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## THE NIGERIAN FINANCIAL CRISIS: A REDUCTIONIST DIAGNOSIS

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### ABSTRACT

*The crisis in the Nigerian financial system from 2008 to 2009 triggered an explosion of scholarly debates on the legal and institutional inadequacies of the Nigerian financial regulatory system that contributed to its inability to anticipate or prevent the financial crisis. Many of the analyses however have yet to consider closely the part played by sub-optimal enforcement of financial laws and regulations before the crisis and how this created opportunities for the crisis.*

*This paper argues for a supervisory failure account of the Nigerian financial crisis. It conceives this failure as an incidence of sub-optimal enforcement of regulatory norms, induced by low or weak regulatory accountability and which largely provides opportunities for a financial crisis. Through a normative analysis of the indicators public sector and financial regulation accountability, it demonstrates how the crisis could have been prevented. In doing so, the paper partly examines the legal and institutional problems of financial regulation in Nigeria; how the Nigerian financial system fared during the financial crisis of 2008 to 2009; and what could have been done to prevent the crisis.*

### 1.0 INTRODUCTION

In March 2008 the Nigerian financial system experienced another financial crisis, the fallout of which has yet to abate.<sup>1</sup> The stock market crashed with a loss of \$60billion in market capitalisation, and the resultant liquidity crisis in banks forced the Central Bank of Nigeria (CBN) to inject \$4.1billion (USD) into eight insolvent banks. Since that period, scholars and commentators have attempted to diagnose the cause(s) of the crisis. On one view, the Global Financial Crisis of 2007 largely caused the crisis. Another is that the crisis was the result of

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<sup>1</sup> The Nigerian Financial System has three subsectors. They are: banking, securities and insurance. These subsectors are regulated on the basis of their functions. Thus the Central Bank of Nigeria ('the CBN') regulates banking; the Securities and Exchange Commission ('SEC') regulates dealing in securities; and the National Insurance Corporation of Nigeria ('NAICOM') regulates insurance. For background to past financial crises in Nigeria an excellent source is Tunde I. Ogowewo and Chibuikwe Uche '[Mis]Using Bank Share Capital as a Regulatory Tool to Force Bank Consolidation in Nigeria' (2006) 50, 2 *Journal of African Law*, 161. Measured by the economic crisis, which followed the stock market crash of 2008 and the banking insolvencies announced by the CBN in 2009; the period, from March 2008 to August 2009, arguably marks the critical phase of the crisis under review. From all indications however, the crisis has yet to effectively abate: In addition to the ensuing economic crisis, issues such as creditor activism, claims of shareholder marginalisation, expropriation of shares in the insolvent banks and the legality of CBN intervention in the banks are yet to be resolved.

‘legislative infidelity,’ which is defined as a law-making tactic that intentionally creates loopholes, distortions, ambiguities, vagueness, and unwarranted complications in texts of laws with the objective of taking advantage of the confusion to advance unfair selfish goals.<sup>2</sup> The ‘interdependent factors’ account attempts a comprehensive analysis by discussing eight pathogenic factors allegedly responsible for the crisis. None of these diagnoses however, has thus far examined closely, the primary factor, in the sense of the principal causative agent, which created the opportunities for most of the secondary factors, which are the several subsidiary causes blamed for the crisis.

This paper reviews and contributes to these debates. It identifies supervisory failure as the principal cause of the Nigerian Financial crisis. It uses a cause – effect approach, to argue that supervisory failure (in the sense of an incidence of sup-optimal enforcement of regulatory norms, induced by low or weak regulatory accountability and which largely provides opportunities for a financial crisis) is the primary cause, the effects of which are the secondary causes blamed for the crisis.

This paper is divided into six sections. This introduction is the first section. The second section reviews existing accounts of the Nigerian financial crisis of 2008 to 2009. The third section develops the supervisory failure analysis of this paper. The fourth section formulates regulatory accountability principles and shows how these could have prevented the crisis. The fifth section uses these principles to justify the argument that most of the factors blamed for the crisis are reducible to supervisory failure. The sixth section concludes the paper.<sup>3</sup>

## 2.0: DIAGNOSES OF THE CRISIS

The literature on the causes of the Nigerian financial crisis of 2008 to 2009 splits into three perspectives, namely, the ‘Global Financial Crisis’ perspective; the ‘legislative infidelity’ perspective; and the ‘interdependent factors’ perspective. The ‘Global Financial Crisis’ perspective contends that because of the interconnectedness of world economies which was evident in the Global Financial Crisis of 2007, ‘the Nigerian capital market was not insulated from this global malignant cancer.’<sup>4</sup>

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<sup>2</sup> C Ikebude, ‘Mismanagement of Emerging Stock Markets: Analysis of the Role Played by “Legislative Infidelity” – a Norm of Int’l Economic Jurisprudence – in the ₦8.1trillion (\$60bn) Crash of Nigerian Stock Market’ (PhD thesis, Golden Gate University 2011) 19 – 23.

<sup>3</sup> Admittedly, the crisis threw up a complex mix of socio-political and economic issues, which for thematic focus shall not be discussed here, but other writers have discussed some of these. For an excellent and detailed account of the part played by erosion of bank capital in Nigerian banks’ insolvencies see, T Ogowewo and C Uche (n 1) 166 – 170. S Apati, *The Nigerian Banking Sector Reforms: Power and Politics* (Basingstoke: Palgrave Macmillan, 2012) 18 – 140, provides an engaging commentary on the socio-political background to the crisis.

<sup>4</sup> C. Nwude, ‘The Crash of the Nigerian Stock Market: What went wrong, the Consequences and the Panacea,’ (2012) vol. 2, No. 9, *Developing Country Studies*, 109 – 11

On this view, the recession in foreign economies such as the USA, United Kingdom and others resulted in capital flight from Nigeria, as foreign investors sought to make up for the deficits in their home countries, by dumping their shares in Nigerian listed companies, beyond the ability of domestic investors to contain.<sup>5</sup> This diagnosis, though persuasive and helpful, is arguably incomplete, in that it focuses only on the Nigerian stock market crash of 2008, and overlooks the question of the extent to which the failure of Nigerian financial regulators to exercise their oversight powers to check stock market manipulation before 2007, in particular exposed the Nigerian financial system, not just to the ‘shock wave’ of the Global Financial Crisis, but as much to the effects of share assets bubble in the banking sub-sector.

The ‘legislative infidelity’ perspective, posits that the stock market crash of 2008, occurred because the regulatory framework was designed to fail through consciously created loopholes, to be used for circumventing or perverting the system.<sup>6</sup> Focussing mainly on the provisions of the Nigerian *Investment and Securities Act*, and the stock market crash of 2008, this perspective argues that the composition and functions of the Board of the Nigerian Securities and Exchange Commission were designed by Nigerian policy makers on the advice of the International Monetary Fund and the Bank for Reconstruction and Development, to create opportunities for regulatory failure and capital market perversion.<sup>7</sup> In support, it argues that the provision for a part-time, non-executive SEC Chairman in section 3(1) a-f of the ISA 2007, who could hold directorship positions in quoted companies, creates opportunities for conflict of interest, undue advantage and the possibility that the chairman would be unable to provide optimal leadership for SEC. Further, it argues that tested and proven safety-nets, key anti-fraud provisions, and settled principles recognised by international best practices, to guarantee market integrity, transparency, orderliness, investor protection are purportedly omitted from the Nigerian capital market arrangement.

This paper disagrees with this diagnosis for two reasons. First, it is narrow in scope as it focuses only on the stock market crash and a legislative account of that crash, even though that crash and the insolvencies of eight systemically significant banks arguably constitute the crisis. In effect, the diagnosis fails to link the crash with the banking insolvencies, which if done would have shown the shared causative factor between the two events. Second, even if this diagnosis were to be applied to the entire financial system, it still fails to address the part played by the shortcomings of the financial regulatory

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<<http://www.iiste.org/Journals/index.php/DCS/article/view/2973> > accessed 10 January 2013.

<sup>5</sup> *ibid.*

<sup>6</sup> C. Ikebodu, (n 2) 95 – 234.

<sup>7</sup> *ibid.*

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system in the crisis. This rather narrow diagnosis therefore overlooks the primary regulatory issue, which is the failure of Nigerian financial regulatory institutions to imbibe accountability best practices that would have assisted in anticipating and preventing the crisis.

The ‘interdependent factors’ perspective opines that the crisis was caused by ‘8 (eight) interdependent factors’ namely macro-economic instability caused by large and sudden capital inflows; major failures in corporate governance at banks; lack of investor and consumer sophistication; inadequate disclosure and transparency about financial position of banks; critical gaps in regulatory framework and regulations; uneven supervision and enforcement; unstructured governance and management processes at the CBN/weaknesses within the CBN; and weaknesses in the business environment.<sup>8</sup> Arguably, this diagnosis offers the most comprehensive and helpful account of the particulars of the crisis.

