

## THE ROLE OF A SINGLE FINANCIAL SERVICES REGULATOR AND THE CENTRAL BANK OF NIGERIA – A VISION 2020 EXPECTATION.

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### **Abstract**

*Central banks being creations of governments are not fully insulated from politics of the day especially in developing countries, which affects performance of assigned function and should mainly be concerned with impacting their economies through the management of the monetary aspects. Having devolved the functions of regulation of the financial system to other institution who manages the system for optimum performance for the benefit the investors and consumers, they are more focused on the economy. This paper argues that the Nigerian financial system should adopt a single financial regulator who would regulate the various financial institutors rather than the present multifarious regulators. In the process, a number of issues on current mode of regulation and problems and their effectiveness were dealt with. This paper is of the opinion that it is proper to adopt the single regulator right away having laid the foundation in the FSCC, with one further step forward and need not wait until 2020 but allow the institution to mature by this period. The FSCC need not regulate all for now but the less key sector with the CBN should regulate the banks and SEC the stock broking firms, for certain reason in the interim. The remaining institutions should be regulated by yjr proposed new financial regulator.*

### **Introduction**

The Central Bank of nations is the most important national financial institution that exists in the country, having been established with the admixture of political and economic viewpoints (Rose, 2000) to manage the financial resources of the nation at the very least and to provide a window to the international arena from within in the financial system. Some other Central banks also combine the position of a regulator and supervision of the banking and other financial institutions with this role. The function of management of the external reserves of the nation is also included in the functions of the Central Bank. Yet in some developing countries, the role of the Bank is much more than this; the functions of debt acquisition, midwifing of development financial institutions, management of the government accounts and all other sorts of functions are saddled with the Central Bank. In some developing countries, the bank maintains an oversight function on the capital market directing its growth as well. This makes the Bank to become heavy with functions leading to lack of focus and direction. From the onset, it manages the side effect of the government fiscal mismanagement of the economy. For this reason most central banks get the blame for being unable to manage the macroeconomic variables of their country, especially inflation, prices and unemployment. Central banks are also involved the data collection so that they have

become the storehouse of information for the purpose of research. In these countries information sourced from the CBN is more accurate and reliable than the main organization set up to gather and disseminate data. All the aforementioned are other ancillary functions the central banks of some nations including Nigeria, perform.

The most visible of the functions of the Central bank of Nigeria are the supervision of the banking and other financial institutions in the country. Having regard to the roles of non bank and other financial institutions in the economy, their supervision in the country is not effective. This makes the sector to be less efficient (Adewunmi, 2005). This naturally brings so many challenges to the economy as the compliance and enforcement level of regulations in the sector is low. Being a government bank, the central bank also sees to the policy direction of the financial system of the economy. Before the current level of deregulation and recapitalization was achieved, Afolabi (1999) mentioned a myriad of regulatory functions of the Central bank of Nigeria. It had directed credit to certain sectors of the economy while controlling the cost as well. This shows the level of authority and power exercised by the Bank over the affairs of the other financial institutions, as well as the direction and the tempo of economy in the country. For example, the CBN recently concluded plans to make an active market in the bonds market by creating a two tier structure at primary and secondary levels. With all of these, the Central Bank of Nigeria as it is today appear overburdened with extraneous responsibilities and functions that could easily be delegated or devolved to a new regulator within the financial system while it maintains focus on the monetary system in the economy and whatever other necessary role it chooses to perform.

To this end, the paper the objectives of this paper are to discuss the issue of regulatory functions of the CBN as it is presently constituted and the adoption of a single regulator of financial services. To achieve these objectives, the paper is structured into five sections. Following the introduction is the review of literature on the performance of the Central Bank within the government's influence. The basic objectives, purposes and theories of financial regulation are discussed. The performance and position of other financial regulators within the system in the present milieu are discussed next. This is followed by the need to establish a new all encompassing financial regulator; and the models and methods adopted by two counties of interest to Nigeria. Finally, recommendations of the expected Nigerian model, conclusion and summary in that order ends the paper.

