



“The Nigerian Banking Industry: what went wrong and the way forward”

By

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1 Protocols

May I begin by thanking the Vice-Chancellor, the Senate and Congregation of this great university for the honour of inviting me to deliver this year's convocation lecture. I am not a graduate of this esteemed institution but my links to it are indeed very deep. On a purely personal level, this university is named after my great grandfather and I take personal pride in being the first among his descendants to stand here and deliver an academic paper. But also, and this may not be known to many of you, some of the earliest professors of this university including a former Provost are my maternal uncles and great uncles. I am proud to count among my mother's uncles some of the professors associated with this university from its earliest days, such as Professor Shehu Galadanci (Arabic) and the late Professor Muhammad Kabir Galadanci (Hausa), and besides them countless uncles and cousins on the academic staff. While I did my own stint as an academic in the economics department of ABU Zaria in the early 80's, I am most proud that my younger brother, Abubakar, Wambai Sanusi is on the academic staff of the economics department of BUK. But this is not all. The 2010 convocation comes with other unplanned joys. In addition to honouring me with the opportunity to take the podium today, the University will tomorrow honour my great-uncle, an illustrious son of this city, AVM Nura Imam (rtd.) with a doctorate degree. And before you think I am through, my immediate younger sister, Zainab Sanusi, is one of the students receiving a Master's degree tomorrow. This could not have been planned better. For all these reasons, and for the many friends and academic colleagues here, this feels truly like a home-coming and I do pray it will be a successful one.

As you all are aware, the world economy was hit by an unprecedented financial and economic crisis in 2007-2009, tipped into recession by the sub-prime crisis in the US in August 2007. This crisis led to the collapse of many

world renowned financial institutions and even caused an entire nation to be rendered bankrupt.

In Nigeria, the economy faltered and the banking system experienced a crisis in 2009, triggered by global events. The stock market collapsed by 70% in 2008-2009 and many Nigerian banks had to be rescued. In order to stabilize the system and return confidence to the markets and investors, the CBN injected N620bn of liquidity into the banking sector and replaced the leadership at 8 Nigerian banks. Since then, the sector has considerably stabilised.

We all know that the functioning of the financial system matters to everyone – to the economy at large and also to each one of us. The Nigerian economy has huge potential for growth. To realise that potential, it is imperative that we learn lessons from the crisis and take steps to not only fix the problems, but also introduce measures to establish financial stability, enable a healthy evolution of the financial sector and ensure the banking system contributes to the development of the real economy. The country, like many others hit by financial crises, is already feeling the pain of financial meltdown, most evident in the slowdown of credit to the economy. This is a natural consequence of bad lending decisions by banks leading to huge provisions and erosion in their capital, as well as challenges resulting from lack of progress in reforming the macroeconomic environment.

During this speech, I would like to talk to you about what went wrong within Nigeria's banking industry and the measures the Central Bank of Nigeria is taking to reform the industry, to ensure a similar crisis does not happen again and that the financial sector in Nigeria develop in a sustainable manner, contributing positively to economic growth.

The original title of this paper was "Transformative Disruption: Relocating the Nigerian Banking Crisis from the Economic to the Social." The choice of title was informed by a strong desire to articulate a correct narrative, in an environment in which we are confronted by a multi-vocal opportunism determined to subvert history through the fabrication of false narratives. Among these, is the assertion that the actions taken by the Central bank are part of a grandiose "northern" agenda against southern Nigeria. Or that perhaps it is an "Islamic" agenda being pushed by a Muslim fundamentalist. There are also other subtler and more sophisticated-albeit just as opportunistic-narratives. For example the new claim by public officers and politicians that there is really no corruption in the public service, that politicians are not corrupt, and that the real corruption is only in banks.

My initial plan was to address these narratives, for as a student of Social Theory I am fully conscious of the reality that crises are often the spaces in which false consciousness finds its articulation. Do we not remember Hitler, and how in post-war Germany he was able to construct the narrative of Nazism and convince Germans that their problem was all caused by the Jews and would end with the extermination of the Jews? Strange and ridiculous as this seems to us today, it was a narrative fervently believed by many

otherwise rational people. It is therefore imperative for us to confront headlong these narratives and not just dismiss them lightly, for in times of insecurity we always gravitate towards a Popperian tribalisation, and confrontations intensify on a mythical plane of constructed-and contested-identities.

In a sense the initial title was inspired by recognition of a sad reality, which needs to be mentioned at the outset. In a moment of such momentous change in our economy and society the universities have been as silent as graveyards. Discourse on the banking crisis has been left to journalists of varying degrees of sophistication, and to faceless agents and charlatans. The voice of the intellectual has been noticeable in its absence. And this is a real tragedy.

It is tragic because the reforms represent transformational moment for our country if only progressive intellectuals grasped it. What we have done in the Central bank, is to fire the opening salvo in what could potentially be a revolutionary battle against the nexus of money and influence that has held this country to ransom for decades. This would not be the first time banks collapse nor are brought to the brink in our national history. And it will certainly not be the last. But this time there is a difference.

In previous crises we said some banks had failed a passive and complicit phrase that masked a gross irresponsibility and crass insensitivity. "The bank has failed". This is somewhat like coming across the corpse of a man whose throat was slit, or whose body is covered with knife wounds or riddled with bullets and saying "the man died." The man did not die. He was killed. He was murdered. And he did not kill himself. To use the term "death" instead of "murder", excuses us from the responsibility of finding the killers and bringing them to book.

And that is exactly what happens when we refer to "failed banks" as if the bank itself, some impersonal structure made up of branches and computers, somehow collapsed on its own. By using-or abusing- the term "failed bank" we are able to mask what is almost always a monumental fraud. But it is a deliberate act of prestidigitation. Failed banks are handed over to NDIC. Insured depositors get paid N50, 000 (later increased to N200, 000). Thousands of poor people, who have kept their life savings in the bank, lose it. Children's school fees, savings for retirement, medical bills, gone into thin air. And who is to blame? No one really. Or maybe the poor people who were foolish enough to keep their money in a bank that "failed"

How many people have died of heart attacks due to this tragedy? How many honest businessmen have been rendered bankrupt? How many people have committed suicide? How many have died because they were unable to pay medical bills as their monies were trapped in these institutions? How many children have dropped out of school? We do not know. Because we live in a society in which they do not matter. They are anonymous. They are poor.