However, as detailed as the ‘interdependent factors’ perspective is, it is suggested that 7 (seven) of the factors identified as ‘independent factors’ are reducible to one primary factor of supervisory failure induced by lack of regulatory accountability in the operations of Nigerian financial regulatory institutions and their officials. The rest of this paper is devoted to developing and justifying this suggestion, which is that supervisory failure induced by lack of regulatory accountability was the principal cause of the Nigerian financial crisis, the effects of which are intricately intertwined with the other factors identified by the ‘interdependent factors’ perspective.

### **3.0 PRE-CRISIS FINANCIAL REFORMS AND SUPERVISORY FAILURE**

This section examines the potential flaws and issues in matching functional regulation with universal banking and financial conglomerates in Nigerian after 2005.<sup>9</sup> It shows how the flaws and issues could have been dealt with; the measures adopted by the regulators; and why in spite of these measures Nigeria experienced a financial crisis in 2008 to 2009. It develops the argument that sub-optimal supervisory response to these flaws by Nigerian financial regulators, namely, the CBN, SEC, NDIC and NAICOM, explicable on the premise of weak regulatory accountability is the principal reasons why some of the flaws arguably precipitated the financial crisis.

In December 2000, the CBN, pursuant to section 61 of the *Banks and Other Financial Institutions Act* (‘BOFIA’) 1991, issued a circular to banks announcing the commencement of

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<sup>8</sup> S Sanusi, ‘The Nigerian Banking Industry: What Went Wrong and the Way Forward,’ (2010) 5, < <http://www.bis.org/review/r100419c.pdf?frames=0> > accessed 15 May 2012; S. Apati, (n 1)94.

<sup>9</sup> A universal bank combines in one institution, commercial banking, securities trading an insurance services; a financial conglomerate, offers these services through two or more subsidiaries, owned and controlled by a holding company.

universal banking ('UB') in Nigeria from January 2001.<sup>10</sup> The key contents of the circular are its redefinition of banking business in Nigeria, the specification of activities that banks could undertake under the UB programme and the consequential regulatory and supervisory framework. UBs generally are financial institutions that combine the lending and payment services of commercial banks with a wider range of financial services, including securities and insurance; they can offer their customers access to a broader range of funds than specialist commercial or investment banks.<sup>11</sup> The UB Guidelines stated that Nigerian banks were free to undertake one or more of clearing-house activities, capital market activities and insurance marketing services, but that core insurance business must be carried out through a subsidiary.<sup>12</sup> The CBN justified its introduction of the programme on two grounds namely the need to remove alleged imbalances in opportunities between commercial and merchant banks<sup>13</sup> and the strengthening of the capacity of Nigerian banks to fund commercial industrial activities.<sup>14</sup>

In December 2005, the CBN consolidated Nigerian UBs into 'mega banks' by increasing the minimum share capital of banks from ₦2billion to ₦25billion and officially recommending mergers and acquisition for banks to meet the recapitalisation deadline of 31 December 2005.<sup>15</sup> This was part of a so called '13-point agenda' to actualise the 'vision of a sound and reliable banking structure for the 21<sup>st</sup> century.'<sup>16</sup> The consolidation policy was justified on two grounds. The first was the need to strengthen existing UBs for a diversified, strong and reliable banking sector for the safety of depositors' money, play an active role in the Nigerian economy, and be competent and competitive players in the African regional and global financial system.<sup>17</sup>

The second was the perceived inability of the Nigerian banking system to embrace voluntary consolidation consistent

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<sup>10</sup> Circular BSD/DO/CIR/Vol.1/10/2000 of 22 December 2000, titled, 'Guidelines for the Practice of Universal Banking in Nigeria' ('the UB Guidelines') < <http://www.cenbank.org/OUT/CIRCULARS/BSD/2000/BSD-10-2000.PDF> > accessed on 15 May 2012.

<sup>11</sup> A. Morrison, 'Universal Banking' in A Berger, Phillip Molyneux and John O. S. Wilson eds., *The Oxford Handbook of Banking* (Oxford: OUP, 2010) 171.

<sup>12</sup> The UB Guidelines (n 7) 2 - 3.

<sup>13</sup> Section 22(1) of the BOFIA, 1991 CAP B3, Laws of Federation of Nigeria 2004, prohibits merchant banks from accepting any deposit withdrawal by cheque; accepting any deposit below an amount which shall be prescribed, from time to time, by the CBN; and holding for more than six months any equity interest acquired in a company while managing an equity issue except as stipulated in section 21 of the Act.

<sup>14</sup> Central Bank of Nigeria, *50 Years of Central Banking in Nigeria: 1958 – 2008* (Abuja: Research Department, Central Bank of Nigeria, 2008) 129.

<sup>15</sup> C. Soludo, 'Consolidating the Nigerian Banking Industry to Meet the Development Challenges of the 21<sup>st</sup> Century' 9 < <http://www.bis.org/review/r040727g.pdf> > accessed on 22 May 2012.

<sup>16</sup> Ibid 7 – 9.

<sup>17</sup> Ibid 8.

with global trends. This allegedly necessitated the adoption of appropriate legal and supervisory frameworks for mergers and acquisitions in the industry, to promote the safety, soundness, stability and enhanced efficiency of the Nigerian financial system.<sup>18</sup> The two grounds corroborate the argument of Fries *et al* that banking systems in transition economies, such as Nigeria, are typically characterised by a need for major restructuring to boost efficiency.<sup>19</sup> What should be noted however, from the Nigerian brand of the efficiency goal, as from a composite appreciation of the policy justifications for the banking consolidation, is that the exercise in reality moved forward the reform started by the UB programme, by creating mega Nigerian banks with a sub-regional and continental spread of operation in Africa.<sup>20</sup>

The regulatory structure after the universal banking and banking consolidation recognised three major financial regulators. These were the CBN, the Securities and Exchange Commission ('the SEC'), and the National Insurance Commission ('NAICOM'). The three agencies were supervised by the Minister of Finance and subject to oversight powers of the National Assembly.<sup>21</sup> The CBN was empowered to grant, vary and revoke banking licence;<sup>22</sup> prescribe minimum paid-up capital of licensed banks;<sup>23</sup> prescribe minimum capital ratio to be maintained by banks;<sup>24</sup> and supervise banks, specialised banks and other financial institutions.<sup>25</sup> The CBN was also empowered to act as banker to other banks<sup>26</sup> and to ensure a high standard of conduct and management throughout the banking system.<sup>27</sup> The SEC was empowered to regulate investments and securities business;<sup>28</sup> register and regulate Securities Exchanges, Capital Trade Points, futures, options and derivatives exchanges, commodity exchanges and any other recognised investment exchanges;<sup>29</sup> register securities to be offered for subscription or sale to the public;<sup>30</sup> register and

<sup>18</sup> *ibid* 4.

<sup>19</sup> S. Fries, D. Neven and P. Seabright, 'Bank Performance in Transition Economies,' (2002) European Bank for Reconstruction and Development Working Paper 505, 19 <<http://www.ebrd.com/downloads/research/economics/workingpapers/wp0076.pdf>> accessed on 15 May 2012.

<sup>20</sup> Apati (n 3) 56 – 68.

<sup>21</sup> Section 88 of the Constitution of Federal Republic of Nigeria, 1999; section 1(1), BOFIA No. 25 of 1991 (as amended by Act No. 4 of 1991); section 4 of the National Insurance Commission Act No. 1 of 1991; section 5 of the Investment and Securities Act (ISA) No. 45 of 1999.

<sup>22</sup> Sections 3, 5 and 12 of the BOFIA (as amended).

<sup>23</sup> *ibid* section 9.

<sup>24</sup> *ibid* sections 13 and 14.

<sup>25</sup> *ibid* sections 31, 32, 33, 34 and 61.

<sup>26</sup> Section 36 of the CBN Act 1991 (as amended) now section 41 of the CBN Act No. 7 of 2007.

<sup>27</sup> *ibid* section 37 (1) (b), now section 42 (1) (b) of the CBN Act No. 7 of 2007.

<sup>28</sup> Section 8(a) ISA 1999, now section 13 of the ISA No. 29 of 2007.

<sup>29</sup> *ibid* section 8(b).

<sup>30</sup> *ibid* section 8(c).

regulate corporate and individual capital market operators;<sup>31</sup> register and regulate the workings of venture capital funds and collective investment schemes, including mutual funds;<sup>32</sup> and act as the regulatory institution for the Nigerian capital market.<sup>33</sup> NAICOM was empowered to establish standards for the conduct of insurance business;<sup>34</sup> approve ratios of insurance premiums to be paid in respect of all classes of insurance business;<sup>35</sup> act as adviser to the Government on all insurance related matters;<sup>36</sup> and protect insurance policy holders and beneficiaries.<sup>37</sup> This fragmented regulatory structure, in effect, statutorily, assigned banking, securities, and insurance regulation to the CBN, the SEC, and NAICOM, respectively.

