ii. ***Unit Tests:*** are performed on an application to confirm whether remediation efforts yield accurate results for that application.

iii. ***Integrated Tests:*** are performed on multiple applications or systems simultaneously. This test will be repeated when operating environment changes.

iv. ***Future Date Test:*** Similar processing of renovated programmes and applications for future critical dates to ensure that those dates will not cause programme or system problems.

Testing should establish the following compliance criteria:

DATE	**REASON**
April 9, 1999	9999 - on the Julian Calendar. In many computer programmes “9999" denotes end of input.
September 9, 1999	9999 - on the Julian Calendar. In many computer programmes “9999" denotes end of input

December 30, 1999	Last business day in 1999 for many markets
December 31, 1999	Last day in 1999
January 1, 2000	Beginning of Year 2000
January 3, 2000	First Business day in Year 2000 for many markets
January 10, 2000	First business day to require 7 digit field 10/1/2000
Feb. 29, 2000	Leap year day
March 31, 2000	End of first quarter of Year 2000
October 10, 2000	First date to require an 8 digit date field
December 31, 2000	End of Year 2000
January 1, 2001	Beginning of Year 2001
December 31, 2001	Check that that Year has 365 days

By the end of July, 1999, any bank that is not Y2K Compliant should resolve to go manual or start making contingency/emergency plans that will provide an efficient fall back and recovery strategy. The strategy is to prioritize the hardware and software requirements with a view to ensuring that support is provided for continuity. This could be as follows:

(a) Hardware contingency failure:- this procedure should include:

- provision of hardware back-up for replacement of converted hardware that is discovered to be non-Y2K compliant;
- provision of routine/program that are executed at machine start off process (boot) (such as batch program) that will be

attached to auto exec.bat program that ensures a forced compliance on the hardware;

- provision of off-line back-up system that would support the banking process even temporarily until recovery from failure. This would include printed basic automated procedures; and
- maintenance of technical support team with ability to quickly resolve hardware problems.

(b) Software: contingency recovery procedures shall include :

- provision of off-line back-up system that would support the banking process; and
- ensuring that software are loosely coupled, this ensures that modules that happen to fail can be isolated from the entire system, as such can be performed manually, and then interfaced with others.

c) Account Reports: all reports for 31st December, 1999 should be printed and kept. This include status reports, customer balances, etc.

(d) Personnel - some staff should also be identified and trained on manual procedures in readiness for that day so that in case everything fails, banks would resort to manual ledgers, books and controls.

Further to the steps taken in 1997 by the CBN, the Y2K Awareness Committee embarked on the next phase of the compliance program which was on-site verification of responses to the questionnaires earlier sent to banks.

The field assessment/verification carried out during the year on 50 banks (out of 89 licensed banks) and the five (5) Discount Houses in operation revealed the following positions:

(a) Three (3) Discount Houses were compliant

(b) 13 banks had credible evidence of work done and had achievable target date of 31st December, 1998.

(c) 17 banks had action programmes and based on work carried out so far, could be adjudged to have achievable target date of 30th June, 1999.

(d) 20 banks did not have credible action programmes to address the Year 2000 related problems.

After the verification, a review was conducted, with the major objective of identifying institutions that posed the highest degree of risk with a view to specially monitor institutions that failed to make satisfactory progress towards compliance.

There are also plans to explore opportunities to work with representatives of the accounting firms in order to improve the industry's preparedness for the year 2000 date change.

2.04 **Criteria for Approving the Financial Statements of Banks and Other Financial Institutions**

Bank managements are obliged to exhibit utmost care and diligence in managing banks' assets and liabilities. They are required to discharge their duties with the greatest sense of accountability and transparency. In view of these objectives, banks are required to publish their audited financial statements annually after necessary approval has been obtained from the CBN.

CBN approval is predicated on a number of factors which include Regulatory Accounting Principles (RAP), Prudential Guidelines, Generally Accepted Accounting Principles (GAAP) and other regulations, conveyed to banks through circulars issued by the CBN from time to time. For instance, in line with Regulatory Accounting Principles (RAP), surpluses on revaluation of fixed assets [own properties] by banks are discounted by 55 percent while the balance of 45 percent are recognised as part of Tier 2 or supplementary capital. For regulatory purposes, where core capital (Tier 1) is negative, no recognition is accorded Tier 2 capital.

The financial statements submitted to the CBN for approval are analysed using the provisions contained in relevant laws and regulations as detailed below:-

1. Banks and Other Financial Institutions Decree (BOFID) 1991, as amended,
2. Companies and Allied Matters Decree (CAMD) 1990,
3. Prudential Guidelines,
4. Monetary, Credit, Foreign Trade and Exchange Policy Guidelines,
5. Statement of Accounting Standards, and
6. Central Bank of Nigeria Circulars.

Banks and Other Financial Institutions Decree

Section 27 (1) of BOFID provides that, subject to the prior approval in writing of the CBN, a bank shall, not later than 4 months after the end of its financial year:

a] cause to be published in a daily newspaper printed in and circulating in Nigeria and approved by the Bank;

b] exhibit in a conspicuous position in each of its offices and branches in Nigeria; and

c] forward to the CBN, copies of the bank balance sheet and profit and loss account duly signed and containing full and correct names of the directors of the bank.

The review of the financial statements is to ensure that they:

- are duly signed and contain full and correct names of the directors;

- disclose in the notes to the accounts, penalties paid as a result of contravention(s) of the provisions of BOFID and any policy guidelines in force during the financial year in question;
- bear on their face the report of an approved auditor which, among others, must contain a disclosure of the contravention(s);
- give a true and fair view of the state of affairs of the bank as at the end of the reporting period; and
- comply with the requirements of any circular that has been issued by the CBN.

The quality of risk assets is rigorously analysed to ascertain that adequate provisions are made for all known losses [loans and other assets] in line with the provisions of the Prudential Guidelines and Bank Examiners' recommendations. In addition, the accounts are analysed to ensure full disclosure of all material facts.