What we do know is that we have today, among those parading themselves as role models in society, people who profited from failed banks. Owners and

managers who go on to become governors and senators. Bad debtors who are multi- billionaires, having taken the money belonging to those poor dead souls and not paid back.

So here is the reality. The owners and managers of banks, the rich borrowers and their clients in the political establishment are one and the same class of people protecting their interest, and trampling underneath their feet the interest of the poor with impunity.

So this time we turned the tables and said “enough is enough”. The banks did not fail. They were destroyed and brought to their knees by acts committed by identifiable people. As a student in Ahmadu Bello University, in the Faculty of Arts and Social Sciences (FASS), and later as a lecturer in the same faculty, one of my chief mentors was my uncle, the late Dr Yusufu Bala Usman. And one thing Bala taught us was we should never shy away from naming names and calling a spade a spade. Do not say that government money has been stolen. Name the thief. And so, in keeping with that tradition, we did not say that banks had failed. We named human beings-the management that stole money in the name of borrowing, the gamblers that took depositors funds to speculate on the stock market and manipulate share prices, the billionaires and captains of industry whose wealth actually was money belonging to the poor which they “borrowed” and refused to pay back.

Fortunately, the President, Umaru Musa ‘Yaradua, understood from the first day that this was an ideological choice we had to make. We could side with the rich and powerful, and say the banks had failed. Or we could side with the poor and save the banks but go after the criminals. And we chose the latter. And the battle was joined.

This was going to be the subject of my paper. A paper in social theory, locating the on- going banking issues in the context of the social. I had wanted to challenge the audience on the silence of progressives, and the failure to seize this opportunity to increase the pressure on a corrupt establishment. We have come this far with the support of a president who has time and again shown his willingness to back us in the struggle. The real challenge is to extend it to other spheres of society even while we pursue the reforms to a logical conclusion. That was the plan, before it changed.

The choice of a new topic, albeit a wider one, was informed by the emergence of a new, more subtle and thus more dangerous narrative. The narrative, which is fast gathering momentum, and being fuelled by articles, advertorials and opportunistic editorials, is that the Central bank really has no strategy. There is no road map to the reforms. A senior government official even suggested that perhaps we are acting “as the spirit directs”. It is often the case that statements are made very lightly and take on a life of their own. The US government is still undertaking its study of what went wrong on Wall Street. This started after the restoration of relative stability and will be completed in about 15 months from now. In our case we commissioned a detailed study with the involvement of Bank and external resources to diagnose the problems and come out with solutions. For the last six months we have been

studying internal memos, various reports and correspondences, and also interviewing regulators, bankers, business persons, government officials and all stakeholders. I am using this platform to unfold the full details of the banking reform programme and to outline exactly what went wrong and what we are going to do about it. Economics is a lot more boring than social theory but bear with me and I will try to make it as painless as possible.

So now we return to economics.

2 What Went Wrong

2.1 Introduction

The Nigerian banking sector witnessed dramatic growth post-consolidation. However, neither the industry nor the regulators were sufficiently prepared to sustain and monitor the sector's explosive growth. Prevailing sentiment and economic orthodoxy all encouraged this rapid growth, creating a blind spot to the risks building up in the system.

Prior to the crisis, the sentiment in the industry was that the banking sector was sound and growth should be encouraged. The IMF endorsed the strength of the banking system to support this growth. However, this sentiment proved misplaced. I believe 8 main interdependent factors led to the creation of an extremely fragile financial system that was tipped into crisis by the global financial crisis and recession. These 8 factors were –

- 1 Macro-economic instability caused by large and sudden capital inflows
- 2 Major failures in corporate governance at banks
- 3 Lack of investor and consumer sophistication
- 4 Inadequate disclosure and transparency about financial position of banks
- 5 Critical gaps in regulatory framework and regulations
- 6 Uneven supervision and enforcement
- 7 Unstructured governance & management processes at the CBN/Weaknesses within the CBN
- 8 Weaknesses in the business environment

Each of these factors is serious on its own right. Acted together they brought the entire Nigerian financial system to the brink of collapse. I will now discuss them in turn

2.2 Economic and macro prudential management

Let me start with the macro-economic issues connected to the financial crisis. Although there is some evidence of diversification, oil maintains an overly dominant position in the Nigerian economy, introducing volatility and posing significant challenges to macro-economic stability. As oil prices increased

steadily between 2004 and 2008, Government spending tracked the price of oil, making fiscal policy highly pro-cyclical and adding to this volatility. Variations in monthly disbursement of oil revenues made it difficult for governments to manage economic development and caused tremendous instability as these varying amounts entered the banking sector.

Simultaneously, the lack of an effective fiscal quarantining mechanism meant that the fiscal authorities failed to prevent this excess liquidity from reaching the domestic banking system. Banking sector activity closely mirrored the price of oil and its volatility. As amounts held in Nigerian deposits increased, banks were able to increase their lending. Consolidation in the domestic banking sector and along with abundant capital increased the speed of credit creation. Bank deposits and credit, tracking the price of oil, grew four-fold from 2004 to 2009 and banking assets grew on average at 76% per annum since consolidation.

There was a belief that financialisation would drive economic growth. However, the reality is more complex. While many developing countries have followed this path, Nigeria's financialisation was far too rapid for the real economy to benefit. The economy was not able to absorb of the excess liquidity from oil revenues and foreign investments in productive sectors. This resulted in significant flows to non-priority sectors and to the capital markets, mostly in the form of margin loans and proprietary trading camouflaged as loans.. As a result, market capitalisation of the NSE increased by 5.3 times between 2004 and its peak in 2007, and the market capitalisation of bank stocks increased by 9 times during the same period. This set the stage for a financial asset bubble particularly in bank stocks. The rapid rise in asset prices and the over concentration of bank shares in the stock market index were clear indications of an accident waiting to happen. Instead of raising concern among regulators, these developments were cheered by most, and voices of protest were waved aside with arrogance. In 2007, the Nigerian Stock Exchange was "the best performing" bourse in the world even though there was no evidence to suggest a commensurate improvement in the fundamentals of real sector corporations.