The foregoing regulatory structure shows that after 2005, Nigeria had what Coffee and Sale typify as functional financial regulation.<sup>38</sup> By design or evolution, functional regulation assigns regulatory oversight over similar financial activities to one regulator.<sup>39</sup> It rests on the proposition that no one regulator can have or easily develop expertise in regulating all aspects of financial services.<sup>40</sup> Thus a banking regulator, such as the CBN, understands banking services; the SEC understands securities business; and NAICOM understands insurance business. This arrangement should work well; and the underlying proposition would be flawless, in a financial system, which maintains a strict segregation of banking, insurance, and securities businesses. Where, as was the case in Nigeria after 2005, financial intermediaries could combine two or more of these services, or the goal is that the convergence of financial services would ‘engender the emergence and existence of financial conglomerates and large banking groups which involve different regulatory authorities’, this proposition is flawed on several counts, but three are pertinent in this context.

First, matching convergence of financial services with functional regulation means that no single regulator would possess all the information necessary to monitor systemic risk, or the potential that events associated with one or more financial conglomerates may induce broad dislocation or a series of defaults that affect the financial system so significantly that the economy is in turn, adversely affected. Assuming, for instance, that universal banks A, B, and C hold

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<sup>31</sup> *ibid* section 8(f).

<sup>32</sup> *ibid* section 8(g).

<sup>33</sup> *ibid* section 8(n).

<sup>34</sup> Section 7(a) of the National Insurance Commission Act No. 1 of 1997.

<sup>35</sup> *ibid* section 7(f).

<sup>36</sup> *ibid* section 7(g).

<sup>37</sup> *ibid* section 7(h).

<sup>38</sup> J. Coffee, Jr. and H. Sale, ‘Redesigning the SEC: Does the Treasury have a Better Idea?’ (2009) 95 Va. L. Rev. 707, 717 – 21.

<sup>39</sup> *ibid* 717.

<sup>40</sup> *ibid* 718.

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an aggregate of 40 per cent of the depositors' funds in such a system, supply nearly half of the credit available to borrowers, provide extensive insurance services through affiliated companies, and engage in high volume securities activities, as underwriters and proprietary traders, the size of their combined businesses means that they are systemically significant, in that their failure could compromise the financial system. However, the fact that their several businesses fall under the remit of separate regulators means that it will be difficult, if not impossible for one regulator to possess the information necessary to prevent their failure and the systemic crisis most likely to result from this.

Second, while financial conglomerates could adopt a consolidated management and accounting structure, they would file fragmentary reports on their activities to different regulators. Apart from the consequence that regulators are not able to have a true view of the entire operations of a conglomerate, this might be exploited by unscrupulous conglomerates to drip-feed regulators with information, or file inaccurate reports. For instance, where companies X, a systemically significant financial conglomerate suffered losses on a group wide basis, it could hide the extent of this fact from regulators, by revealing snippets of information relating to the losses in reports submitted by its subsidiaries to regulators.

Third, matching functional regulation with convergence of financial services tends to result in duplication of certain common services across regulators. While some degree of specialisation might be important for the regulation of financial intermediaries, many aspects of financial regulation and consumer protection regulation have common themes. For example, although the key measures of financial health have different terminology in banking and insurance – capital and surplus – they both serve a similar function of ensuring the financial strength and ability of financial institutions to meet their obligations. Similarly, the goal of most consumer protection regulation is to ensure consumers receive adequate information regarding the terms of financial transactions and that financial intermediaries comply with appropriate sales practices. However, beyond the obvious question of efficiency, duplication of common services could still be helpful in a functional regulatory system, if the performance of these services is linked to so as to reduce inefficiency and closing possible gaps in the regulatory framework. For instance, SEC<sup>41</sup> and NAICOM<sup>42</sup> not only have consumer/investor protection functions; they also have separate compensation schemes that duplicate the core function of Nigerian Deposit Insurance

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<sup>41</sup> Section 13 (k) ISA 2007.

<sup>42</sup> Sections 7 (h) and 8 (a), Insurance Act 2003.



Corporation (NDIC).<sup>43</sup> This inefficient arrangement and the gap created by the absence of a financial ombudsman could be dealt with by way of improvisation, if the three agencies appreciate the need to link the exercise of their statutory powers and functions in this respect.

Linked to these flaws are the peculiar challenges of regulating universal banks and financial conglomerates. These can be approached from several perspectives, but three are particularly significant in this context. The first, the formation of large UBs to spur a country's industrialisation and economic development, as was intended in Nigeria, means that they would be overly pivotal to the economy to be allowed to fail.<sup>44</sup> This, for instance, could create a moral hazard problem, namely the tendency of managers of UBs to exploit public safety nets, provided by the lender of last resort role of a Central Bank and the deposit insurance fund, as subsidies for risky business decisions. The second is the possibility that securities affiliates of UBs and financial conglomerates could have indirect access to the deposit insurance safety net available to commercial banks. This could happen, for instance, where they take on more risk than they would have done as stand-alone firms, and thereafter devise a way to pass on some, if not all the risk to the banking affiliate.<sup>45</sup> The third is that the combination of commercial and merchant (investment) banking with insurance and securities operations could create vulnerabilities, which might result in systemic financial crisis. This occurs where a collapse of the securities market or instability in the insurance sub-sector infects commercial banks through UBs, whose operations agglomerate securities, insurance and banking. Admittedly, stand-alone commercial banks could have exposure to the securities market through margin and other loans and therefore have similar vulnerability to the collapse of the securities market. The focus here however is on the systemic implications of the universal banking structure.

Generally, in managing these flaws and responding to the challenges, as was the case in Nigeria after 2005, a financial system could ensure that its prudential regulations, disclosure obligations and financial malpractice laws are vigorously enforced against universal banks and financial conglomerates. It could also adopt a number of strategies to deal with specific issues.<sup>46</sup> It could introduce measures to separate banking and non-banking financial services rendered by universal banks, to remove the possibility that their securities affiliates could have

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<sup>43</sup> Section 2 (b) and (c) of the NDIC Act No. 16 of 2006.

<sup>44</sup> Morrison (n 11) 172 – 177; J. Adam, 'The Policy Challenges of Bank Consolidation in Nigeria' (2008) vol. 18 NDIC Quarterly, 25, 40 – 41.

<sup>45</sup> X Freixas, G. Loranth and A.D. Morrison, 'Regulating Financial Conglomerates' (2007) 16 Journal of Financial Intermediation, 479 – 514.

<sup>46</sup> G. Ogunleye, 'The Regulatory Imperatives of Implementing the Universal Banking Concept' (2001) vol. 11, NDIC Quarterly 23 – 31.

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access to depositors' funds for stock trading and the conflict of interest that could arise from using confidential information about depositors, for securities trading purposes.

The system could adopt a uniform and encompassing format for the returns to be filed by universal banks, to give regulators a true view of all the affairs of a universal bank or a conglomerate. A framework can also be instituted for the purposes of co-ordinating the work of regulators so as to close possible gaps in the regulatory system. Further to this framework, one regulatory institution could be appointed as the lead regulator and consolidated supervisor, who can take coordinated action through the financial system, particularly with respect to systemic issues.

A surveillance system could be instituted to monitor the financial strength of financial intermediaries, so as to enable the lead regulator or at least one regulator to act promptly to prevent the collapse of an intermediary and/or a financial crisis. Measures could also be introduced to deal with possible corporate governance infractions by the management of financial conglomerates such as concealment of losses or insider abuses. Where the activities of a conglomerate could lead to depletion of depositors' funds or engage the activation of public safety nets (i.e. the deposit insurance fund and the central bank's lender of last resort facility) it should be possible for one regulator to act promptly to prevent this. Lastly, measures can be instituted to ensure that the process leading to the emergence of the universal banks and financial conglomerates accords with best practices and is not marred by issues that could later unravel the process or induce the collapse of the financial corporate entities so created.

Most of the foregoing measures were adopted in Nigeria after 2005. These were in addition to the prudential regulations, disclosure obligations, and financial malpractice prohibitions contained in the *BOFIA*, the *CBN Act*, the *ISA*, and the *Money Laundering (Prohibition) Act*. Notably, the UB Guidelines stated that where banks undertake other financial activities (i.e. insurance, securities and discounting of bills) the CBN would be the lead regulator and consolidated supervisor of such banks.<sup>47</sup> A Financial Services Regulatory Co-ordinating Committee (FSRCC) was created after the introduction of universal banking and banking consolidation.<sup>48</sup> The Governor of the Central Bank of Nigeria chairs the committee, which still exists. Three of its objectives are, to cause reduction in arbitrage and opportunities, created by differing regulation and supervision standards amongst supervisory authorities; eliminate the information gap encountered by any regulatory agency in its relationship with

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<sup>47</sup> The UB Guidelines (n 7) 5.