Companies and Allied Matters Decree (CAMD)

In line with the provisions of the Companies and Allied Matters Decree, banks and other financial institutions, as limited liability companies, are expected to comply with the provisions of Part XI (Sections

331-369) on Financial Statements and Audit, especially the requirements of Section 334(2) on the content of financial statements. These are:

a] Statement of Accounting Policies;

b] The Balance Sheet;

c] Profit and Loss Account;

d] Notes to the Account;

e] Auditors Report;

f] Directors Report;

g] Statement of Sources and Application of Funds;

h] Value Added Statement;

I] Five-year Financial Summary; and

j] In the case of a holding company, the group financial statements.

Where the provisions of this Decree are inconsistent with that of BOFID, that of BOFID shall prevail in matters relating to the accounts of banks and other financial institutions.

Prudential Guidelines

The Prudential Guidelines were issued vide Circular Ref. BSD/DO/23/VOL.1/11 of 7th November, 1990. In line with the provisions contained therein, all licensed banks are required to adhere to the Prudential Guidelines (which are regarded as minimum requirements) for reviewing and reporting their risk assets.

The Guidelines deal mainly with credit portfolio classification, provisioning and disclosure requirements. These include:

a] Analysis of credits by performance

b] Provisioning for risk assets

I. Segregation between principal and interest in suspense

ii. Disclosure of general provision on risk assets

iii. Disclosure of provision charged per profit and loss account

iv. Provision per Balance Sheet.

The provisions for risk assets contained in the most recent routine/target examination carried out by the CBN must be adopted in the published financial statements. Any reduction arising from recoveries should be subject to verification before the lower figure can be accepted.

Monetary, Credit, Foreign Trade and Exchange Policy Guidelines

In adherence to the provisions of the Monetary Policy Guidelines, the following computations are made in appraising banks' financial statements.

a] Risk weighted asset ratio (capital adequacy ratio)

At least 50% of the components of a bank's capital should comprise paid-up capital and reserves i.e. Tier I or core capital (statutory reserve, share premium, bonus issue reserves, general reserves and other unappropriated profit) with the remaining being Tier 2 or supplementary capital.

b] Adjusted capital to net total credits.

Statements of Accounting Standards (SAS)

The financial statements of banks and other financial institutions should comply with SAS 10 and 15 which deal with accounting by banks and non-bank financial institutions (Parts I & II). Other relevant statements include Disclosure of Accounting Policies (SAS I), Information to be Disclosed in Financial Statements (SAS 2), Foreign Currency Conversions and Translations (SAS 7), Leases (SAS 11), Investment (SAS 13) and Statement of Cash Flows (SAS 18).

CBN Circulars

While auditing financial statements, auditors are expected to confirm that the statements comply with relevant CBN circulars issued from time
to time. A statement to that effect is expected to form an integral part of the Auditors' Report.

During the year under review 84 audited accounts were approved for publication, in line with Section 27(1) of BOFID 1991 (as amended). Out of these 11 accounts, which were from distressed banks, were for operating years between 1993 and 1996.

The 73 accounts relating to 1997/98 accounting year showed that:

(i) all but two banks recorded profits

(ii) profit before tax of 60 banks showed improvement over the performance of the previous years

(iii) except for 13 banks, the total provisions for losses made by all the banks whose accounts were processed increased.

It was generally observed that the credit performance of may banks continued to deteriorate, as evidenced by the increased provisions, while the management reports received from the auditors revealed weaknesses in the internal control of banks and lack of preparedness and/or contingency plans for the envisaged Year 2000 computer problem.

On the other hand, delays in granting approvals, on the party of the CBN, were attributable to:

(a) inadequate provisions for losses by banks;

(b) failure of auditors of banks to send management reports directly to CBN;

(c) non-disclosure of frauds which occurred during the financial year, and

(d) non-payment of penalties imposed for contraventions in the accounts.

2.05 **Cash Reserve Requirement [CRR] as a Tool of Monetary Policy**

One of the major objectives of the Central Bank of Nigeria [CBN] is the maintenance of monetary stability in the economy. To achieve this, the Bank applies a number of monetary control tools including Open Market Operations [OMO], Minimum Rediscount Rate (MRR), Cash Reserve Requirement, Liquidity Ratio, special deposits, selective controls and moral suasion.

In Nigeria, OMO has become the most important market-based tool used by the CBN to control the volume of money in the economy through the purchase or sale of government securities in the open market. Due to the prevalent liquidity glut in the economy, the sale of securities, rather than purchase has been predominant. The use of OMO is complemented by Cash Reserve Requirement (CRR) which is a specified ratio of a commercial bank's total deposit liabilities mandatorily maintained as cash deposit with the CBN.

Section 15(1) of the Banks and Other Financial Institutions Decree [BOFID] 1991, as amended, empowers CBN to prescribe from time to time the cash reserve that banks are required to maintain. In line with the Decree, the CBN, through the Monetary Policy Circulars issued annually specified the minimum cash ratio for banks.

The cash ratio is reviewed from time to time, depending on the policy thrust. The table below shows an eight-year trend of the CRR specified by the CBN between 1991 and 1998.

CASH RESERVE RATIO - 1991 TO 1998

TABLE 2.05.I:

Year	1991	1992	1993	1994	1995	1996	1997	1998
CRR	3%	3%	6%	6%	6%	8%	8%	8%

The 1996 review was largely meant to minimise the likely expansionary impact of the gradual phasing out of stabilization securities which involved refund of huge sums of money to the banks. There was also the need to further deregulate the financial sector and rely more on market-based instruments of monetary management.

In practice, when the CRR is computed, the amount that is credited or debited to the Cash Reserve Account depends on whether the volume of a bank's deposits is increasing or decreasing.

The CRR as an indirect monetary control and management tool was applied throughout the year under review to regulate the availability of funds to the banks and therefore restrain the banks from excessively expanding credits. In the process, the CRR served the dual role of regulating banks' ability to create money and mopping up excess liquidity.