### **Central Banks, Governments and Politics**

The role of Central Bank became important as from the time governments' need for an institution to handle its financial affairs became recognized forcing it to become an appendage of the Treasury or Finance Ministry. This in the process of time had turned the central bank into government bank that controlled the financial side of the economy with assigned and other functions incidental to the performance of a major one. Since governments cannot be divorced from politics it became embroiled in the process. Cuikerman and Webb (1995) measured the influence of politics and the changes in government on the possibility of changes in the governor of central bank within six

months of ascendancy of such government and found that the indicators vary across countries and correlates with changes in inflation real growth and real interest rates. These often lead to instability in the government policies and avenues of implementing them as found in most developing countries, Nigeria inclusive. Alesina and Summers (1993), had earlier concluded that central bank independence promotes price instability and that it had no measurable impact on real economic performance. Governments have been known to quickly turn to the central banks to provide funds when in need, through for example (in Nigeria) ways and means advance (improperly) and treasury bills. The choice of the method to be adopted is left to the central bank. Recent experiences have made it important to consider the role of the central bank in the macroeconomic environment, where some of the actions of the government through it have had negative effects on the economy. A perfect example is constant monetization of oil receipts, which is in dollars causing sudden infusion of money into the economy. With this scenario, the central bank is left to clean up the financial system to optimal levels. This involves a cost. With these the challenges and others before the Nigerian central bank as noted by Obadan and Iyoha (1996) to include issues of macroeconomic policy environment, appropriate policy mix, the choice between fixed and flexible targets approaches and availability of reliable data to formulate policies, the central bank needs to have a rethink of its economy wide regulatory activities.

The requirements of adequate regulation by the central bank are independence, credibility, transparency and accountability in no particular order for better policy outcomes (Ccechetti and Krause, 2002). With the role of the government, it is doubtful if effective regulation can be performed by the central bank especially in developing country's environment such as Nigeria. The International Monetary Fund, in order to ensure standards requires that a code of transparency issued in 1999 should be adhered to by all countries. This is because of policy goals should be fully understood by the public at announcement stage, while it calls for accountability where a measure of autonomy has been granted to it. Nigeria has consistently scored low in the measures of accountability. Where better macroeconomic performance and more efficient policy are indentified with values close to zero, Nigeria has been found with the following indices: average inflation of 26.08%, independence level of 0.42, accountability 0.92, and transparency 0.37 (Ccechetti and Krause, 2002). By irregular mode of appointment and its constant change, the Central banks have been made weaker, which in a way has disallowed the institution to grow up and mature (Calomiris and Powell, 2000).

Today the Nigeria Central Bank regulates the banking and other financial institution in the system as to capital adequacy and other institutional framework. These regulations hardly cover products and services of the institutions, which should be the main attention of regulation where the investors and consumers who need protection from powerful institutions. Ekpo (2003) concludes that use of policy instruments by the Nigerian central bank has not impacted well on the economy with the basic challenges confronting the CBN such as the management of the underground economy poverty

reduction among others, still largely remaining. As a national financial institution, it is necessarily affected by politics and the lack of political will can be a stumbling block toward the achievement of its goals. A Senator of the Federal Republic was quoted to as saying the objectives of Vision 2020 plans are impossible to meet given the current situation of things. And yet the banking recapitalization and consolidation exercise would have failed if the politicians were allowed to have their way. The CBN has been reengineering itself in the past couple years and it should continue in this way to achieve its purposes. The Nigeria Deposit Insurance Corporation, like most deposit insurers act more like undertakers as they feature more prominently when the bank is in trouble to sound a death knell and pay off qualifying depositors. The role of the NDIC is reduced to that of adjunct and ancillary regulator in the performance of its functions within the financial system.