<sup>48</sup> Sections 38A and 38B of the *Central Bank of Nigeria (CBN) Act No. 24 of 1991* (as amended), now sections 43 and 44 of the *CBN Act No. 7 of 2007*.

any group of financial institutions; and to develop strategies for the promotion of safe, sound and efficient practices by financial intermediaries.<sup>49</sup> The CBN introduced an automated system for the filing of returns by banks through the electronic Financial Analysis and Surveillance System (e-FASS).<sup>50</sup> A Financial Intelligence Unit (FIU) was established by the CBN in collaboration with the Economic and Financial Crimes Commission (EFCC) to enforce money laundering prohibitions and other economic crimes measures.<sup>51</sup>

The CBN also instituted a process of capital verification at the beginning of the consolidation programme. This was meant to verify that banks actually had the unimpaired capital they claimed to have raised; and that additional capital was raised through the stock market without violating financial and corporate laws, such as the one prohibiting incorporated companies from the granting of loans to purchase their shares.<sup>52</sup> In January 2006, the CBN introduced the *Corporate Governance Code for Banks in Nigeria Post Consolidation* ('Corporate Governance Code').<sup>53</sup> The NDIC was empowered to take corrective action<sup>54</sup> where the result of a banking examination shows that the directors or staff of an insured institution (a bank) are engaging or about to engage in unsafe and unsound practices in conducting the business of the institution or have violated or are violating any provisions of any law or regulation to which that institution is subject<sup>55</sup> and to prosecute financial malpractices.<sup>56</sup>

The deduction from the foregoing is that, after 2005, financial regulators in Nigeria had extensive regulatory powers to deal with the flaws and issues elicited by matching functional regulation with universal banking and financial conglomerates. Of course, there is nothing substantially wrong with the extensive powers conferred on Nigerian financial regulators, post universal banking and financial consolidation. The conferral is arguably necessary. The thesis of this paper however, is that the powers were not substantially reflected in the supervisory actions of the regulators post 2005. If the powers really reflected, one could ask, why did Nigeria experience a financial crisis? Why for

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<sup>49</sup> *ibid.*

<sup>50</sup> Soludo (n 15) 8.

<sup>51</sup> *ibid* 9.

<sup>52</sup> Section 159 of the *Companies and Allied Matters Act (CAMA), 1990*.

<sup>53</sup> The Central Bank of Nigeria, 'Corporate Governance Code for Banks in Nigeria Post Consolidation' (2006) <  
<http://www.cenbank.org/out/Publications/bsb/2006/Corp.Govpost%20con.pdf>. >  
 Accessed on 15 May 2012.

<sup>54</sup>Section 32 of the *NDIC Act No 16* of 2006.

<sup>55</sup> Before the action could be taken, the target institution shall be notified of the incriminating report of a bank examination and be allowed 30days to implement corrective measures: *ibid* section 32 (1) and (2).

<sup>56</sup> *ibid* section 47.

<sup>56</sup> Section 27 of the *CBN Act, No. 7* of 2007.

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instance, did the CBN, SEC and EFCC not know that Afribank, one of the banks declared insolvent in the crisis by the CBN, used depositors' funds to purchase 80% of its initial public offer (IPO), buying its shares at over double the market price – purchasing them at ₦25 per share when the shares were trading at ₦1 on the Nigerian Stock Exchange – and finding itself exposed when the shares later dropped less than ₦3 per share?<sup>57</sup> Similarly for other bank declared insolvent by the CBN in 2009, why did the regulators fail to discover that 30% of Intercontinental Bank Plc. shares were purchased with customers' deposits; and that the chief executive officer of Oceanic Bank controlled over 30% of the bank through special purpose vehicles borrowing customer deposits?<sup>58</sup>

It is argued, in answer to these questions that the abuses leading to these insolvencies occurred, not so much as due to the absence of laws and the requisite supervisory powers to enforce the laws, but as much for the fact that the CBN, NDIC, SEC and EFCC, did not enforce the laws optimally. They could have done this, by acting early after 2005, to effectively and thoroughly investigate possible abuses in the system and sanction culpable financial intermediaries and/or their staff. Given that these agencies could only have acted through their officials, it is further argued that the failure of the agencies to exercise their supervisory powers and enforce the measures above was induced by the fact that their officials did not appreciate any serious or practical accountability consequences that could attach to this failure.

Support for the supervisory failure and accountability arguments are drawn from two facts. First, while the powers of financial regulators in Nigeria after 2005, were and still are circumscribed, by legislative oversight and ministerial supervision and,<sup>59</sup> the House of Representatives has only investigated the stock market crash;<sup>60</sup> the Minister of Finance, the senior government official overseeing the financial sector is yet to conduct an accountability review of what financial regulators did or failed to do, with respect to the regulatory issues implicated in the crisis (i.e. insider abuses, corporate governance infractions and violations of disclosure obligations). Second, thus far, no individual or aggregated claims have been brought successfully against regulatory institutions for the failure to enforce the measures above, in time enough to prevent the crisis. It is the thesis of this paper, that while the immediate cause of the Nigeria financial crisis of 2008 to 2009 was the liquidity problems suffered by certain banks as a result of the collapse of the Nigerian capital

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<sup>57</sup> Sanusi (n 8) 7; Apati, (n 3)94.

<sup>58</sup> Sanusi (n 8) 7.

<sup>59</sup> Section 4, second schedule Part 1 (Exclusive Legislative List, Item 6) Constitution of the Federal Republic of Nigeria 1999; section 1(1), BOFIA.

<sup>60</sup> This was done through the Ad-Hoc Committee on the Investigation into the Near Collapse of the Nigerian Capital set up by Resolution No HR70/2012.

market, the remote and ultimate cause was supervisory failure induced by weak regulatory accountability. The next section of this paper explores the normative indicators of public service and regulatory accountability and demonstrates how they could have prevented the Nigerian financial crisis.

#### 4.0 NORMATIVE INDICATORS OF REGULATORY ACCOUNTABILITY

This section examines international best practices on public sector and financial regulation accountability. It formulates three normative indicators of regulatory accountability from the best practices and demonstrates how they could have prevented the Nigerian financial crisis of 2008 to 2009.

Broadly, accountability speaks to the need for public officials to demonstrate that oversight functions have been conducted in accordance with statutory rules and standards and to report fairly and accurately on performance results vis-à-vis mandated roles and/or plans.<sup>61</sup> It stands for the need to know the agency that is responsible for a regulatory matter;<sup>62</sup> the imperative to make public officials answerable for their behaviour and responsive to the entity from which they derive their authority; and the establishment of criteria to measure the performance of public officials, as well as oversight mechanisms to ensure that standards are met.<sup>63</sup> For financial regulators in particular, it approximates the need for them to have sound governance and be answerable for the discharge of their duties and use of resources.<sup>64</sup>

With respect to the oversight functions of financial institutions, three normative indicators of accountability could be formulated from these best practice propositions. They are: (a) collaborative discharge of inter-agency responsibilities; (b) several intra-agency responsibilities to prevent regulatory failure; and (c) institutional culpability for regulatory failure. In what follows, it will be shown how these indicators could have prevented the Nigerian financial crisis.

##### *A. Collaborative Discharge of Inter-agency Responsibilities*

This means that financial regulatory agencies, would link their regulatory and supervisory powers over financial intermediaries, to investigate and prevent issues that could facilitate a sub-optimal performance or foundering of the regulatory system. It means, the absence of consensual and/or

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<sup>61</sup>Organisation for Economic Co-operation and Development (OECD), 'Public Sector Transparency and Accountability: Making it Happen' OECD (2002) 7.

<sup>62</sup> E. Pan, 'Structural Reform of Financial Regulation,' (2011) vol. 19 *Transnational Law & Contemporary Problems* 796, 809.

<sup>63</sup> Australian Council of Auditors-General, 'Effective Public Sector Accountability' <<http://www.acag.org.au/epsa.htm>> accessed 15 January 2013.

<sup>64</sup> Basel Committee on Banking Supervision (BCBS), *Core Principles of Effective Banking Supervision* (Basel, Bank for International Settlements, September 2012). Principle 2, at 10, 22 – 4.

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discretionary collaboration between these institutions. It discourages a regulatory institution from carving out a regulatory enclave from the extensive operations of a financial conglomerate. Moreover, it imposes an incidental duty on regulatory institutions to close regulatory gaps, provide inter-agency regulatory assistance to each other, and recommend improvements to the supervisory processes of each agency, all with a view to eliminating or limiting opportunities for regulatory inadequacy. Further, it eliminates or reduces regulatory competition, which could be exploited by financial intermediaries for regulatory arbitrage purposes.<sup>65</sup> For instance, Felsenfeld and Glass argue that US banks are comfortable with a multiple (functional) regulatory structure, where each agency feels a responsibility for the banks under its care and even a competitive position relative to other regulators, with the result that no regulator wants to fall behind its competitor, neither does it want “its” banks to fall behind their competitors.<sup>66</sup> Collective inter-agency responsibility could thus engender the emergence of a financial regulatory network, in which each regulator not only acknowledges and acts consistently with the wider systemic consequences of its functions and powers, but also appreciates a need to mainstream all financial laws and rules.