2.06 Examination of Banks - The Role and Focus of Regulatory Authorities

At a workshop on "Integrity and Independence in Financial

Reporting and Examination in the Banking Industry" jointly organized by the Nigeria Deposit Insurance Corporation (NDIC) and the Institute of Chartered Accountants of Nigeria (ICAN) in December, 1998, a paper was presented by the Director, Banking Supervision Department, Central Bank of Nigeria (CBN) on "Examination of Banks- The Role and Focus of Regulatory Authorities." The highlights of the paper were as stated below:-

Role Of The Regulatory Authority

The promotion of monetary stability and a sound financial system was recognised as one of the major functions of the CBN. In fulfilment of this role, banks are subjected to supervision and regulation which include periodic examination by the CBN Examiners to assess the soundness of the banks as well as their compliance with relevant laws and regulations. The specific objectives of supervision include depositors' protection, promotion of financial stability, efficiency, competition and consumer protection. In order to sustain public confidence, a "safety net" is provided consisting of three main components, namely, the lender of last resort role of the CBN, effective supervision and deposit insurance.

Measures taken by the CBN in the last decade to instal a strong "safety net", including regulatory initiatives, institutional changes and legal reforms were highlighted.

Some of the major regulatory initiatives of the CBN include the following:

- The use of NDIC accommodation bills to provide liquidity support to banks that were badly affected by the withdrawal of public sector deposits from commercial and merchant banks to the CBN in 1989;
- Introduction of the Prudential Guidelines in 1990 which focussed on risk assets classification, provision for losses and income recognition in order to promote transparency and accountability as well as prevent window-dressing;
- The adoption of the Basle Committee's Capital Accord of 1988 which required banks to maintain a minimum capital to risk weighted assets ratio of 8% of which core capital component should not be less than 50%;
- The development of an automated Banking Analysis System (BAS) in conjunction with NDIC. BAS, which is planned to go "live" early in 1999, will facilitate a faster and more effective framework for assessing the financial condition of banks;
- Establishment of a Credit Risk Management System (Credit Bureau) in 1997 to strengthen the credit appraisal procedures of financial

  institutions with a view to enhancing credit quality in the banking sector;
- Issuance of guidelines on Bankers Acceptances and Commercial Papers in August, 1997 to ensure standardized and uniform

practices and proper reporting on the use of the instruments in the industry; and

- Prompting the development of the Statement of Accounting Standard No. 10 by the Nigerian Accounting Standard Board, to complement the implementation of the Prudential Guidelines.

Similarly, in order to ensure the soundness and safety of the financial system, the following key institutional changes were made:

- The NDIC was established in 1988 to insure bank deposits against bank failures;
- CBN/NDIC established a Joint Technical Committee on Problem Banks in April, 1990, to provide a framework for identifying, monitoring and rehabilitating distressed banks. In 1992 the CBN/NDIC Joint Executive Committee on Problem Banks was formed to handle policy initiatives aimed at tackling the problem of financial distress and strengthening the supervisory and regulatory machinery of both institutions.
- In 1994, the Financial Services Regulation Co-ordinating Committee (FSRCC) was established to promote co-ordination, co-operation and harmonization of standards and supervisory efforts among the various regulatory authorities in the financial system. The Committee comprised the CBN, NDIC, Federal Ministry of Finance, Securities and Exchange Commission, The Nigerian Stock

Exchange, Federal Mortgage Bank of Nigeria, National Insurance Supervisory Board, The National Board for Community Banks and the Corporate Affairs Commission. The FSRCC was replaced in 1997 with the Financial Services Coordinating Committee (FSCC) which subsequently reverted to FSRCC and given a legal backing in 1998.

Legal reforms were also put in place to strengthen the financial system, among which were:

- Promulgation of the Central Bank of Nigeria and the Banks and Other Financial Institutions Decree (BOFID) of 1991, which expanded CBN's supervisory powers as well as established a procedure for handling problem banks. The CBN, BOFI and the NDIC Decrees were further amended in 1998 to expand the supervisory responsibility of the CBN to cover development banks and primary mortgage institutions and also eliminate the co-ordinate powers vested in NDIC on distress resolution.
- In 1994, the Failed Banks (Recovery of Debts) and Financial Malpractices in Banks Decree was promulgated to stem the incidence of financial malpractices which adversely affected the safety and soundness of banks.

Techniques Of Banking Supervision

Two major techniques, namely, off-site supervision and on-site examination have been adopted for supervising banks in Nigeria.

Off-site supervision embodies the analysis of statutory and prudential returns which are rendered to both the CBN and NDIC monthly, quarterly, half-yearly and yearly. The financial condition of banks is, therefore, monitored on a continuous basis. On-site examination, comprising maiden, routine, target and special, involves a physical examination of the books and records of banks, viz:

- Maiden examinations are conducted within the first six months of operation to ensure that policies and procedures are in place to facilitate the smooth and efficient running of the bank.
- Routine examinations are done periodically (currently once every twelve to eighteen months) to review the entire operations of licensed banks. This type of examination focuses on corporate governance issues, appraisal of risk assets, risk management practices, accounting and management information systems, internal control systems, capital adequacy, liquidity, deposit profile, earnings etc.
- Target examinations are usually limited in scope and currently focus on risk assets to ascertain adequacy of provision for losses before approval of a bank's audited year-end accounts.
- Special examinations are ordered under certain circumstances, such as when a bank is suspected to be carrying on its business in

a manner detrimental to the interest of depositors and creditors or when a bank has insufficient assets to cover its liabilities to the public.

Examination coverage ranges between 70% and 90% of a bank's volume of business. At the conclusion of an examination, a Report is issued which highlights the Examiners' findings and recommendations which the bank is required to implement. The Report is presented to the bank's Board of Directors. Given the complementary nature of the roles of Bank Examiners and auditors, external auditors of banks were recently required to be in attendance as observers, at the Board presentation of Examination Reports.

2.07 **Frauds and Forgeries in the Financial Sector**

Fraud involves wilful misrepresentation, the deliberate concealment of a material fact for the purpose of inducing another person to do something unethical or the failure to disclose a material fact. Therefore, any material alteration, whether by addition, insertion, obliteration, erasure, removal, which is done to deceive and to cheat an unsuspecting victim, constitutes a fraud. Against this background, it is easy to observe that fraud is an umbrella-crime concept covering a wide range of criminal behaviour.

Most frauds are rooted in the desire by some individuals to get rich quick, while virtually all frauds are perpetrated with the intent to confer some advantage (mainly financial) which the fraudster does not deserve. Since the ultimate aim is to confer some kind of financial benefits, the

financial services industry, by its very nature, has always been the principal target of fraudsters.

