REGULATORY REFORM OF FINANCIAL INSTITUTION,POST FINANCIAL CRISES. BEING PAPER PRESENTED

PROTOCOL/INTRODUCTION

It is quite an honour to be here to address this gathering. Am quite priviledged to be part of this conference where top legal minds around the Commonwealth and the world meet to exchange ideas and views on varied mostly legal issues. It is hoped that my humble contribution will aid the Commonwealth Lawyers Association in the development of the law. My paper on Regulatory Reform of Financial Institutions Post Financial crises focuses on the Nigerian experience.

THE CRISES

It is generally believed that the financial crises was triggered in the USA and went round the world. This could be traced to the burst, collapse of corporate giants and then the housing bubble burst resulting in destruction of equity and real estate wealth.

The reoccurring decimals in the crises were lack of accountability poor/non disclosure, distorted incentives ad most especially failure of regulation.

In Nigeria, for example there was the added issue of inflation of rating by rating agencies of the financial institution especially banks. It came out that banks with AAA ratings were far below those exaggerated ratings. The collateral damage to Nigeria has been much. A most noticeable one was the shrinking of capital flow. The Nigeria capital market experienced a sharp decline. Unfortunately when the crises began there was the talk by some supposed “experts on the Nigerian economy” that Nigeria will be spared as if we were not integrated to the global financial economy. Their position may have been advised on the pre – crises position of the Nigerian capital market where sometimes certain happening that one would expect to affect the prices of some stocks did not so affect. With benefit of hindsight the said “experts” have been proved wrong.

Everyone is at one that the failure of regulation caused the global crises. The Nigerian capital market was no exception and took serious bruising loosing considerable value and plunging investor's confidence to very low ebb. The Nigerian Stock Market was down by 45.77% in 2008. Before the bubble burst the Nigerian Capital Market witnessed an unprecedented growth and increased varied investors participation.

Prior the Global financial crises there was a recapitalization of banks policy by the Central Bank of Nigeria sometime in 2004. The Central Bank of Nigeria had discovered that some banks especially fourteen (14) of about 89 banks then operating in Nigeria were marginal in terms of soundness. The situation was bad that banks were engaging in unethical practices to stay afloat one of which was offering outrageous interest rates to attract depositors. At the end of 2004 N71.36 billion was being owed the Central Bank of Nigeria by the banks with virtually all of them not able to repay same.

With the recapitalization policy the banks went to the Capital market to raise funds through public offers. Coincidentally at that period there was an unprecedented upward movement in the world oil prices resulting in excess liquidity in the country. The public offers with this liquidity were in many cases over subscribed. The banks awashed with funds went into non core banking areas. Speculative lending mainly to oil and gas sector with the rising oil prices and a highly unregulated margin facilities to broker and individuals to buy the bank stocks kept their market prices soaring. Malpractices were rife. Foreign investors with the high returns in the market came in to invest, infact the bull run was virtually permanent in the market. With this apparent sudden enlarged investors' appetite issuers took advantage and made new issues.

From the Nigerian Stock Exchange records new issues hit a record high of N1.3 trillion in 2007 as against N405 billion in 2005. The equity market capitalization grew from N2.5 trillion to N10.3 trillion in 2007 and infact peaked N12,64 trillion in 2006.

This growth was not fundamentals supported as caution was thrown to the wind. With the regulatory body weak or deliberately closing it eyes, uninformed investors got attracted and got locked in, then came the tsunami from the global crises and the bubble burst. With the global crises the foreign investor exited the market to address their home challenges, stocks prices plummeted, investors panicked and sale orders were given further taking down to market and eroding confidence. At the end of 2008 the market had dropped to N6.96 trillion.

An important fact is that whilst enormous resources have been committed to bail outs and rescue packages by many developed economies, there has not been (as far as am aware) a global approach to it especially as regards Africa. In fact at the 2012 International Bar Conference in Dublin, Professor Joseph Stiglitz a Nobel Price Winning economist in his keynote address on the financial crises dwelt on Europe and America, mentioning China/Asia but said nothing about Africa as if we do not exist in the global financial sphere.

REFORMS

As banking is the major financial institution directly in the line of fire, I will first delve into banking and with particular reference to the regulatory reforms by Central Bank of Nigeria. The Central bank of Nigeria faced with the crises had to take tough measures to tackle the effect of crises. This resulted in significant reduction of banks balance sheets with economic losses as fall out effects.

The Central Bank of Nigeria tagged its reforms Project Alpha Initiative, the primary aim being to reform the Nigerian Financial System with the banking sector as the focus.

The reform started with a consolidations programme aimed to strengthen the banks resulting in mergers and acquisition raising the capital base of banks from N2 billion to N25 billion. The resultant effect is that the number of banks shrunk from 89 – 25.