All other countries that experienced equally rapid financial asset growth crashed and suffered years of low or negative growth. As credit levels rose and stock prices inflated, the CBN failed to halt this vicious circle and foresee the consequences. The CBN did not highlight or failed to communicate the problem to fiscal authorities and the market in general. The sad story in all this is that we now have evidence that junior officers in the CBN did document their concerns to CBN top management at that time, but no action was taken. We also have evidence that the NDIC documented its concerns but its efforts to get the CBN leadership to act quickly were rebuffed. Also, during this period, CBN's macro-prudential management did not sufficiently address the impact of these oil-related inflows, and with the fiscal policy being pro-cyclical, this exacerbated the crisis.

2.3 Corporate governance at banks

The huge surge in capital availability occurred during the time when corporate governance standards at banks were extremely weak. In fact, failure in corporate governance at banks was indeed a principal factor contributing to the financial crisis. Consolidation created bigger banks but failed to overcome the fundamental weaknesses in corporate governance in many of these banks. It was well known in the industry that since consolidation, some banks were engaging in unethical and potentially fraudulent business practices and the scope and depth of these activities were documented in recent CBN examinations.

Governance malpractice within banks, unchecked at consolidation, became a way of life in large parts of the sector, enriching a few at the expense of many depositors and investors. Corporate governance in many banks failed because boards ignored these practices for reasons including being misled by executive management, participating themselves in obtaining un-secured loans at the expense of depositors and not having the qualifications to enforce good governance on bank management. In addition, the audit process at all banks appeared not to have taken fully into account the rapid deterioration of the economy and hence of the need for aggressive provisioning against risk assets.

As banks grew in size and complexity, bank boards often did not fulfil their function and were lulled into a sense of well-being by the apparent year-over-year growth in assets and profits. In hindsight, boards and executive management in some major banks were not equipped to run their institutions. The bank chairman/CEO often had an overbearing influence on the board, and some boards lacked independence; directors often failed to make meaningful contributions to safeguard the growth and development of the bank and had weak ethical standards; the board committees were also often ineffective or dormant.

We have already published details of the extent of insider abuse in several of the banks. CEOs set up Special Purpose Vehicles to lend money to themselves for stock price manipulation or the purchase of estates all over the world. One bank borrowed money and purchased private jets which we later discovered were registered in the name of the CEO's son. In another bank the management set up 100 fake companies for the purpose of perpetrating fraud. A lot of the capital supposedly raised by these so called "mega banks" was fake capital financed from depositors' funds. 30% of the share capital of Intercontinental bank was purchased with customer deposits. Afribank used depositors' funds to purchase 80% of its IPO. It paid N25 per share when the shares were trading at N11 on the NSE and these shares later collapsed to under N3. The CEO of Oceanic bank controlled over 35% of the bank through SPVs borrowing customer deposits. The collapse of the capital market wiped out these customer deposits amounting to hundreds of billions of naira. The Central Bank had a process of capital verification at the beginning of consolidation to avoid bubble capital. For some unexplained reason, this process was stopped. As a result, we have now discovered that in many

cases consolidation was a sham and the banks never raised the capital they claimed they did.

2.4 Investor and consumer sophistication

Bank boards are hardly the only ones to blame for failure to deal with the sudden surplus in capital. A lack of investor and consumer sophistication also contributed to the crisis by failing to impose market discipline and allowing banks to take advantage of consumers. Investors, many new to investing, were unaware of the risks they were taking and consumers were often subjected to poor service and sometimes hidden fees.

Nigeria does not have a tradition of consumer activism or investor protection and as a consequence many Nigerians made investments without a proper understanding the risks.

The limited consumer protection framework did exist in Nigeria. However, the framework was inadequate and as a result consumers' rights were not sufficiently protected.

2.5 Disclosure and transparency

Given the low sophistication among many consumers and investor, inadequate disclosure by the banks was another major contributing factor to the crisis. Bank reports to the CBN and investors often were inaccurate, incomplete and late, depriving the CBN of the right information to effectively supervise the industry and depriving investors of information required to make informed investment decisions.

The CBN did not act to enforce the data quality in banks to ensure their reports were accurate. The CBN's internal reporting system could not serve as an effective warning system for bank surveillance.

In addition, banks made public information on their operations on a highly selective basis and investors were unable to make informed decisions on the quality of bank earnings, the strength of their balance sheets or the risks in their businesses. Without accurate information, investors made ill-advised decisions regarding bank stocks, enticed by a speculative market bubble which was allegedly partly fuelled by the banks through the practice of margin lending.

Some banks even engaged in manipulating their books by colluding with other banks to artificially enhance financial positions and therefore stock prices. Practices such as converting non-performing loans into commercial papers and bank acceptances and setting up off-balance sheet special purpose vehicles to hide losses were prevalent. Recently the CBN put an end to these practices and the collapse of the equity markets effectively put an end to alleged stock price manipulation.

2.6 Regulatory framework and prudential regulations

Now I will turn to the failure of the authorities, the CBN and other government bodies with oversight for the financial sector. Lack of co-ordination among regulators prevented the CBN from having a comprehensive consolidated bank view of its activities. In addition, regulations concerning the major causes of the crisis were often incomplete.

There is little co-ordination among the FS regulators. In spite of the widespread knowledge of bank malpractice and propensity for regulatory arbitrage, the FSRCC, the coordinating body for financial regulators did not meet for two years during this time. Whilst excess capital gave rise to strong growth in lending, banks were also allowed to use the capital to enter many other non-lending activities such as stock market investments, most of which were hived off in subsidiaries thus escaping the ongoing supervisory scrutiny by the CBN. The CBN did not receive examination reports from the SEC covering bank subsidiaries, nor was there a framework for consolidated bank examination.

Regulations governing the issues that caused the crisis were incomplete. In fact, of the 373 circulars issued by the CBN since January 2008, only 44 addressed issues relating to the crisis and none addressed the issue of corporate governance. A comparison of Nigerian regulations with those of international regulators indicated the Nigerian set of regulations was not as comprehensive. An example was the lack of a legal and regulatory framework governing the margin lending activity.