The effect of frauds and forgeries on banks' balance sheets can be very negative as full provisioning must be made to cover them, thereby leading to adverse consequences on banks' operations. It is, however, most disturbing that whereas bank frauds used to be prevalent amongst the junior staff, the trend in recent times is that more incidents are found among senior members of banks' staff and most regrettably even amongst the top management.

Statistics on frauds and forgeries in the banking system were compiled from returns rendered by banks on monthly basis but the official statistics might not capture the totality of frauds perpetrated due to the failure of banks to render accurate and prompt returns. The reluctance to promptly report cases of frauds and forgeries could not be divorced from

the desire of banks' management to avoid negative publicity and reaction as well as the full provisioning that such reports might engender.

There were various types of frauds and forgeries among which the most common were:

a. Defalcation of customers' cash lodgements by bank employees.

b. Substitution/suppression of clearing cheques by bank employees.

c. Manipulation of customers' accounts.

d. Clearing of forged bank cheques and drafts through other banks or branches.

e. Dry-posting of fictitious credits through the computer.

f. Cross firing/kiting.

g. Granting of unauthorised credits.

h. Payment against uncleared effects.

I. Issuance of bank cheques/drafts without cover.

j. Encashment of forged cheques by fraudsters.

k. Fraudulent transfers based on forged letter of authority.

l. Operation of fraudulent and parallel accounts to facilitate cheque conversion and fraudulent withdrawals.

m. Debiting of head office account through forged inter-branch credit advice.

n. Foreign exchange frauds such as forged transfer instructions, misappropriation of travellers' cheque proceeds, stealing of currencies etc.

The above fraud types could be classified into externally and internally induced. Internally induced frauds are perpetrated by insiders (bank employees) while externally induced frauds are often initiated by big-time fraudsters operating as criminals.

The causes of frauds can be classified into institutional and social factors. Among the institutional factors are:

- Poor internal control system; loopholes in internal control converted by fraudsters into advantage.
- Inadequate experience and lack of training of bank staff exploited by fraudsters.
- Poor monitoring and supervision of loan portfolio.
- Poor record-keeping.
- Poor conditions of service; job insecurity, lack of incentive, poor remuneration and blurred prospects for career advancement.

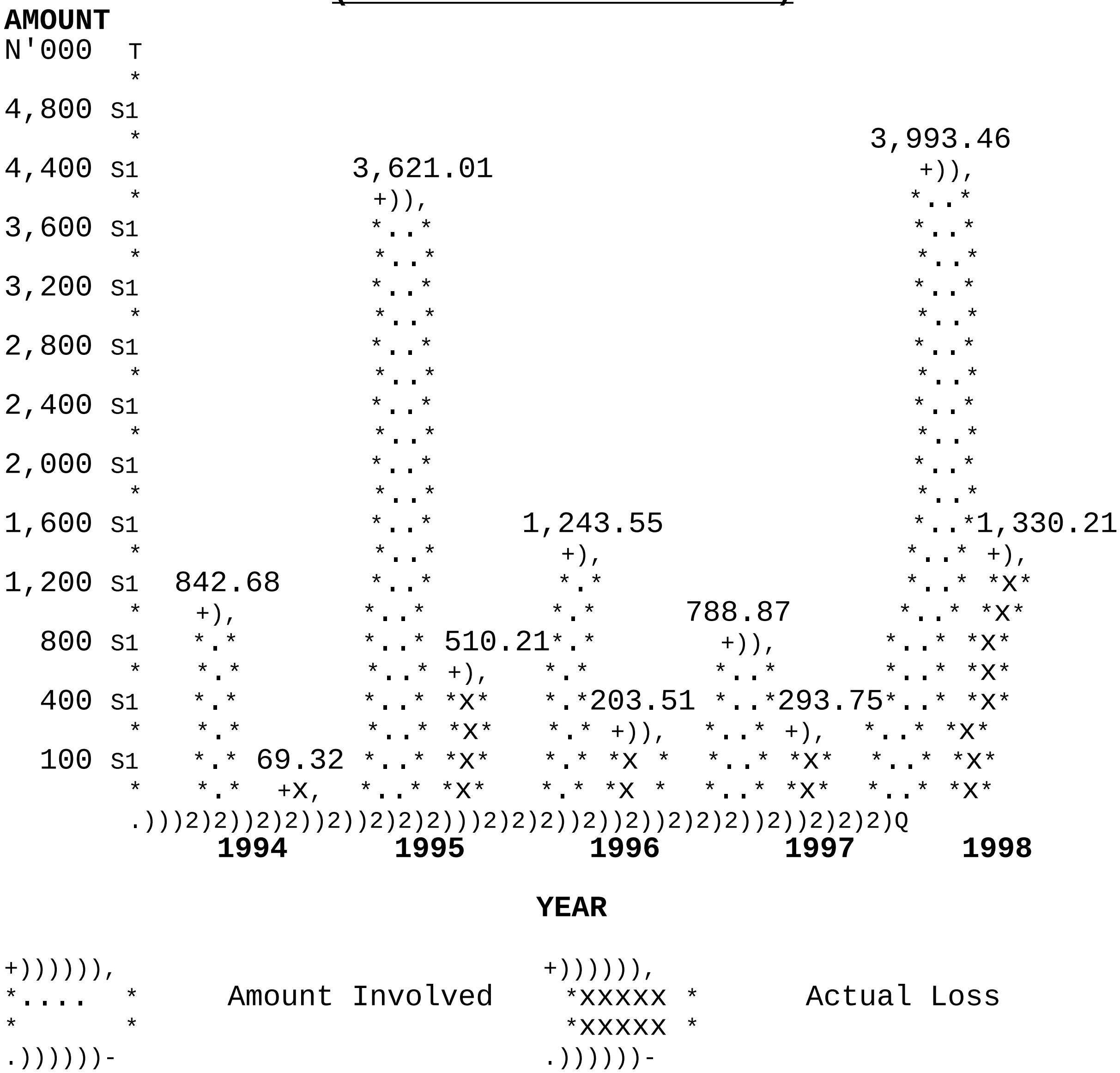
The societal factors comprise declining moral values,slow criminal adjudication system, severe downturn in the economy leading to worsening unemployment situation and absence of credible reward and sanction system for bank employees.