The implications of the foregoing for the Nigerian financial system after 2005 are two-fold. First, the CBN, SEC, NAICOM, NDIC, CAC, at least would have been fixed with the collective responsibility for the consolidated supervision of Nigerian universal banks and financial conglomerates, particularly to prevent regulatory failure. They could have done this through the FSRCC. *A fortiori*, section 52(5) of the NDIC Act imposes a duty of cooperation on the NDIC on matters affecting any insured financial institution.

Second, they would also have perceived the financial law(s) within their several regulatory remits as crucial aspects of a monolithic financial regulatory system, the various parts of which must be harmonised to achieve effective regulatory vigilance. For instance, the SEC would have realised early that securities market manipulations and risky margin trading in banks' shares, constitute not just violations of the *ISA*, but are equally, if not more serious pathogens of a systemic financial crisis. It would therefore have collaborated earnestly with the CBN, NDIC, EFCC, Corporate Affairs Commission (CAC), and NAICOM, to institute counter-measures to forestall a financial crisis and take disciplinary actions against erring intermediaries and/or their officials.

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<sup>65</sup> In this context, regulatory arbitrage arises, where financial intermediaries structure their operations to exploit perceived weakness(es) in the regulatory framework. This should be distinguished from transactional arbitrage, namely, the profitable exploitation of exchange rate or price differences across markets.

<sup>66</sup> C. Felsenfeld and D. Glass, *Banking Regulation in the United States*, Third Edition (New York: Juris Publishing, 2011) 48 – 9.

*B. Several Intra-agency Responsibilities to Prevent Supervisory Failure*

A corollary of collaborative discharge of inter-agency responsibilities is several intra-agency responsibilities, by which each regulatory agency accepts its responsibility towards other regulators to prevent regulatory failure from occurring under its watch. This means that an agency would work to eliminate or reduce internal inefficiencies with respect to the activities of its officials and appreciates the need for sustained collaboration between its officials and those of other institutional agencies so as to eliminate or reduce the possibility of regulatory failure. It means also that an agency would appreciate the need for a process driven regulation that manifests in regulatory thoroughness and effective cross-collaboration among regulatory officials. By extension, where an agency has an express or implied statutory duty to initiate a process, a meeting or an action in concert with other agencies, it would do so with the right level of seriousness and regularity necessary for that process, meeting or action to be effective. Further, given that much of the routine supervision of financial intermediaries is often devolved to middle level officers, imbuing regulatory accountability at this level would enhance the appreciation of an incidental public service obligation to work together, to detect regulatory infractions, which might be difficult, if not impossible for officials of one agency to discover.

In the context of the Nigerian financial crisis, the foregoing points could have made CBN, the SEC, NDIC, NAICOM, and the CAC, appreciate their several responsibilities to maintain a and sound financial system by adopting practices and processes that give little or no opportunity for regulatory failure within each agency. CBN, as the lead regulator of universal banks and financial conglomerates, would have appreciated a higher responsibility to detect possible regulatory abuses or infractions by these financial intermediaries that could induce a systemic crisis. For instance, the leadership of the CBN would have used the avenue of the FSRCC to constantly give effect to the role of the CBN as the consolidated supervisor of universal banks and conglomerates. They would have appreciated the need for the Director of Banking Supervision and its examiners to collaborate with officials of the EFCC, NDIC, SEC, NAICOM and CAC, not only for the purposes of consolidated supervision, but as much to discover elusive infractions of financial and corporate laws by financial intermediaries, in the implementation of the banking consolidation programme.

Similarly, the Director-General of the SEC would have seen the need for its officers to link their supervision of securities subsidiaries or affiliates of Nigerian financial conglomerates, with the supervision of insurance and banking affiliates or subsidiaries by officials of NAICOM, CBN and NDIC. This paper argues that this middle level collaboration

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across regulatory agencies would have assisted an early detection and prevention of the securities manipulation particularly with respect to bank shares. For instance, it would have assisted the aggregation of the information provided in a fragmentary manner separately to the CBN, the SEC and the NDIC, which could have enabled a clearer picture of the reporting entity's position, and thus shown the need to intervene earlier or prevent the abuses that contributed to the crisis.<sup>67</sup>

*C. Institutional Culpability for Supervisory Failure*

The third indicator deducible from regulatory accountability is regulatory culpability, by which regulatory institutions are to be liable, if supervisory failure were to induce a financial crisis. Liability for the crisis rests on the accountability consequences attaching to the failure, in so far as it can be shown that the failure substantially created or engendered the vulnerabilities that facilitated the crisis. This would arguably enable aggrieved claimants, namely, investors, depositors and financial intermediaries affected by the crisis to institute individual or aggregated claims against financial regulatory agencies responsible for the crisis. The claim(s) should notionally rests on two conditions, namely: that such a right of action in law and that but for the failure of the agency or agencies sued, the crisis and the loss suffered by the claimant(s) would not have occurred.

In the Nigerian context, one statutory obstacle in the way of the right of action canvassed here is the protection against adverse claims with which these regulatory agencies tend to be clothed. The usual tenor of this protection is that the agencies and their officers cannot be sued for anything done in pursuance of their statutory powers save where they have acted in bad faith.<sup>68</sup> Arguably, four policy justifications could be canvassed for the protection. The first is the concern that adverse claims might induce regulators to act defensively or make the work of regulators risky and less attractive ('the chilling effect argument'). The second is that the possibly large compensatory pay-outs consequent on such claims would ultimately draw on the limited resources of the State ('the limited resources argument'). The third is that the externalities of a bank failure, i.e. runs on other banks, inter-bank credit freeze, and assets fire sales, are not easily controllable by regulators as such to warrant their exposure to adverse claims on the harm suffered by third parties from these externalities ('the uncontrollable externalities argument'). The fourth is that without the protection, regulators are potentially liable for inchoate lapses and at the

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<sup>67</sup> Sanusi (n 8) 5 – 7.

<sup>68</sup> Section 53, BOFIA; section 52, CBN Act No. 7 of 2007; section 302 of the ISA No. 29 of 2007.



suit of indefinable category of claimants ('the floodgate argument').

Persuasive as the foregoing policy justifications might seem, we could ask the question whether they truly are truly justifiable in a system with weak regulatory accountability. 'The chilling effect argument' is arguably true if regulators are sued even where they have acted diligently and pro-actively. If however, regulators are not so sued or when sued, could prove that they have acted diligently within their statutory powers, the protection against adverse claims is not necessarily justifiable. Arguably, a surer protection against adverse claims for a regulator is a reputation for diligence and regulatory due process. Where therefore, a regulator has been evidently negligent in a financial system where regulatory accountability is weak, the protection against adverse claims on the basis of 'the chilling effect argument' is an unjustifiable protection, which effectively denies aggrieved claimants justice as much as it impedes accountability.

Arguably, 'the limited resources argument' is not without faults. Under general law, the State is liable to compensate victims of wrongs committed by its servants and agents in the course of their employment or where the act leading to the wrongs is closely connected to what they (servants or agents) are authorised to do. So for instance the Nigerian government is liable to compensate victims of highhandedness by its security officials or for third party losses resulting from the negligence of its officials. Compensatory pay-outs for losses arising from supervisory failure by financial regulators therefore, do not and would not draw from the so called limited resources of State any more than the State is liable to pay for the ordinary wrongs of its officials. Rather, it would seem more sensible to institute a strict accountability process for financial regulatory institutions and their officials, to enhance their diligence and thus limit the occasions where compensations would be paid to victims of supervisory failure, than for these institutions and their officials to be protected from adverse claims. The unfairness implicit in the protection is that whereas victims of police brutality or negligence of Customs officials leading to loss of third party goods might be able to recover against the State, but third party losses arising from supervisory failure are not compensable. It is therefore submitted that where the State has failed to institute a strict accountability process for its regulatory institutions and officials, to prevent supervisory failure, it is unjustifiable to protect these institutions and officials from adverse claims on 'the limited resources argument' because in reality, State is paying for its failure to perform its primary oversight function.

'The externalities argument' assumes effectively that financial crises are neither easily predictable nor controllable by regulators and for this reasons, it would be unfair to 'persecute' regulators when a crisis occurs. Applied to the

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Nigerian context however, it seems hardly justifiable. From January to December 2007, the price of banks' traded shares increased by 167 per cent relative to the Nigerian stock market average of 75 per cent and 31 – 35 per cent average for emerging markets.<sup>69</sup> Also in 2007, the 24 banks in Nigeria, declared a combined profits before tax of approximately \$10billion. Yet a report by J. P. Morgan in the same year suggested that many of the leading banks were overvalued by as much as 50 per cent.<sup>70</sup> The report apart, from January 2006 to December 2007, Nigeria recorded only a marginal increase in real Gross Domestic Product (GDP) growth, from 6.2 per cent in 2006 to 7 per cent in 2007.<sup>71</sup> Clearly, the price increase in banks' shares and the combined huge profit declared by the banks did not correlate with the overall increase in productivity in the economy. Arguably, this mismatch ought to have alerted Nigeria's financial regulators that the strange prosperity of the banks in 2007 was a classic boom that most often precedes a financial crisis. Their suspicion, it is further argued, ought to have been heightened, considering that in the time under review, there were 'allegations of sharp practices' behind the performance of banks. For instance, Apati states that three unwholesome practices were prevalent among the banks before the crisis: first was the practice of trading in their own shares through employees; second was insider trading through stock brokers; and the third was practice of warehousing and dumping other banks' stocks to depress their price.<sup>72</sup>

With this background, it is hardly convincing to justify the protection against adverse claims at least in the context of the Nigerian financial crisis on the basis of 'the uncontrollable externalities argument'. It is submitted that where the signs that a financial crisis is looming are evident, as was the case in 2007, and regulators failed to act diligently to forestall the crisis, even though as shown above, they have extensive powers to do so; it is unjustifiable to protect them from adverse claims, arising from proven third losses caused by the ensuing crisis.