2.7 Supervision and enforcement

Uneven supervision and inadequate enforcement also played a significant role in exacerbating the problems associated with the crisis. Regulators were ineffective in foreseeing and supervising the massive changes in the industry or in eliminating the pervasive corporate governance failures.

The Supervision Department within the CBN was not structured to supervise effectively and to enforce regulation. No one was held accountable for addressing the key industry issues such as risk management, corporate governance, fraud, money laundering, cross-regulatory co-ordination, enforcement, legal prosecution or for ensuring examination policies and procedures were well adapted to the prevailing environment. Moreover, the geographic separation of on-site and off-site examiners hindered the building of integrated and effective supervisory teams. Critical processes, like enforcement, pre-examination planning and people development were not delivering the results required to effectively supervise and engage banks to enforce good conduct.

There were many instances of weaknesses in the supervision and enforcement process. For example, bank examinations were not conducted on a bank consolidated basis. Pre-examination planning did not question

banks' use of the Expanded Discount Window nor did it include a review of prior SEC or NAICOM reports (if any) on bank subsidiaries. In addition, the CBN did not provide input to the SEC in planning its examinations of bank activities. Also, the ratings and depth of analysis wasn't sufficient to capture the issues. For example, CAMEL ratings did not differentiate the performance of successful and failed banks. While some examinations identified critical risk management issues, many issues that caused the crisis escaped examination, though they were well known in the industry. Sense of urgency was low with some examinations taking between 9 months to more than a year to complete

Enforcement was the biggest failure among surveillance processes, despite the CBN having all the powers it needed to enforce examination recommendations. Financial penalties are inadequate to enforce bank compliance. By paying fines, banks effectively annulled key aspects of the examination reports. With examination cycles between 6 and 12 months, follow-up on examination recommendations rolled into the following year's examination. The prevailing view that the sector was healthy, a culture of tolerance, and acceptance of the status quo and the shortage of specialist skills compromised supervision's effectiveness.

There was insufficient discipline in holding the banks to clear remedial programmes. While banks responded to examination reports, they seldom committed to specific deliverables, timing or executive responsibility for implementation. Hence it was difficult to measure bank progress against compliance with some of the major recommendations. Banks' compliance record was poor. They frequently ignored the examiners recommendations in spite of the seriousness of the issues. The consequence to the banks of non-compliance was not sufficient to change behaviour. Directors faced no personal consequences for non-compliance. The CBN allowed this practice and behaviour to go unchecked, establishing a way of doing business that compromised the supervision process.

2.8 CBN governance and management processes

Still on the role of the authority in this crisis, the governance and management processes at the CBN also had a significant impact on its ability to deliver its mandate adequately. Governance and internal processes were unstructured and this compromised the CBN's ability to supervise the industry. Corporate governance at the CBN was laissez-faire. Board agendas were set by the Governor and consequently reflected his priorities, and there were inadequate committee structures and processes to ensure the CBN Board's independence in assessing whether the CBN was fulfilling its mission.

Issues concerning the stability of the financial sector and economic development were not discussed comprehensively at the CBN Board meetings— these risks include for example, global economic risks, federal / state economic development strategies and fiscal policies, formation of asset bubbles, exchange rate risk, capital market depth, informal sector economy etc.

The CBN was not organised to monitor adequately and analyse the macro-economic issues and systems risks inherent in the financial sector. There is no overarching architecture to manage the risks in the banking system, linking economic indicators to macro-prudential guidelines and to individual bank prudential guidelines. As a consequence, managing the risks to the banking system from the impact of oil price volatility, cross-border capital flows, asset price bubbles and weak corporate governance did not have the necessary urgency at the CBN board or within the CBN itself. Management information to analyse the risks in the banking system was inefficient. There were also data quality issues with the CBN's internal reporting system and the research department at the CBN is under-equipped to access the latest economic data and analysis.

Leadership and culture issues included an apparent lack of political will to enforce the sanctions for infractions and a belief, supported by the IMF that the sector was sound and that growth was a healthy development blunted the understanding of the real risks threatening the economy and the banking system. It was almost as if, having made "consolidation" the hallmark of success, there was a desperate need to remain in a state of denial rather than recognise that mistakes had been made and take corrective action.

2.9 Business environment

Finally, a lack of a sufficiently developed infrastructure and business environment has had a negative influence on the banking industry. The legal process, an absence of reliable credit rating agencies and poor infrastructure all contributed to non-standard banking practices.

Nigeria's legal process is long and expensive and banks seldom pursue borrowers in court. Few banks were able to foreclose on borrowers, and this led to borrowers abusing the system.

Basic lack of credit information on customers, largely because there is no uniform way to identify customers, has held back the development of credit bureaus and hampered customer credit assessment at banks, increasing the stock of bad debt in the system.

3 Reform Program

3.1 Introduction

Having discussed the causes of the financial crisis let me turn on to the solutions that we are pursuing. The blueprint for reforming the Nigerian financial system in the next decade is built around 4 pillars.

Pillar 1: Enhancing the quality of banks

Pillar 2: Establishing financial stability

Pillar 3: Enabling healthy financial sector evolution

Pillar 4: Ensuring the financial sector contributes to the real economy

In many areas, CBN needs to take the lead in implementing reforms; in other areas, CBN needs to play a key advocacy role.

3.2 Enhancing the quality of banks

Let me begin with the first pillar – enhancing the quality of banks. The CBN will initiate a 5 part programme to enhance the operations and quality of banks in Nigeria. The programme will consist of **industry remedial programmes** to fix the key causes of the crisis. It will also include implementation of **risk based supervision, reforms to regulations and regulatory framework**, enhanced provisions for **consumer protection**, and **internal transformation of the CBN**.

In the first part, the **industry remedial programmes** will include a set of initiatives to fix the key causes of the crisis, namely data quality, enforcement, governance, risk management and financial crime. These initiatives will be structured in such a manner that the banks do most of the work to embed new behaviours in the industry, with the CBN playing a cross-industry programme management role. A key plank of this programme is that we must hold individuals responsible for their actions, we must pursue all criminal cases to their logical conclusion and we must ensure that nobody, no matter how highly placed, is permitted to benefit from the fruits of crime. This is our commitment and we intend to stand by it no matter how long it takes and no matter whose ox is gored.