STATISTICAL ANALYSIS OF FRAUDS AND FORGERIES IN THE NIGERIAN BANKING INDUSTRY,1994-1998

	1994	1995	1996	1997	1998
Number of Reported cases	675	657	403	414	612
Amounts Involved	N842.6 8m	N3,621.01m	N1,243.55m	N788.87m	N3,993.46m
Actual Loss	N69.32m	N510.21m	N203.51m	N293.75	N1,330.21m
Percentage of Success (in relation to total number of reported cases).	52%	58%	60%	71%	49%
Nature of Fraud	Suppression, conversion forgery, stealing etc.	Forgery, Dry posting, conversion, unauthorised grant of credit facilities by staff members etc.	Armed robbery attack, forgery, defalcation, conversion, suppression, fake inter-branch transfers, unauthorised grant of credit facilities etc.	Forgery, suppressi on, clearing fraud, armed robbery attack, fake telex messages, computer-aided frauds etc.	Clearing fraud, suppression, forgery, armed robbery attack, diversion, forged inter-branch transfers, payments against uncleared effects, defalcation etc.

Source: Bank Returns

Frauds and Forgeries in the Banking System
(Amount involved and Loss)



Source: Bank Returns

The available statistics from 1994 to 1998 show that, while there has not been growth in the incidence of fraud, or the rate of success, the value of frauds has grown tremendously. For example, while actual loss in 1994 was ₦69.32 million and ₦203.51 million in 1996, the figure grew alarmingly to ₦1,330.21 million in 1998. A new dimension also observed is the growing incidence of loss arising from armed robbery attacks on banks.

There is therefore need for a resolute, consistent, and sustainable policy actions by all stakeholders of banks, the law enforcement agencies and the society at large to prevent and/or reduce the incidence of fraud and the rising trend of armed robbery in the banking industry.

2.08 **Update on Electronic Banking**

It would be recalled that electronic money was introduced into the Nigerian Banking System in 1996 when the Central Bank of Nigeria gave approval to Allstates Trust Bank Limited to introduce a financial product known as the ESCA Smart Card , an electronic purse. Subsequently, Diamond Bank Limited introduced a similar product known as Diamond Pay Card. However, electronic banking scheme received a boost in 1998 when a consortium of 19 licensed banks obtained CBN approval to form a smart card company, Smartcard Nigeria Plc, with a mandate to produce and manage the cards issued by member banks of the consortium. This arrangement has among others, the advantages of spreading the cost and risk of establishing the system, standardisation and attracting wide patronage and acceptability

A related development to electronic money was electronic money transfer service which had become popular among Nigerian banks. For instance, CBN gave approval to four banks to undertake international money transfer service with reputable international money transmitters such as Western Union, MoneyGram and Vigo Money Transfer. While this particular service has the potential to enhance the profitability of bank's offering it, it has the inherent problem of precipitating liquity problems in such banks especially when the foreign exchange received by the banks abroad are not repatriated to offset payments in local currency.

Furthermore, a number of domestic banks had launched internet banking services which enabled their customers to use the World Wide Web (WWW) to access their accounts, though their use of the network was limited to electronic mailing and advertisements, indicating that the culture of electronic banking and commerce had taken root in the country.

In the light of these developments, a set of operating guidelines was put in place by the CBN which, among others, included:

i. restriction of issuance of e-money products to only licensed banks under the supervisory purview of the CBN or eligible subsidiary companies of same;

ii. any bank or company intending to serve as issuer of e-money to seek and obtain prior clearance and approval of CBN;

iii. the bank or subsidiary company to submit a detailed feasibility report covering areas such as the scheme structure, documentation including prototype (sample card) products, clearing and settlement arrangements, security and systems control, float management, business plan and contingency plans i.e. disaster recovery plan and back-up system;

iv. the promoters of e-money schemes to enter into contractual agreement with the Nigerian Interbank Settlement System (NIBSS) for the clearing and settlement of e-money products; and

v. to disclose to the CBN and the National Drug Law Enforcement Agency (NDLEA) any single transaction, lodgement or transfer of funds in excess of N500,000 and N2 million or their equivalent for individuals and corporate bodies respectively in line with the provisions of the Money Laundering Decree 1995.

Since the second half of 1998, the Central Bank of Nigeria, through its Banking Supervision Department, has participated in the Bank for International Settlement (BIS) bi-annual survey on electronic money. The survey monitors developments relating to e-money products and the approaches taken by central banks and other regulatory authorities with respect to such products on a global and regular basis. It has provided an essential point of reference in the evolving regulatory and supervisory framework for e-money schemes in Nigeria.

Given that Nigeria is at an early stage of information technology development, to issue strict/rigid regulations prematurely might pre-empt the broader public benefits which accrue from experimentation and innovation. In the circumstance, the CBN has decided to work closely with

the operators of e-money schemes to fine-tune the rules and regulations for electronic commerce in Nigeria.

2.09 **<u>Farming Out CBN Supervisory Functions</u>**

The main objectives of banking supervision are to determine the financial condition of each bank, ensure safe and sound banking practice, take corrective actions where weaknesses are observed and enforce compliance with the provisions of the law. In line with these objectives, the BOFI Decree empowers the Governor of the Central Bank of Nigeria to appoint the Director of Banking Supervision whose responsibilities include:

[i] examining the books and records of a bank with a view to determining its financial position at a given time;

[ii] ensuring compliance with banking laws and regulations and other CBN circulars/guidelines;

[iii] recommending appropriate sanctions for non-compliance with BOFID and other CBN regulations; and

[iv] recommending corrective measures aimed at restructuring ailing banks.

The deregulation of the financial system and the subsequent increase in the number of licensed banks and other financial institutions resulted in too rapid growth and expansion of the banking system for the

existing capacity of the Central Bank of Nigeria to cope with the increased supervisory responsibilities.