Arguably, the idea at the heart of 'the floodgate argument' is that protection against adverse claims screens the possible claims for which a regulator may be liable and only allows those founded on bad faith to proceed to trial. This is however a flawed idea in that it conflates good faith with diligence. What is contended for here and what could arguably reduce the risk of financial crisis is not so much a greater

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<sup>69</sup> Apati (n 3) 92 – 93, referencing Afrinvest Nigeria (2007 and 2008) Review and 2008 Market Outlook.

<sup>70</sup> *ibid.*

<sup>71</sup> Figures sourced from Global Finance, Country Economic Report & GDP Data, available at <http://www.gfmag.com/gdp-data-country-reports/207-nigeria-gdp-country-report.html#axzz2em0SSgf1> and accessed on 13 August 2013.

<sup>72</sup> Apati (n 3) 93.

measure of good faith but an enhanced supervisory diligence. A claim against a regulatory agency for supervisory failure, should not therefore require allegations of bad faith, any more than an action against a governmental agency should be defensible by a plea of good faith. Where the law creates a duty to prevent supervisory failure and provides a right of action for depositors, investors and financial intermediaries, consequent on its breach; the breach of that duty should not be conflated with a conduct inconsistent with good faith: A regulator could act negligently in good faith.

The gist of a claim founded on supervisory failure should be a provable incidence of negligence by the regulator, which occasioned pecuniary loss to a depositor, investor or financial intermediary. It is submitted that negligence here should be construed as a breach of an institutional public service obligation to ensure the safety and soundness of the financial system, severally and jointly by regulatory agencies. The occurrence of a financial crisis might not necessarily implicate the breach of this duty, but it should be possible for aggrieved depositors, investors and financial intermediaries to institute individual or aggregate claims where they could link their losses to supervisory failure. The plea of good faith should therefore not avail a financial regulator, where losses to depositors, investors and financial intermediaries following a financial crisis or the collapse of a financial institution are traceable to its negligent supervisory performance. A proposition to the contrary, arguably turns the plea of immunity to impunity, which could make financial regulatory agencies hardly accountable. At any rate, if the immunity from adverse claims were to prove insurmountable, a breach of this obligation could support inquiries by elected citizens' representatives to establish the culpability of these institutions and their officers as a prelude to possible reform(s) and/or governmental disciplinary action.<sup>73</sup> It is submitted that a financial regulatory system bereft of a strong accountability mechanism as argued here, could induce incompetence and impunity much more than diligence.

Accountability could foster regulatory diligence and responsibility, in that the certainty of institutional indictment for supervisory failure would most likely instil greater seriousness in the operations of regulatory institutions and their officers. One effect of this should be a reduction in the cycle of financial crisis. Where the cycle of financial crisis is reduced, it follows that public safety nets in the sense of capital guarantee and deposit insurance will not be activated so often, to rescue systemically significant financial institutions

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<sup>73</sup> The House of Representatives ultimately but controversially did in 2012: Report of the Ad-Hoc Committee on the Investigation into the Near Collapse of the Nigerian Capital Market, National Assembly, Abuja, Resolution No (HR70/2012); ₦44m Bribery Scandal Rocks House Committee, *ThisDay*, 6 March 2012.

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and for pay out to depositors and investors. The implications of these points for the Nigerian financial crisis are twofold. First, the capital verification process by the CBN at the beginning of the banking consolidation programme to avoid bubble capital would have been taken seriously and undertaken with exhaustive co-ordination with the SEC, NAICOM, CAC, NDIC and EFCC. This would have been to prevent illicit recapitalisation with depositors' funds and concealment of bubble assets, which in turn created a liquidity crisis for the alleged insolvent banks. Second, after the crisis, it would have been possible to hold the CBN, SEC, NDIC and CAC, culpable either through litigation or by public enquiry, if it could be established that regulatory failure under their watch, substantially caused the crisis.

The next section applies the foregoing arguments to the particulars of the crisis. It reduces some of the articulated causes of the financial collapse to the manifestations of regulatory laxity, i.e. the fact that Nigerian financial regulators operated under a framework, which attaches little or no accountability consequences to institutional supervisory failure.

## **5.0 A SUPERVISORY FAILURE ACCOUNT OF THE FINANCIAL CRISIS**

This section applies the regulatory accountability principles discussed in section 4.0 to the particulars provided by the 'interdependent factors' account of the Nigerian financial crisis. In so doing, this section argues that 7 (seven) of the 8 (eight) factors identified by this account, are reducible to supervisory failure induced by lack of accountability. In essence, the argument that runs through this section is that regulatory laxity induced by lack of accountability is the cause, while the 7 (seven) factors are the effects.

During the period between March and December 2008, the All-Share-Index (ASI) of the Nigerian Stock Exchange (NSE) fell from 66,121.93 to 29,551.84 losing 36,570.89 or 48.1 per cent of the ASI at the beginning of the year. In the same period, market capitalization decreased from ₦12.6 trillion to ₦6.54 trillion, resulting in a loss ₦6.06 trillion.<sup>74</sup> On 14 August 2009, the CBN announced the findings of an arguably belated special examination of 10 consolidated universal banks, which determined that five were insolvent.<sup>75</sup> These banks were also heavily dependent on the CBN Expanded Discount Window, which could be interpreted to mean that they had liquidity problems. To improve their

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<sup>74</sup> Nwude (n 4) 11.

<sup>75</sup> The five were, Oceanic Bank, Union Bank, Afribank, Finbank and Intercontinental Bank: Lucky Fiakpa, 'If a Bank is Sick, the Signs Are Self-Evident, says Sanusi' *Thisday* (Lagos, 16 August 2009) 1.

liquidity, the CBN injected ~~N~~420 billion into these banks as subordinated loans.<sup>76</sup> These affected banks held approximately 30% of the deposits in the Nigerian banking system.<sup>77</sup> This in effect means they were systemically important. A follow up special examination of the remaining 15 universal banks showed that three were insolvent, which necessitated an injection of ~~N~~200 billion by the CBN. Altogether, the eight (8) insolvent banks received ~~N~~620 billion (approximately \$4.1 billion USD) from the CBN<sup>78</sup>

A post-crisis appraisal of the background to the stock market crash and the bank insolvencies by the ‘interdependent factors’ perspective identifies ‘8 interdependent factors’ as responsible for the crisis.<sup>79</sup> These are: (i) macro-economic instability caused by large and sudden capital inflow; (ii) major failures in corporate governance at banks; (iii) lack of consumer sophistication; (iv) inadequate disclosure and transparency about bank's financial position; (v) critical gaps in regulatory framework and regulators; (vi) uneven supervision and enforcement; (vii) weaknesses, unstructured governance and management processes within the CBN; and (viii) weaknesses in the business environment.

The macro-economic instability factor is particularised as the result of sudden inflow of excess liquidity from oil revenues and foreign direct investment attracted by the banking consolidation. The excess liquidity allegedly streamed to the capital market, in the form of margin loans and proprietary trading by banks, which in some cases were hidden as loans to their securities subsidiaries and debtors fronting for insiders.<sup>80</sup> In consequence, the NSE market capitalisation increased by 5.3 times, between 2004 and 2007, with market capitalisation of bank stocks increasing nine times during the same period.<sup>81</sup> Accordingly, ‘[t]his sets the stage for a financial asset bubble particularly in bank stocks’.<sup>82</sup> In checking these particulars against the law, it should be noted that two statutory objects of the CBN are to ensure monetary stability and promote a sound financial system in Nigeria.<sup>83</sup> A bank is prohibited from granting a single obligor loan in excess of 25 per cent of its shareholders’ fund, unimpaired by losses (or 50 per cent for merchant banks) and unsecured advances, without the prior approval of the CBN.<sup>84</sup> CBN approval is also mandatory for unsecured advances to directors of banks in

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<sup>76</sup> D. Alford, ‘Nigerian Banking Reform: Recent Actions and Future Prospects’ 5, < <http://ssrn.com/abstract=1592599> > accessed on 22 May 2012.