In order to address failures of corporate governance in the industry, the CBN will establish a specialist function focusing on **governance** issues to ensure governance best practices are embedded in the industry. The reform programme will strengthen corporate governance in both banks and the CBN, embedding a culture across the industry that **good governance is good business**. A remedial programme will be launched to implement and monitor a new set of corporate governance guidelines incorporating a range of reforms. The reform measures will include updated corporate governance statements prepared by the banks and establishment of mandatory board committees and a definition of their responsibilities. Reform measures will also include education of board directors on their responsibilities and on the

unethical and allegedly fraudulent activities and the penalties they carry. Amnesty period for full disclosure of ownership and related party transactions by board directors will be introduced. An extended fit and proper test will be developed to include an assessment of qualifications and face-to-face interviews. This will include a retrospective review of individuals admitted to a Board in the last 10 years. An enhanced annual performance measurement process for Boards and individual directors will be introduced shortly. In addition, any bank with assets larger than a certain pre-defined level will be required to form an international advisory panel to aid good corporate governance practices within the bank. Furthermore, the CBN will encourage all banks to appoint qualified directors with international experience.

The CBN has established an internal **risk management** specialist function to develop Nigerian Capital Adequacy and Enterprise Risk Assessment Process guidelines, based on the ICAAP (UK) and COSO (US) frameworks, to ensure the industry adapts and complies with the highest standards of risk management and Boards are well-informed on how their organisations are managing risk. We have already introduced tenure limits for bank CEOs and intend to implement the term limits set out in the 2006 Code of Conduct for the banking Industry with respect to non executive directors and auditors in the immediate future.

We have already begun the transition to a **risk-based supervision**, thus aligning the CBN with international regulators. This is part 2 of our 5-part programme. The CBN will ensure RBS principles, methodology and processes are established across the CBN and NDIC. A programme management structure will be established within the CBN to ensure that there is a high level of communication with the industry, implementation quality is measured and examiners acquire the necessary skills. A monitoring mechanism to measure the programme's impact and to ensure a high level of responsiveness to issues raised by the industry will also be established.

The third part in the programme to enhance quality of banks is the **regulation and regulatory framework** reform programme that I mentioned earlier. This has three sub-parts: First, in conjunction with other regulators, the CBN will embark on a systematic review of regulations and guidelines around the key contributors to the crisis namely; data quality, enforcement, governance, and risk management. Second, sponsored by the FSRCC, the CBN will lead a programme to reform fundamentally the financial services regulatory framework focusing initially on harmonising and raising to world-class standards the supervision processes, technology and people within the various financial regulators. A multi-regulator task force will integrate process reforms across jurisdictions to ensure a comprehensive bank regulatory framework. Third, a centre of competence for IFRS and N-GAAP+ implementation will be established to support examination teams and contribute to the NASB IFRS committee.

In the fourth part, Consumer protection is also an integral part of the reform program. The CBN will become the consumer's advocate, setting standards of customer service for the industry and ensuring that customers

are treated fairly in all their dealings with the industry. The CBN will establish a consumer protection department to restore consumer confidence in the industry. Its objectives would be to educate consumers on financial products, to respond to major consumer issues and to ensure the industry treats customers fairly. After 3-5 years, the consumer protection department will be rolled out into a Nigeria Financial Ombudsman Service, with the rules being set by CBN. The consumer protection department will increase consumer understanding and ensure banks understand their responsibilities. This department will work with supervisors to ensure appropriate rules and regulations are enforced by the banks.

In addition to the initiatives I have already mentioned, the reform programme will also include measures to **transform the CBN** itself in its fifth and last part. Core to transforming the CBN is Corporate Governance within the CBN. Board agendas, processes and procedures will be structured and institutionalised to ensure good governance is not dependent on the leadership of the Governor. The organisation structure within the CBN is already being streamlined to enable the CBN to better supervise and regulate the industry. In addition, the CBN will deploy a stronger management information framework to effectively supervise the industry. Management information dashboards will be developed for all key job roles, including bank examiners, group heads, deputy governors and their direct reports, and the Governor. Finally, CBN disclosure will also be enhanced to levels expected in major investor countries namely the United States, the United Kingdom, South Africa, China and India.

3.3 Establishing financial stability

The second and very crucial pillar in our four pillar reform program is establishing financial stability. The key features of this pillar centre **around strengthening the financial stability committee within the CBN**, establishment of a **hybrid monetary policy and macro-prudential rules**, development of directional economic policy and counter-cyclical fiscal policies by the government and further development of capital markets as alternative to bank funding.

Nigeria has dramatically underperformed its economic potential. Nigeria can only improve its economic performance if it deals squarely with two fundamental issues:

- Volatility and instability caused by over-reliance on oil and sub-optimal management of oil revenue, and
- Ability of the non-oil real economy to productively absorb investment and debt.

While the CBN is a critical player, success will require co-operation from many players in the economy and specifically fiscal policies that address these two fundamental issues.

Nigeria's economic performance falls short of its potential, although GDP per capita has risen in recent years. While oil should provide significant benefits to the economy, the reality is Nigeria will not progress, and will be subject to further financial crises, unless it addresses the fundamental volatility induced by oil dependence. Both the federal and state governments are exacerbating

volatility with pro-cyclical fiscal policies. It's also important to bear in mind that the current financial crisis resulted from dramatic financialisation that should have been foreseen.

We need to deal directly with the fundamental economic volatility related to the dominant role of the oil sector. We need to make better use of our oil endowment by harnessing it for strategic investment purposes. We also need to ensure lending and investment get to the real economy, especially its priority sectors, instead of being used to inflate financial asset bubbles.

Economic orthodoxy, including the 'Washington consensus', which consists of ten broad policy recommendations promoted by the IMF and the World Bank since the late 1980s is being fundamentally rethought based on recent experiences and specifically the Financial Crises. Beginning with Reaganism and Thatcherism in the 1980, and following the collapse of the Soviet bloc, a new orthodoxy was imposed on the world. In Nigeria, beginning with the Structural Adjustment Programme of the mid-1980s, successive governments have adopted this new religion of Friedmanism. There is a naive belief that the market solves all problems, that rules and regulations are bad, that greed and profit maximisation by a few, are the ultimate signs of success of an economy. The result is that in the last decade for example we have had consistent GDP growth, yet poverty and joblessness have been on the increase. A few individuals and corporations have amassed fantastic levels of wealth while millions languish in poverty. The stock market was booming and banks were making huge profits while factories were closing down and workers were being laid off.