In response to the developments and in line with its desire to continually improve on the performance of its supervisory functions, the Central Bank of Nigeria, in 1991, and in accordance with the powers conferred on the Bank by the Central Bank of Nigeria Decree 24, 1991 (as amended) and the Banks and Other Financial Institutions Decree No. 25, 1991 (as amended) considered the idea of farming out some of its supervisory duties to capable professionals. However, when distress engulfed the financial system, the Bank was too pre-occupied with resolving the distress and sanitising the system to give the idea further consideration.

With the recent developments in the banking system, especially the increased responsibilities given to the CBN for the regulation and supervision of all banks and other financial institutions (primary mortgage institutions, community banks, specialised banks etc) and the expectations of a grant of instrument autonomy to the Bank, the issue re-surfaced in 1998 following requests received from various audit firms and consultants, that CBN should farm out some aspects of its examination functions. The scope of the requests was wider than what the Bank had earlier envisaged. The requests covered the following areas:

[i] Conduct of routine examination of banks and other financial institutions.

[ii] Conduct of special diagnostic examination .

[iii] Conduct of investigation into specific operations or transactions.

[iv] Conduct of post-examination monitoring.

[v] Conduct of regulatory compliance reviews to complement the off-site supervisory functions being handled by the Banking Supervision and Trade and Exchange Departments.

[vi] Training and/or retraining of on-site and off-site Bank Examiners.

[vii] Research and conduct of studies or surveys with regard to the banking industry.

[viii] Bank rating services.

[ix] Credit rating services.

The proposals are being appraised from the point of view of the subsisting legal provisions and the objectives of banking supervision and regulation. The Banks and Other Financial Institutions Decree (BOFID) 1991 (as amended) especially in Section 1 [4] provides that "The Bank may, either generally or in any particular case, appoint any person who is not an officer or employee of the Bank, to render such assistance as it may specify in the exercise of its powers, the performance of its functions or the discharge of its duties under this Decree or to exercise, perform or discharge the functions and duties on behalf of and in the name of the

Bank". Discussions on the matter were still going on by the end of 1998.

2.10 Framework for Prudential Guidelines for Specialised Financial Institutions

Following the amendments to CBN Decree No. 24, 1991 and the Banks and Other Financial Institutions (BOFI) Decree No. 25, 1991, the regulatory and supervisory purview of CBN was expanded to include development banks, mortgage institutions, community banks and People's Bank of Nigeria.

Consequently, an appropriate supervisory framework had to be designed for these institutions because of their peculiarities and specialised functions while other complementary measures necessary to enhance the effectiveness of CBN surveillance activities and the orderly development in the financial sector would be pursued.

Since it might not be appropriate to apply the provisions of the existing prudential guidelines for licensed banks to these institutions, the Bank Examination/Banking Supervision Departments set up a committee to review the operations of these organisations and recommend how the prudential guidelines would be tailored to suit their operations and ensure prudence and efficiency. The Committee's work was still on by end of 1998.

2.11 Leasing Operations in Banks

A lease is a contract for the hire of a specific asset whereby the lessor retains ownership of the asset and conveys the right to its use to the lessee for an agreed period of time in return for the payment of specified rentals. While there are various types of lease arrangements, our focus is on operating lease, finance lease and sale and lease back which most Nigerian banks engage in.

The distinction between a finance lease and an operating lease will usually be evident from the terms of the contract between the lessor and the lessee. Accounting standards recommend that where the rights and obligations of the lessee are such that his corresponding rewards and risks are, despite the absence of the ability to obtain legal title, substantially similar to those of an outright purchaser of the asset in question, the lease should be regarded as a finance lease. On the other hand, a sale and leaseback transaction is a linked arrangement whereby the owner of an asset sells that asset and immediately leases it back from the purchaser. The object of the sale and leaseback in banks is usually real estate but could also be other types of assets.

During the period under review, regulatory concern was on leases described as operating leases and as such capitalised as fixed assets in the records of the bank. A review of such transactions revealed that in practice, banks had adopted the strategy of describing as operating leases those leases which were essentially finance leases because of the taxation benefits that would accrue to them as well as the reduced impact on certain prudential requirements. Thus, the balance sheet presentation of some arrangements as operating leases, when indeed the transactions were finance leases, did not present a true and fair view of the banks' credit exposure and could result in misleading analysis, conclusions and recommendations.

In respect of sale and lease back, banks were usually compelled to enter into such an arrangement as a result of:

(1) Over-investment in fixed assets which resulted in violation of the regulatory limits placed on a banks' investment in fixed assets vis-a-vis shareholders funds.

(2) Liquidity problems as a result of over-investment or mis-match of investments in fixed assets.

Experience showed that some sale and lease back transactions were not done at arms length and the sales were usually funded by the banks, the lessees, thus rendering the arrangement unprofessional. In the coming year, the structuring and reporting of lease transactions by banks would be subjected to stricter scrutiny by the Banking Supervision and Bank Examination Departments.

2.12 <u>Self Regulation</u>

Regulation is a body of specific rules of agreed behaviour which are either imposed by the government or self-imposed by agreement among members within an industry. Self regulation in this context, is a situation whereby an organisation or a trade group/professional body decides to set minimum standards of ethical behaviour and professional conduct for their members to observe.

In the banking industry, self-regulation is achieved either on individual bank basis or accomplished through self-regulatory organisations (SROs) within the industry.

The emergence of distress among banks had led to the erosion of confidence in the banking industry. In an attempt to engender public confidence in banks, some of the main elements of focus were transparency and accountability. Because of the perceived negative effects of lack of transparency among bank operators, the financial sector had been looking inwards to discourage sharp practices and win back public acceptability. This has informed the involvement of some self-regulatory organisations in monitoring the activities of their members with a view to checkmating unwholesome practices. Among these Self-Regulatory Organisations (SROs), are:

1. The Money Market Association of Nigeria.
2. The Chartered Institute of Bankers of Nigeria.
3. Institute of Chartered Accountants of Nigeria.
4. Association of Bank Chief Inspectors.
5. Nigerian Discount Market Association.