<sup>77</sup> *ibid.*

<sup>78</sup> *ibid.*

<sup>79</sup> Sanusi (n 8) 5.

<sup>80</sup> Sanusi (n 8) 6.

<sup>81</sup> *ibid.*

<sup>82</sup> *ibid.*

<sup>83</sup> Section 2(a) (d) of the CBN Act No. 7 of 2007.

<sup>84</sup> Section 20(1) of the BOFIA No. 25 of 1991 (as amended).

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excess of ₦50, 000, to any entity in which that bank or any one or more of its directors is interested, or any firm, of which any of its directors is a guarantor.<sup>85</sup> Further, where a bank, its directors or staff have engaged in unsafe and unsound practices, or violated a financial law, the NDIC could direct that bank to take corrective action or initiate such action in consultation with the CBN.<sup>86</sup> The SEC is empowered to protect the integrity of the securities market against all forms of abuses including insider dealing and fraudulent and unfair trade practices relating to the securities industry.<sup>87</sup> It should be noted particularly that the CBN instituted a financial surveillance programme (e-FASS) and established a financial intelligence unit (NFIU) after 2005, partly to monitor the solvency of financial intermediaries. The SEC in particular is empowered to regulate excessive use of credit for the purchase of securities by dealers or member companies of the NSE.<sup>88</sup>

The foregoing show that Nigerian financial laws were capable of preventing macro-economic instability induced by banking and securities malpractices, if the CBN, NDIC and the SEC had enforced the relevant statutory provisions early before 2008; more so when in practice, banks are required to report monthly and quarterly to the CBN about credit exposures to different sectors of Nigerian economy. In 2007, most of the reports showed excessive exposure to the stock market.<sup>89</sup>

The deduction from the foregoing is that the CBN arguably knew or ought to have known, the financial health of the allegedly insolvent banks at least by 2007. If this is so, one could raise the question why they (NDIC and CBN) fail to instruct these banks to take corrective action, failing which they (the CBN and NDIC) could have taken such corrective action. On the thesis of this paper, a question such as this seems explicable on the premise of supervisory failure, which is attributable to a behavioural pattern which assumes that no serious accountability consequences would attach to their failure to take prompt corrective action against universal banks and financial conglomerates excessively exposed to the stock market. Support can be found for this argument in that although, as shown above, the CBN, NDIC and SEC were subject to the supervision of the Minister of Finance and legislative oversight of the National Assembly, neither the Minister, nor the Assembly conducted an accountability review of the actions of these agencies with respect to margin loans, at least in 2007, when it was a notorious fact that ‘they

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<sup>85</sup>ibid section 20(2).

<sup>86</sup> Section 32, NDIC Act of No. 16 of 2006.

<sup>87</sup> Section 13(n) (aa) of the ISA of 2007.

<sup>88</sup> ibid Section 104.

<sup>89</sup> Apati (n 3) 94.

[margin loans] had become the order of the day in the Nigerian financial system.’<sup>90</sup>

With respect to ‘major failures in corporate governance at banks,’ the ‘interdependent factors’ perspective states that the capital surge in the Nigerian financial system after the banking consolidation of 2005, occurred when corporate governance standards at banks were extremely weak and in fact that failure in corporate governance at banks contributed principally to the crisis. It particularises this factor with the revelation referenced in section 3.0 above that the capital supposedly raised by some banks was financed from depositors’ funds.<sup>91</sup> This paper does not deny the roles played by corporate governance infractions in the crisis; rather it argues that sub-optimal or lax regulatory response created opportunities for these infractions.

In support of this argument, it is noteworthy that the Corporate Governance Code acknowledges fraudulent and self-serving practices by banks’ board members, management and staff as well as abuses in lending as corporate governance weaknesses in Nigerian banks.<sup>92</sup> Arguably, two pertinent questions are provoked by the alleged persistence of corporate governance infractions in Nigerian banks after the introduction of the Code. First, what was the point of introducing the Code? Second, why it was not enforced to check those infractions known to exist in the banking system, before they assumed crisis proportion? It is argued, that the CBN and the NDIC failed to enforce the Code in order to prevent corporate governance infractions from leading to a financial crisis because they operated under an oversight framework that did and even still, does not subject financial regulatory agencies to any serious or practical accountability consequences for supervisory failure. In the case of the CBN, a statutory basis for such accountability could have been supplied on the ground that since the Code was issued in the exercise of its powers in section 61 of *BOFIA* and section 2(d) of the *CBN Act*<sup>93</sup>, its failure to enforce it, more so when its enforcement could have promoted soundness in the financial system, was a breach of these enabling provisions.<sup>94</sup> This shows in essence that ‘major failures in corporate governance at banks’ are the consequences of a lax regulatory response on

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<sup>90</sup> *ibid.*

<sup>91</sup> Sanusi (n 8) 7.

<sup>92</sup> Corporate Governance Code (n 50) paras. 2.3 and 2.10. The Code at page 1 para. 1.3, references a survey conducted by SEC in 2003, which identified poor corporate governance ‘as one of the major factors in virtually all known instances of a financial institution’s distress in the country.’

<sup>93</sup> The two sections empowered CBN, to regulate banks and promote a sound financial system in Nigeria

<sup>94</sup> The NDIC, the SEC and the CAC also could have been subjected to the same accountability consequences on for failing to exercise their respective statutory powers in this regard, which are to be found in section 32 of the *NDIC Act*; *Section 13(r) (aa) of the ISA*; *Section 159(2) of the CAMA*.

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the part of the NDIC and the CBN to the infractions of the Corporate Governance Code.

Further, the ‘interdependent factors’ perspective argues that lack of investor and consumer sophistication contributed to the crisis by failing to impose market discipline and allowing banks to take advantage of consumers. This revelation should be checked against Nigerian financial laws as they stood after 2005. There is civil and criminal liability for misstatements in a prospectus or any document offering securities to the public.<sup>95</sup> Every bank is obligated to display at its offices and branches, its lending and deposit rates and publish its financial accounts in a daily newspaper.<sup>96</sup> The Governor of the CBN is empowered to order a special examination or investigation of the books and affairs of a bank where he is satisfied that the bank has been carrying on its business in a manner detrimental to the interest of its depositors.<sup>97</sup> The SEC is empowered to act in the public interest, particularly with respect to investors’ protection, maintenance of fair and orderly securities markets and the promotion of investors’ education.<sup>98</sup>

Two questions might be asked in view of these provisions. First, could they not have been enforced by the CBN and SEC to deal with exploitation of investors and depositors, in the absence of a financial ombudsman? If they could have been enforced, why were they not so enforced? It is argued that a plausible answer to the two questions is that the CBN and SEC failed to enforce these provisions because there were no accountability consequences for this failure. This means that the investor and consumer exploitation issue implicated in the Nigerian financial crisis could be characterised, not so much as due truly to the lack of investor sophistication, but as a manifestation of the failure of the CBN and the SEC to act severally and/or jointly within their statutory powers, to protect investors and consumers from exploitation, by financial intermediaries.

Inadequate disclosure and violations of transparency obligations as causative factor, is particularised, in the revelation that bank reports to the CBN and investors were often inaccurate, incomplete and late, thereby depriving the CBN of the right information to supervise the industry, and depriving investors of the necessary information to make informed investment decisions.<sup>99</sup> In checking this factor against the law, it is noteworthy that Nigerian financial regulations contain extensive provisions on disclosure and transparency with respect to banks: Every bank is obligated to keep proper books of accounts of all its transactions that give

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<sup>95</sup> Section 85 and 86 of the ISA.

<sup>96</sup> Section 23 and 27 of the BOFIA.

<sup>97</sup> *ibid* section 33(1) (b).

<sup>98</sup> Section 13(k) and (s) of the ISA.

<sup>99</sup> Sanusi (n 8) 8.



a true and fair view of the state of affairs of the bank and comply with the accounting standards as may be prescribed for banks. The book must be kept at the principal administrative office of a bank and at the branches of each bank in English language or any other language approved by the Federal Government of Nigeria.<sup>100</sup> According to Section 24(4) of *BOFIA*:

Where the books of account, kept by a bank are in the opinion of the CBN not properly prepared and kept, or where a bank renders returns which in the opinion of the CBN are inaccurate, the CBN may appoint a firm of qualified accountants to prepare proper books of account or render accurate returns for the bank and the cost shall be borne by the bank.<sup>101</sup>

This section clearly empowers the CBN to ascertain the true state of a reporting entity's financial health without necessarily relying on the returns rendered by such entity,<sup>102</sup> more so, when that is adjudged to be inaccurate.

Further, every bank must submit to the NDIC such returns and information as may be required by the Corporation from time to time.<sup>103</sup> The Corporation may also require persons having access thereto, to supply to it information, in such manner or form as it may from time to time direct, relating or touching on or concerning matters affecting the interests of depositors of an insured institution.<sup>104</sup> Examiners appointed by the Corporation may also request all information from an insured institution, which they deem necessary for the performance of their functions.<sup>105</sup> The Corporation, as discussed above, may take prompt corrective action in consultation with the CBN against an insured institution found to be violating or to have violated a law to which that institution is subject.<sup>106</sup> In this context, the action would be for failing to fulfil the statutory disclosure obligations to the CBN, the NDIC, financial consumers and the public.