Privatisation became a polite name for nepotism and cronyism, with public assets sold cheaply to politically connected persons. The "free market" came to mean a lack of regulation or protection for the consumer or general public. In service delivery, competition rules, consumer protection and matters of the environment, we had regulatory agencies that had been "captured" by big business. Those who were supposed to regulate operators, be they banks, listed companies, stock exchanges or telecoms companies, became themselves agents and protectors of those they were supposed to regulate.

As a country we have pursued international trade policies that have destroyed our productive base. Wrong tariffs, a naive believe in free-market platitudes and a willingness to succumb too easily to the wishes of western powers have led us to a state in which we operate a dysfunctional economy, one capable of delivering rapid GDP growth without improving the quality of life of the majority.

We need to carefully evaluate the most up-to-date evidence in developing economic policy, realising that in some cases, the best policy response will be radically different than the orthodoxy of just a few years ago. A more interventionist, directional economic policy stance should be adopted by Nigeria.

To address these issues, many new initiatives are being developed within the CBN.

The first set of initiatives is related to Monetary and macro-prudential policies.

1. The CBN will strengthen the **Financial Stability Committee (FSC)** whose focus will be on maintaining systemic stability; this committee will be supported by a strong technical working group. In recent years excessive credit and financial asset growth went unchecked. Academic literature has shown Nigeria - as a developing open economy, with a relatively small financial system and a dependence on oil - is particularly prone to asset price bubbles. Banking reforms are a necessary but not sufficient condition to ensure this does not happen again - there is need for additional macro-prudential oversight. There is an emerging international consensus that price stability should be supplemented by a robust macro-prudential regulatory framework, which monitors and acts on signs of systemic risk. Warning signs are easy to miss without an organisation in place with specific remit to monitor systemic risk and act on signs of distress. Although the CBN has for years now had an FSSC, it is surprising that it did not function when it was most needed and in fact did not meet at all for most of the period of the global economic crisis.

The MPC and the FSC would be at the core of the new macro-prudential framework; The MPC and FSC would work together to ensure that monetary policy is shaped by systemic risk trends and consistent with the expanded hybrid goals for asset price stability. Informed decision-making by the MPC and the FSC will be possible with better data and analysis following investment in the CBN's analytical function. We expect a number of members of the FSC to also sit on the MPC to ensure Committees are working in unison. CBN will communicate regularly with the Ministry of Finance to ensure that monetary and fiscal policies are consistent.

As regarding the Monetary Policy Committee (MPC), it will continue with its focus on price stability. However, we will now task it further with the goal of avoiding asset bubbles. There is an emerging international consensus that price stability should be supplemented by a robust macro-prudential regulatory framework including a function that monitors asset price bubbles and acts to eliminate them. Asset price bubbles have been a major source of instability and introducing an explicit asset price remit for the MPC is one way to reduce these destabilising bubbles. Nigeria as a developing open economy with a relatively small financial system dependent on oil is particularly prone to asset price bubbles, which have caused real growth volatility. Volatility lowers growth, especially for low income countries like Nigeria. A study has shown that a one percentage point increase in real GDP growth volatility reduces a country's average growth rate by 0.31 percentage points.

2. The CBN will also introduce **new macro-prudential rules** to address several of the specific causes of the crisis. An oversight function such as the FSC will be ineffective without tools with which to effect policy. It is important to have well-specified policy tools so as not to adversely affect the real economy. Dynamic provisioning can be one such tool; however it is difficult to implement and needs to be considered with care. Due to the Nigeria's unique economic situation, it makes it more appropriate to have some form of oil price linked provisioning regime. Potential levers could include:

- Limiting capital market lending to a set proportion of a bank's balance sheets
- Prohibiting banks from using depositors funds for proprietary trading, private equity or venture capital investments (the "Volcker rule" or some version of Glass-Steagall)
- Adjusting capital adequacy ratios depending on the perceived riskiness of the bank or financial institution
- Adjusting capital adequacy depending on the perceived point in cycle and
- Forward looking capital requirement driven by stress tests conducted by CBN

Some form of an oil price-linked provisioning regime, augmented by consideration of other macroeconomic indicators, need to be adopted for Nigeria.

Furthermore, the current managed exchange rate regime needs to be developed to ensure policies and reserves are in place to credibly defend the currency in times of distress. Exchange rate policies are being designed to limit exchange rate volatility which has been shown to reduce growth. Our commitment to maintaining a stable exchange rate has been communicated to the market and measures put in place to ensure stability is maintained. Any significant movement in the exchange rate will be overseen in an orderly way with the rationale for it clearly explained to all stakeholders. I am sure you have all noticed that we have avoided the volatility that characterised the exchange rate in the first half of 2009 and maintained convergence between the official and parallel market rates of exchange for about eight consecutive months now. A recent **paper shows that, in countries with relatively thin financial markets like Nigeria, a high degree of exchange rate flexibility consistently leads to lower growth. A 50% increase in exchange rate volatility leads to a 0.33% reduction in annual productivity growth; and a fixed exchange rate could add almost one percentage point to a country like Nigeria's annual GDP growth.**

3. Capital control approaches to prevent foreign 'hot money' from destabilising the capital markets and the real economy is another initiative under consideration. Evidence suggests that external capital flows are highly pro-cyclical and are a source of financial instability. Many believe foreign capital flows contributed to the recent credit bubble, as they were increasingly channelled into non-priority sectors of the Nigerian economy. Some would advise us to institute "hot money controls" similar to those put in place by Brazil. Without ruling this option out permanently, our present

thinking is that the bubble in our market was largely driven by leverage from local banks and any actions now to discourage capital flows may be precipitate. We will monitor capital flows but only intervene where they are seen to be a major, or primary, contributor to the problem.