The involvement/emergence of these associations is indicative of the fact that the pursuit of transparency and accountability in the banking industry is a desirable objective. Experience has shown that compliance is usually high with self-regulatory mechanism due to the existence of a very effective sanction system which often makes the use of statutory intervention or judicial arbitration unnecessary. Self-regulation is also complemented in some organisations with instruments of corporate governance, including internal audit and control which are in turn complemented by the activities and role of external auditors and various Audit Committees set up within the banks/institutions. The whole mechanism is aimed at ensuring that controls and operating procedures are put in place to protect a bank from losses due to inefficiencies, inaccuracies, irregularities and wilful manipulations. The trends in global financial markets and the risk of market failure have strengthened the case for improved standards beyond statutory regulation. Therefore, the role of professional and self-regulatory bodies cannot be over-emphasised in the promotion of high ethical standards among their members. In fact, the problem of frauds and forgeries can be better addressed by instituting high ethical standards and we strongly believe that self-regulation within the banking industry should complement statutory intervention in encouraging safe and sound banking practices and fostering professionalism.

CHAPTER 3

3.00 LEGAL FRAMEWORK AND SUPERVISION

3.01 The 1998 Bankers' Tariff

Following the approval of the Bankers' Committee, a new Bankers' Tariff was published by the Central Bank of Nigeria in February 1998 effective from 1st March, 1998. This replaced the old one which was reviewed in 1992.

The new Tariff took into cognisance the growing inflationary trend and the deregulated banking system in the review of the charges.

Based on the increase in the associated costs, the following, among others, were reviewed upwards:

- Non-drawing fees (for consortium lending)
- Bank Cheques
- Stopped Cheques
- Counter Cheques
- Closing of Savings and Current Accounts.

In the case of non-drawing fees (for consortium lending), an increase to 1% per annum from 0.25% per annum for amounts over ₦1 million was approved.

The increase from ₦50 to ₦100 for counter-cheques was to discourage the use of such cheques while the charge per stopped cheque was increased from ₦100 to ₦200. A distinction was made between customers and non-customers in the case of bank cheques. The former was to be charged ₦50 flat while the latter would pay ₦100 or 0.5% of the value of the cheque, whichever was higher. The closing of savings and current accounts were to attract a charge of ₦100 and ₦50 respectively. Handling of bulk salary payment by way of cash across the counter which used to be free would attract a charge of ₦20 per company's employee to be borne by the employer.

Intra-state and up-country clearing which previously took 11 and 20 clearing days respectively were reduced to 6 and 12 clearing days while local clearing remained at 4 clearing days. Commission on turnover (COT) increased from ₦2 per mille to ₦5 per mille while interest/fees related charges were made negotiable. Some of the newly introduced charges included:-

- additional interest on authorised excess which would be negotiable;
- warehousing facility charge - also negotiable;
- processing fee for consent for share of security which would attract a charge of 0.25% of amount of facility; and
- late repayment of loan facility - 1% flat per month on unpaid instalment in addition to a charge based on the current rate of interest on outstanding. This was to serve as a deterrent to defaulting customers.

The CBN enjoined all banks to adhere strictly to the provisions of the Tariff.

3.02 Amendments to CBN, BOFI and NDIC Decrees

To guarantee safety and soundness and penalise unwholesome practices in the banking and other financial services sector, a review of the legal framework for supervision was carried out in 1998 which resulted in the amendments to the following decrees.

i) Central Bank of Nigeria Decree No. 24, 1991 (as amended);

ii) Banks and Other Financial Institutions Decree (BOFID) No. 25, 1991 (as amended);

iii) Nigeria Deposit Insurance Corporation (NDIC) Decree No. 22, 1988 (as amended).

1. CBN (AMENDMENT) DECREE 37, 1998

The 1998 amendment provided for an eleven (11) member Board comprising the Governor as the Chairman, four Deputy Governors, the Permanent Secretary, Federal Ministry of Finance and five other Directors. The Decree granted instrument autonomy to the Bank, thereby charging it with full responsibility for monetary and banking policies.

The Financial Services Regulation Coordinating Committee (FSRCC) also received statutory recognition in the Decree. The Committee was restructured to include the Governor of the Bank as Chairman, Director-General, Securities and Exchange Commission, the Commissioner for Insurance, the Registrar-General, Corporate Affairs Commission and a representative of the Federal Ministry of Finance.

2. BOFI (AMENDMENT) DECREE NO. 38, 1998

The amendment to BOFID addressed not only the anomalies introduced by the 1997 amendment but also strengthened the CBN's authority to regulate and supervise commercial, merchant and specialised banks as well as other financial institutions.

The amendments empowered the CBN to grant to any bank registered in Nigeria or a foreign bank, licence to undertake offshore banking business from Nigeria. In the same vein, no foreign bank shall operate branch or representative office in Nigeria without prior approval of the Bank. The Bank was also given power to determine the minimum paid-up share capital requirement for each category of banks licenced under the Decree.

In respect of auditors of banks, the Decree prohibits the appointment as an auditor of a bank any person who is indebted to the bank.

It gave additional powers to the Central Bank of Nigeria to carry out supervisory duties in respect of banks, other financial institutions and specialised banks. The Decree reinforced the powers of the Bank to deal with distressed banks. In the previous Decree and its amendments, most of the penalties were subject to conviction at the court. Such provisions made the imposition of some of the penalties virtually impossible. However, in order to solve the problem, the Governor was granted power to compound such offence by accepting such sums of money as he thinks fit, not exceeding the maximum fine applicable on conviction.

3. **NDIC (AMENDMENT) DECREE 39, 1998**

The 1997 amendment to the NDIC Decree brought about serious role conflict between the Corporation and the CBN. However, in order to strengthen the hands of CBN in dealing with significantly or critically under-capitalised banks, the relevant sections in the NDIC Decree (i.e. sections 23A, 23B, 23C and 23D), which were a replica of the provisions of Sections 32 to 38 of BOFID 1991, were abrogated, thus removing the role conflict between the two organisations.