Further steps taken by the Central Bank of Nigeria were:

- Risk focused and rule based regulatory framework.
- Zero tolerance in regulatory framework in data information rendition/reporting and interaction.
- Strict enforcement of corporate governance.
- Customer & Financial Protection Division through which customers could seek redress.
- Review of Bank charges aimed at realistic and customer friendly service.

- Global best practice through financial reporting and disclosure with the adoption of International Finance Standard in the Nigeria Banking sector.
- Cashless policy to ensure adequate capturing of currency in circulation within the banking system.
- Expeditious process for rendition of returns by banks and other financial institutions.
- Revision and updating relevant laws for effective corporate governance.
- Introduction of flexible interest rate based framework that made the monetary policy rate the operating target.
- Collaboration with the Nigerian Stock Exchange and the Securities And Exchange Commission to reduce cost of transaction particularly bond issues so as to diversify funding sources from banks ad also attract foreign portfolio investors.

A new banking model that banks are allowed to operate either as commercial, merchant, specialized (micro – finance, mortgage non – interest) and development finance institution has been rolled out. With the regulatory reforms by the Central Bank of Nigeria the resulting effects have been:

- Best practice in corporate governance and risk management.
- Some banks returning to profit making from their financial statements.
- Resumption of lending by banks.
- Nigerian banks being global players within the top 20 banks in Africa.
- A fall in lending and deposit rates.
- Control to a large extent of the volatility of the exchange rate.

As with the Central Bank of Nigeria, The Securities And Exchange Commission being the Regulatory body overseeing the capital market also came up with reforms post the global crises. Knowing that the investors remain the best assets of the capital market the reforms are targeted as protecting them. For a start there was a changes in the leadership of the Nigerian Stock Exchange.

The reforms introduced amongst other were

- Reforms in offers making requirements for bonds simplified in line with international best practice. Bond trading introduced and traded on retail basis like equity.

- To enhance the bond trading the Securities And Exchange Commission has a Resident Bond Adviser from the World Bank.
- Enhanced enforcement framework capable of actions on violations of regulations.
- Self regulations amongst the broker/dealers and enforcing of the rules have been put in place. The Securities And Exchange Commission and the Nigerian Stock Exchange are working jointly towards achieving this resulting in the emergence of the Association of Stock Broking Houses that self regulates its members.
- Sound institutions have been put in place to punish violators of the securities laws.
- Strengthened relationship between the Commission ad institutions that enforce violation that are criminal in nature. There has been a successful prosecution and these have been deterrence to would be violators.
- Naming and shaming of market violators has been also an effective tool.
- Overhauled and improved investigations of infractions/violations of set rules.
- Improved technology resulting in electronic filing of documents & periodic returns timeneously.
- Strengthened disclosure with the Commission now ensuring that public companies release periodic information timeneously.
- Reclassification of stocks along related industry in line with international practice.
- Introduction of market makers – where some operators are appointed as market makers and some stocks gradually enlisted to be traded on the platform based on set criteria.
- Short selling introduced to deepen the market.
- Security lending introduced though on a small scale.
- Listing rules relaxed to enlist companies on the second tier market for companies that have raised funds through private placement.
- Market daily trading ceiling increased from 5% to 10%.

Another area of reform was the establishment of Assets Management Corporation of Nigeria (hereinafter referred to as AMCON) by an Act of the National Assembly, as a vehicle to address non performing loans in the Nigerian banking system. It has so far acquired non performing risk assets of banks worth about N1.7 trillion. The foregoing position has in turn boosted the banks liquidity enhancing their soundness. With AMCON intervention banking ratio on non – performing loans dropped to 4.95% from 34.4% between 2010 and December 2011.

The Central bank of Nigeria and deposit banks has signed a memorandum of understanding on financing. AMCON with Central Bank of Nigeria contribute N50 billion annually to this fund whilst each bank contributes 0.3% of its total assets annually to the fund as at the date of their audited financial statement.

CONCLUSION

An efficient regulation demands a well functioning regulatory infrastructure with efficient monitoring regulator. Public confidence can only be built through transparent and efficient credible financial disclosure. This is vital for the stock market also financial statements to be trusted. The damages caused by the crises were quite severe that there may be the temptation to get the government to over regulate. That would be the wrong approach as the regulator should not determine what is best for the investors but act more as oversights. A well functioning market with clearly defined rules will always thrive.

Financial institutions from the crises need regulation but what is most needed is good regulation. If there are good regulatory schemes, frequency and severity of crises will be reduced. Shunning globalization cannot help, but as we delve into globalization we should develop appropriate measures to manage the risk and resolve crises.

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