4. In addition to the monetary and macro-prudential initiatives I have just mentioned, the CBN will become a champion to encourage implementation of **directional economic policy** to improve basic infrastructure, diversify the economy, and increase the investment absorption capacity of priority sectors and support measures that enable sustainable economic growth. We would like to encourage reforms to improve Nigeria's business environment, including property rights, rule of law, ease of doing business and investor risk.

Nigeria scores relatively poorly on the World Economic Forum's Global Competitiveness Index. Factors contributing to Nigeria's low GCI score include:

- Low efficiency and the lack of independence and transparency of public institutions,
- Infrastructure of insufficient quality,
- Health and education systems deficiencies,
- Low productivity and the brain drain and
- Low technological readiness

Comparator countries with higher GCI scores tend to have higher GDP per capita. This presents a strong argument for addressing some of the structural weaknesses of the Nigerian economy that are highlighted by the GCI.

Nigeria needs to support priority sectors more aggressively. Diversification away from oil can be achieved either through domestic support measures or through attracting foreign direct investment (FDI) to priority sectors. The recent credit boom showed that Nigeria has access to plentiful capital which has been misallocated. Nevertheless, Nigeria should still target FDI in priority sectors as it tends to lead to valuable inflows of technology and knowledge. Nigeria falls behind many countries with comparable macroeconomic characteristics, having low levels of per capita GDP and FDI. Diversification, typically with a focus on exports from sectors, in which a country has a comparative advantage, can also be achieved by protecting or subsidizing domestic companies until they attain global scale. Countries that have actively sought to diversify their economies, whether through FDI (e.g. Malaysia and Brazil) or through domestic support measures (e.g. Brazil and Korea), have increased their GDP per capita more quickly than Nigeria. Irrespective of the selected method for driving diversification, it is important to select the right sectors that match Nigeria's human capital and natural endowment advantages, such as agriculture, oil refining, petroleum products and basic manufacturing.

In December 2009, in Enugu for the first time in our banking history a weekend retreat was held involving the committee of governors and the

CEOs of all 24 banks specifically to map out strategies for growing credit to the real sector. We identified three major areas: power, transport infrastructure and agriculture. We then agreed to meet as a group with willing state governors in order to find bankable projects they are sponsoring. So far we have met with the governors of Lagos and Delta. In the middle of March, we shall meet with the governors of Cross River, Ogun and Kaduna. We have made rapid progress and this process is opening new vistas in the relations between banks and the public sector. In the meantime the Central Bank is working on strategies for making long term single digit interest rate loans to small and medium-scale manufacturers, as well as to state-sponsored projects identified as viable in the course of implementing the decisions of the Enugu retreat. We will make an announcement in the very near future.

I have always held the view that a central bank governor in an emerging economy like Nigeria must balance the desire for low inflation with the critical need for economic growth and poverty alleviation. It is for this reason that I soft-pedalled on the CBN's earlier effort to fast-track to an explicit inflation-targeting regime. The evidence for inflation targeting in poor countries remains dubious and francophone West Africa is a case in point. As we stand today, countries like Botswana have abandoned the policy. New Zealand, Brazil and Argentina are having second thoughts about the wisdom of pursuing a very low inflation target. Even IMF officials have recently advised the central banks in advanced countries, including the ECB to relax their target. There is a raging debate in South Africa over the SARB's insistence on maintaining an inflation target of 3-6% at a time of very weak GDP growth. So while the Central Bank will continue to maintain price stability, it will be an active player in the economic development space and encourage policies that and reforms that lead to the growth of the real economy, including attracting foreign investment into critical sectors.

The point here is not to signal that we are abandoning a primary task of central banking, the maintenance of price stability. Without price stability and some ability to anchor inflation expectations monetary policy begins to lose traction. However in setting inflation targets we must set targets that are compatible with our growth and poverty alleviation objectives, and then gradually adjust over time as these objectives are attained. History shows us that some countries have experienced rapid economic growth with inflation in the lower double-digits. The policy of retraining needed spending and making huge sacrifices to attain single digit inflation needs to my mind, considerable review.

1. 5 Further **development of Nigeria's capital markets** is yet another initiative under development within the CBN. Individuals and most private sector companies are dependent on banks for funding, but there has been a timing mismatch between lending and borrowing in the Nigerian financial system. There is little long term lending available, which reduces long term investment and growth. Nurturing other ways to raise funds could increase

competition thus reducing costs, encourage best practice lending and encourage better, longer term investment.

A diverse capital market is a necessary step to becoming a financially developed economy. Improving capital market depth and accessibility by **promoting alternative forms of raising finance** for priority sectors is therefore very much on our agenda. This can be achieved through developing an infrastructure for a **corporate bond market**, more accessible **equity markets**, supporting deeper **venture capital and micro-financing** of new businesses and establishing a sustainable **private equity** environment, potentially with government seed capital.

In partnership with the Finance Ministry, we are about to obtain presidential approval for tax waivers to promote the fixed income market. We will also put in place appropriate measures to improve attractiveness of sub-national bonds to the banking sector.

2. We are also considering developing measures around counter-cyclical fiscal policies. For example, one proposal under consideration is whether to **significantly expand the Excess Crude Account (ECA)** into a fully-fledged stabilisation fund that effectively quarantines oil-related excess liquidity before it reaches the Nigerian banking system. An enhanced ECA would have four main objectives: revenues above a set level would be quarantined in the ECA before they could reach the economy, predictable levels from oil revenues would reach the treasury and the economy, which encourages long-term planning, funds accumulated in the ECA could be used to top up oil revenue flows to the economy when they fall below the set, predictable level, or when the economy needs a counter-cyclical boost and funds would be invested in needed local infrastructure provided it would not cause overheating by relying on imports and idle labour capacity. We are also of the view that appropriate hedging arrangements for oil exports will not only protect government revenues from sharp drops due to a collapse in commodity prices, but reduce the volatilities that cause huge imbalances and precipitate economic cycles.

3.4 Enabling healthy financial sector evolution

I will now talk about the third pillar of our reform blueprint – enabling healthy financial sector evolution. Some of the areas that fall under this include banking industry structure, banking infrastructure such as credit bureaus and registrars, cost structure of banks, and role of the informal economy.