CHAPTER 4

4.00 PERFORMANCE TRENDS IN THE BANKING SECTOR

Although as many as 26 banks were transferred to NDIC for liquidation in 1998, thus bringing the number of liquidated banks since 1994 to 31, the volume of banks' activities expanded significantly over the level achieved in the previous year. Some of the factors responsible for this growth include the increase in the prescribed minimum paid-up capital of commercial and merchant banks from N50 million and N40 million respectively to a uniform level of N500 million which put a large pool of funds in the hands of banks for investment, the introduction of a number of new banking products or new distribution channels (e.g. electronic funds transfer services) which resulted in increased deposit mobilisation as well as core process re-engineering embarked upon by many banks. Below are the highlights of banks' performances in 1998.

Deposits

The aggregate bank deposits as at December 1998 was N369 billion, reflecting an increase of N56 billion [17.9%] from the N313 billion for December 1997. Out of this, demand, savings, term and miscellaneous deposits made up N161 billion [43%], N102 billion [28%], N93 billion [25%] and N13 billion [4%], respectively. [See Figure 1.1]. While commercial banks' share of the total deposits amounted to N331 billion [90%], that of merchant banks was N38 billion (10%). The structure of commercial and merchant banks' deposits are shown in Figures 1.2

and 1.3 while Figure 1.4 reflects the comparative monthly deposits for 1997 and 1998.

The volume of monthly deposits for 1998 remained consistently higher than what obtained during the corresponding period in 1997 while the aggregate credit/deposit ratio rose from 85.30% as at December 1997 to 88.35% in December 1998. Distressed banks had N24.4 billion or 6.61% of the aggregate industry deposits of N369 billion.

Loans and Advances

Credits accounted for 39.8% of the gross assets of N819.21 billion in the banking system as at December 1998. The aggregate loans and advances increased to N326 billion from the December 1997 level of N267 billion, a growth of N59 billion (22.10%). During the same period, commercial banks' share of the aggregate credit decreased marginally from 84% in 1997 to 83% in 1998 while that of merchant banks increased by the same margin. [See Figures 2.1 & 2.2]. Aggregate non-performing credits for 1998 was N76.28 billion comprising N67.67 billion [88.71%] for commercial banks and N8.61 billion [11.29%] for merchant banks. The provision for non-performing credits amounted to N41.7 billion in the proportion of N34.81 billion (83.48%) for commercial banks and N6.89 billion (16.25%) for merchant banks.

Distressed banks' credits fell from N65 billion in 1997 to N24 billion in 1998 as a result of the liquidation of 26 banks. Figure 2.3 shows the annual comparative credit levels of healthy banks relative to distressed banks.

Assets

The total assets [gross] in the banking system rose by N172.51 billion [26.67%] from N646.7 billion as at December 1997 to N819.21 billion in December 1998. Commercial banks' share of the total assets of the banking system which amounted to N556.16 billion in 1997 increased by N138.95 billion [24.98%] to N695.11 billion in December 1998. Distressed banks' assets of N50.29 billion as at December 1998 were 6.14% of the total assets. This was N47.27 billion less than the figure of N97.56 billion in 1997 (see Figures 3.1, 3.2 and 3.3). The fall was also as a result of the liquidation of 26 banks earlier mentioned.

Liquidity

The prescribed minimum liquidity ratio remained 30% during the period under review. Seventy three (73) banks [39 commercial and 34 merchant] met the prescribed minimum liquidity ratio as at December, 1998 as against fifty-nine (59) banks in December, 1997. Out of the sixteen banks that could not meet the minimum liquidity ratio requirement, nine recorded zero or negative ratio [7 commercial and 2 merchant] in December 1998 as against thirty six in 1997.

Capital Adequacy

Seventy-two (72) banks [39 commercial and 33 merchant] met the prescribed minimum capital adequacy ratio of 8% as at December 1998 as against the sixty-two reported in 1997. The improvement was a result of efforts made by shareholders to re-capitalise in order to meet the N500 million statutory paid up capital requirement. The capital base of 15 banks was completely eroded by losses as compared with forty-two (42) as at December 1997.

The adjusted shareholders' funds unimpaired by losses stood at N54.58 billion as at December 1998, made up of N36.33 billion [66.56%] for commercial banks and N18.25 billion [33.44%] for merchant banks.

Earnings

The aggregate profit before tax of the banking system rose by N13.8 billion (189%) from N7.3 billion in 1997 to N21.1 billion in 1998. The share of commercial banks rose by 327% from N4.8 billion in 1997 to N15.7 billion in 1998 while that of merchant banks increased by 125% from N2.4 billion in 1997 to N5.4 billion. The return on assets was 2.88% in December 1998 as against 0.81% recorded in December 1997.

CHAPTER 5

5.00 CAPACITY BUILDING FOR SUPERVISION

The financial system in any country requires a comprehensive regulatory and supervisory framework designed to promote financial stability. In order to enhance the performance of the supervisory/regulatory authorities, their personnel should be developed and empowered through capacity building. Capacity building requires a number of actions to be taken in the areas of training, legislation and motivation. As more and more banks engage in business process re-engineering, there would be a greater need for training and re-training of staff to enable them meet up with developments in the banking industry.

The training needs of the Banking Supervision and Bank Examination Departments were tailored to enable the Examiners understand and apply necessary examination techniques using the various tools available in carrying out their functions. In order to improve on these techniques to meet the changes in the financial industry and international standards, all the syllabi of the Examiners' courses were reviewed in 1998. New areas, especially in electronic data processing, money and capital market operations, distress management, etc were introduced while other areas would be included from time to time to broaden the various objectives and enrich the course contents. Conferences and seminars were also organised to update Examiners on new developments in the financial world.

Computerisation has introduced sophistication into information management systems. Therefore the need to match the trend with equally sophisticated techniques and tools cannot be over emphasised. Consequently, personal computers, note books or lap-tops are being provided to enhance the efficiency and effectiveness of Examiners.

The supervisory capacity can also be enhanced through an appropriate legislative framework that enables the supervisory authority to enforce its guidelines and regulations designed to promote monetary stability as well as uphold the best standard practice in the banking industry. Thus, the recent amendment to the CBN and BOFI Decrees, which granted instrument autonomy to the CBN and strengthened its enforcement capacity, has provided the much needed empowerment.

The need to build regulatory/supervisory capacity appropriate for an electronic banking system has also come to the fore. This calls for competence build-up in auditing through computer-based systems which will help in achieving an appropriate surveillance/monitoring framework.