These foregoing statutory provisions show that Nigerian banks have inescapable transparency and disclosure obligations with respect to their financial status, and particularly so, if that information could affect the economy of Nigeria. More significant is the fact that these provisions give the CBN and the NDIC powers to obtain information about a bank where

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<sup>100</sup> Section 24(2) (3) of the *BOFIA*.

<sup>101</sup> *ibid* section 24 (4). Italics and underline supplied for emphasis.

<sup>102</sup> The CBN also had extensive disclosure and transparency enforcement powers in sections 27 (1) (2); 28 (1) (2); 31 (1) (2) (b) (c); 33 (1) (a) (d) of the *BOFIA*, and Section 33 (1) (a) (b), of the CBN Act No. 7 of 2007.

<sup>103</sup> Section 27 (1), NDIC Act No. 16 of 2006.

<sup>104</sup> *ibid* section 27 (3).

<sup>105</sup> *ibid* sections 28 and 29.

<sup>106</sup> *ibid* section 32.

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they apprehend an infraction of transparency and disclosure obligations with regard to the returns filed by that bank. In light of these points, it is submitted that what is fundamentally implicated by the factor of inaccurate disclosure and false returns by banks is the failure or omission of the CBN and NDIC to exercise their pre-emptory powers to prevent transparency infractions by banks from attaining crisis proposition. This submission is fortified by the fact that the CBN, in the Code of Corporate Governance, identifies filing of false returns, transparency and inadequate disclosure of information as corporate governance challenges for banks after the consolidation programme.<sup>107</sup> On the thesis of this paper, it follows that transparency and disclosure infractions by banks attained crisis proportion in Nigeria. This was not so much due to the absence of statutory countermeasures, but because the CBN and NDIC failed to exercise their powers, which failure was rooted in an oversight framework that attached no accountability consequences to such supervisory failure.

Concerning critical gaps in the regulatory framework, the ‘interdependent factors’ perspective argues that sub-optimal co-ordination among regulators prevented the CBN from having a consolidated assessment of a bank’s activities and that ‘[i]n spite of widespread knowledge of bank malpractice and propensity for regulatory arbitrage, the FSRCC did not meet for two years during this time.’<sup>108</sup> The FSRCC, as shown in section 3.0, was created essentially to eliminate the regulatory arbitrage opportunities that are inherent in the functional regulatory model practised in Nigeria. Admittedly, apart from enumerating the objectives of the committee, sections 43 and 44 of the *CBN Act* do not provide for when and how the FSRCC should meet. Even so, it is argued that it would be a mere formalism to adduce this statutory omission as the reason why the FSRCC did not meet before the crisis. This is so, in that if the consolidated supervisor status of the CBN, as stated in the UB Guidelines, is placed within the context of the *CBN Act*, the CBN had an inferential if not a statutory duty to initiate the meeting of the FSRCC, with such regularity necessary for it to achieve its objectives.

It could be surmised that if the committee had met constantly after 2005 at the instigation of the CBN, it would have had to deliberate on the violations of financial laws by banks presumably by using information sourced through the e-Fass and the NFIU. It would have had, for instance, to deal with the fact that reports submitted by some banks to financial regulators were fragmentary, incomplete and inaccurate.<sup>109</sup> In light of these, it is submitted that the inability of the FSRCC to meet and deliberate on violations of financial laws before

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<sup>107</sup> Code of Corporate Governance (n 50) 4-5 paras. 3.10 and 16.

<sup>108</sup> Sanusi (n 8) 9.

<sup>109</sup> Sanusi (n 8) 8.

the crisis of 2008 to 2009, could and should be seen as a consequence of the failure of the CBN to initiate meetings of the committee, with such seriousness and regularity to give effect to the role of the CBN as the lead regulator of Nigeria UBs and financial conglomerates.

The ‘interdependent factors’ perspective attributes ‘uneven supervision and enforcement’ to two sub-factors: one is the conduct of supervision within the CBN and the other is the weakness in enforcement across financial regulators.<sup>110</sup> It states that the Banking Supervision Department in the CBN did not work effectively to enforce regulations, with the result that no one was held accountable for addressing key industry issues, such as risk management, corporate governance, fraud, money laundering, cross-regulatory co-ordination, enforcement, legal prosecution, or for ensuring that examination policies and procedures were adapted to the prevailing environment.<sup>111</sup> Section 31 of the *BOFIA*, empowers the Governor of the CBN to appoint an officer of the CBN as the Director of Banking Supervision.<sup>112</sup> The Director and examiners from his department could examine all the books, documents and information of every bank.<sup>113</sup> This means that the Director and the examiners are accountable to the Governor of the CBN for the exercise of their banking examination powers, but not for neglecting to prosecute corporate governance violations, fraud and money laundering in banks. This is so, because the Director and his examiners’ powers are limited to examining the books and account of banks, whilst the *NDIC Act* and *Money Laundering (Prohibition) Act 2004*, reserve exclusively for the NDIC, the EFCC and the National Drug Law Enforcement Agency (NDLEA), the power to prosecute corporate governance violations in banks, fraud and money laundering. The best they (bank examiners) could have done where they discover abuses and infractions in the course of banking examination would be to notify the appropriate agency with power to prosecute such infractions.

The accountability issue implicated by uneven supervision and enforcement speaks to leadership failure. It means the leadership of the CBN failed to perform its role within the Bank, by eliminating inefficiencies and ensuring that banking supervision was process driven. This could have been done through a directive to the Banking Supervision Department to collaborate constantly with relevant officials of other regulatory agencies in the course of conducting banking supervision. Based on the thesis of this paper, the failure to perform this leadership role, which answers for the sub-optimal performance of the Banking Supervision Department

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<sup>110</sup> Sanusi (n 8) 9.

<sup>111</sup> *ibid*

<sup>112</sup> Section 31(1) of the *BOFIA* (as amended by Act No. 38 of 1998).

<sup>113</sup> *ibid* section 31 (2) (3) (4) (6) (7) (8) (as amended by Acts No. 4 of 1997 and No. 38 of 1998).

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before the crisis, could be linked to the fact that the leadership of the CBN of the time did not appreciate any serious accountability consequences for this failure, or its overall public service accountability for supervisory failure under the Bank's watch. This argument applies to the sub-factor of weaknesses in enforcement across financial regulators, which the 'interdependent factors' perspective identifies as the second limb of uneven supervision and enforcement. In other words, leadership failure across financial regulatory institutions, induced by lack of accountability gave room for uneven supervision and enforcement.

Lastly, and in addition to the six (6) factors discussed thus far, the 'interdependent factors' perspective identifies failure of governance and management process within the CBN, and the negative effect of the business environment on the banking industry as two other factors responsible for the Nigerian financial crisis. This paper argues that the former relates to the accountability issue discussed above. Thus it could be argued that the absence of an effective accountability mechanism created opportunities for intra-agency sub-optimal performance, an instance of which was the weak governance and management processes within the CBN. The latter factor speaks to the need for stable economic policies a point considered to be beyond the scope of this paper, and will therefore not be discussed.

## **6.0 CONCLUSION**

Overall, the thrust of this paper has been that supervisory failure induced by lack of regulatory accountability primarily caused the Nigerian financial crisis of 2008 to 2009; that the effects of this primary cause are the regulatory infractions which led to the stock market crash and insolvencies of 8 (eight) systemically significant banks. In developing and justifying this argument, this paper has shown that of the existing three accounts of the Nigerian financial crisis of 2008 to 2009, the 'interdependent factors' perspective is the most comprehensive. Even so, it was argued here that most of the particulars of the crisis supplied by this perspective, speak to supervisory failure.

To achieve this, the paper sought to demonstrate that Nigerian financial regulators had extensive regulatory powers which they failed to exercise to prevent the flaws and challenges inherent in matching functional regulation with universal banking and financial conglomerates in Nigeria, from causing a financial crisis. It was argued that they failed to do so, because they operated under a framework, which did not imbibe accountability best practice nor attach any serious accountability consequences to supervisory failure. It demonstrated how the normative indicators of regulatory accountability best practice could have prevented the crisis. It

justified the arguments canvassed in discussing these indicators by applying them to the '8 interdependent factors', which the 'interdependent factors' perspective blames for the Nigerian financial crisis. The paper argued that 7 (seven) of these factors are reducible to supervisory failure linked to lack of accountability.

Further research is however required to determine how this supervisory failure, lack of accountability as well as the other defects in the extant financial laws and institutions in Nigeria could be reformed to prevent the reoccurrence of that crisis or a different form of financial crises in the future. Specifically, what is the best mix of regulations, law, policies and institutions required to reform Nigeria's financial systems? This will be the focus in a subsequent paper.