Let me start by saying that consolidation is not an end in itself in terms of **banking industry structure**. An examination of four countries that successfully-navigated their banking crises (Brazil, Turkey, Indonesia, Malaysia) shows there are many eventual banking industry structures that can serve Nigeria well. However, all of them have several common patterns. For example – the Central Bank or the apex regulator in each of these countries played an important role in determining the ultimate structure of the banking

sector. Banking crises in Turkey, Brazil and Malaysia resulted in significant consolidation in their banking sectors, with the number of banks decreasing post crisis. Also, foreign ownership played an essential role in raising standards in the industry.

The creation of the Asset Management Corporation will provide the first step towards resolution of the non performing loan problem in banks and eventually facilitate further consolidation. This process is on-going and we expect all banks to be totally weaned off CBN support by the end of Q3 2010.

I should also mention that we are reviewing the basic one-size-fits-all model of banking that has emerged since consolidation. In addition to reviewing the universal banking model, we consider it appropriate to introduce greater diversity in bank mandates. In the near-term, it should be possible to have international, national, regional, mono-line and specialised banks such as Islamic banks in the country. Capital requirements will vary with the range and complexity of mandate. We will continue to ensure that our banks are well-capitalised but bear in mind that required capitalisation is always relative to risk profile. Indeed there is evidence that the pressure on banks to deliver high returns to their shareholders after the rapid expansion in their capital base post-consolidation contributed to some of the highly risky behaviour that led to the collapse of some of the banks.

3.5 Ensuring the financial sector contributes to the real economy

The last and final pillar of our reform blue print is ensuring that the financial sector contributes to the real economy.

Rapid financialisation in Nigeria did not benefit the real economy as much as had been anticipated. Development financial institutions set up for specific purposes such as housing finance, trade finance, urban development have not fulfilled their mandates. Many successful emerging markets have seen proactive government actions to ensure that the financial sector contribute to the real economy. Nigeria can learn from countries with successful track records in creating financial accommodation for economic growth through initiatives such as development finance, foreign direct investment, venture capital and public private partnerships. The CBN is in a good position to advocate economic development in Nigeria.

Nigeria can learn from the experience of other economies. In successful emerging markets, many of the successful policy lending programmes share common features. For example, many policy lending programmes were conducted through State-owned/State-controlled banks particularly in East Asian economies such as Japan, Korea, China and Vietnam. Many programmes were funded by state budget or through government controlled savings system (such as postal savings in Japan). The state invariably provided seed funding as equity in specialised development financial institutions (e.g. Brazil, China). Some funding also came from development agencies such as IFAD, WB and ADB.

To ensure the financial sector contributes to the real economy, the following areas need further consideration –

1. Leveraging the CBN Governor's role as advisor to the President on economic matters to ensure that the financial sector contributes to the real economy
2. Taking the lead in measuring more accurately the relationship between the real economy and financial sector and the transmission mechanism
3. Evaluating continuously the effectiveness of existing development finance initiatives such as agriculture credits and import-export guarantees
4. Taking the public lead in encouraging examination of critical issues for economic development (impact of infrastructure such as power, port and railways)
5. Leading further studies on the potential of venture capital and private public partnership initiatives for Nigeria
6. Cooperating with a state government to run a pilot programme in directing the financial sector's contribution to the State's social economic development

3.6 Closing remarks

Nigeria's economy in 2009 is like a structurally-compromised ship in a storm. This is partly due to inherent economic weaknesses such as insufficient diversification of the economy, high security risks, a complex business operating environment and inadequate infrastructure.

Financial sector and overall economic success will require the CBN and Nigeria to do a lot of heavy lifting in many policy areas. Rapid financialisation is not just a risky growth strategy; it is also a lazy way of growing an economy. A sustainable growth path can be achieved only through substantial and fundamental economic reform. This includes ensuring that physical and institutional infrastructure is of a scale and quality required. It also calls for political will to act to reduce corruption and uphold the rule of law.

I have gone into great detail to lay out clearly our vision for the banking sector and our roadmap to the future. It is indeed a great honour for me to have been given this opportunity and I can think of no better platform than this. In the next few weeks we will conclude the internal CBN restructuring exercise and also set up teams with clear targets and work streams. The reform process is on-going and happens over time.

A final word to the graduating students. A university degree, and especially a doctorate degree, is the beginning of your education and not the end of it. Walk into life and through life as a thirsty woman or man drinking from the fountain of knowledge. At every stage you will find your learning in a previous stage useful. Over the course of your life you will discover that no knowledge is useless.

Guard jealously words of wisdom you come across from great men of history and you will find them good advice at some stage in your life. During the most difficult days of the on-going banking reforms I found comfort in these short words of the Roman Emperor and philosopher-king Marcus Aurelius: "Do what is Right, not Popular; Do what you do for Others first, and for Yourself second."

Most important for you as you go out into the world, I urge you to remember the words of John F Kennedy to the American people in the 60s. Take those words as if they were addressed to you. It is time for you to stop asking what your country can do for you. Each of you must from now on say to herself or himself: What can I do for my country? Nigeria needs you now, more than ever.

Thank you

In May 2005, Fidelity bank joined the list of commercial banks in the Nigerian Stock Exchange and in December, it merged with FSB international Bank and Manny Bank to form the currently enlarged Fidelity Bank. Significance of the study. Despite the challenges that have hit the fragile banking industry, financial performance of Fidelity Bank shows remarkable growth.Â The Nigerian banking industry: what went wrong and the way forward. Central Bank of Nigeria. Chiejine, F.C., 2010. Corporate governance in the Nigerian banking sector: an ethical analysis of the 2009 regulator intervention and operatorsâ€™ behaviours. University of Pennsylvania. Fadun, O.S., 2013. The Nigerian Banking Industry: What Went Wrong and the Way Forward. Lecture delivered at Bayero University Kano. Repositioning Nigerian Banks Turbulent Entry Barriers.Â Consolidation in the Nigeria Banking Industry; A strategy for Survival and Development. A paper presented during the visit of the Nigerian Economy Student Association. Jan 2005. O I Imala. Imala, O. I. (2005). Consolidation in the Nigeria Banking Industry; A strategy for Survival and Development. A paper presented during the visit of the Nigerian Economy Student Association (NESA) University of Abuja Chapter. The Impact of E-Banking on Customers' Satisfaction.