### **Objectives of Financial Regulation**

While it is important to regulate the institutions to ensure they meet minimum capital adequacy standards, the basic objectives of regulation, according to Millinex and Murinde, (2003), are consumer protection which looks at compensation to the customer where he is injured (not necessarily physically). Capital adequacy, which has been the main focus of the central bank, to ensure that insolvency is not permitted, and where it exists it is quickly corrected. Conduct of business in the market place addresses the fairness of prices for services as information asymmetry problem exist for the customer to choose between homogenous products and between providers. The institutions have better knowledge of the market than the consumers and lastly the promotion of integrity in the marketplace. This discourages market manipulation and lack of transparency in product offering and avoids systemic risk which requires a level playing field. A fading objective is the control and direction of the invisible hand of price by the market (Bernanke 2007), as potential risks have led institutions to be less adventurous in their products offering leading to market discipline (Calomiris and Gorton, 1991) and assumption of responsibility and self regulation. Aspinwall (1993), says because the objectives conflict, there is a reason to separate the management of regulatory institutions from operators.

The main targets of regulation are the institutions, services and products and the entire system in that order. This must be case in these days of financial market concentration where few oligopolists control sizeable proportions of total market. The first parameter is the encouragement of the institutions to be disciplined for the sake of the market and the system, ensuring that numerical targets set for them are evaluated to see shortfalls (Kotaro 2005). The practice of universal banking with its tripod arrangement has complicated matters for central banks and other regulators who do not have integrated approach to financial regulation.



### **Other Financial Sector Regulators**

The CBN has less powerful counterparts in the insurance sector, capital market, and pension funds management. These regulators: National Insurance Commission, Securities and Exchange Commission and the Pension Commission all have their various enabling and statutory laws that sanctioned their existence. All have narrow scopes that are daily thinning out and becoming complicated in a globalizing and integrating world. In this way the universal banking structure that Nigerian banks operates have blurred the separation of the functions in the financial market. Clearly, universal banking allows a bank to have an integrated capital market arm within its group. It can also perform insurance functions up to agency and brokerage levels or full services through a subsidiary.

### **Pension Commission**

The Pension Commission is the youngest of the regulators with very direct and specified functions which came as a result of the reforms in the sector. The institutions operating in the sector are mostly affiliated to insurance companies who are affiliated to or a subsidiary of a bank, where the bank does not directly own or run pension funds as permitted by the Pension Reform Act 2004. Banks are mostly the Pension Fund Custodians. The registration, supervision and regulation of pension fund administrators and custodians become a daily affair that can be handled by the companies themselves except when breaches occur or new regulation is in the offing. There are presently 25 Pension Fund administrators 4 Pension fund Custodians and 6 Closed Pension Fund Administrators operating in the country.

### **Securities and Exchange Commission: Capital Market**

All the banks have capital market arm which acts as the investment outfit for the bank. This subsidiary carries out all the functions of the capital market from issuing house functions to registrar activities. The financial system through the banks allows funds to filter from the money market into the capital market. At the conceptualization of the universal banking practice in Nigeria, regulators had proposed that the regulators will regulate each of the arms of the banks as if they were separate. This might seem easy, but funds flow from capital to money markets and back and forth freely. The spate of activities and registrations in the market especially during market bubbles can be confusing, so much so that parallel and wild cat operators may infiltrate the market and begin to dupe people of hard earned funds. The capital market is one where little transparency is seen as so much is taken for granted by the investors. This governance problems start from the registrars who would not post dividend warrants to withholding of certificates after allotment and clearance, to brokers who misapply funds of their clients and mishandle their investment, Trade Alert notwithstanding. It is now known that it is possible to commit fraud in the Central Securities and Clearing System Ltd CSCS- the monopoly central depository institution in the capital market since its procedures are deficient (Onuoha, 2007). This is therefore one market to watch and continuously observe. This calls for adequate and quality regulation. The complications

arising from dealing in this market need be handled carefully in order to encourage investors to place their funds in the market and ensure the business firms access funds when they require it. The Investment and Securities Tribunal has not been seen to do much having handled 50 cases only between 1997 and 2003.

### **National Insurance Commission Insurance**

The situation is more clear and less nebulous in the insurance sector though it having it is own share of challenges. The bases of regulation of the companies include capital adequacy, investment of funds, and fair market practices in form of early and quick settlement of genuine claims. National Insurance Commission has been active in the first and less concerned with others. Investments by insurance companies can lead to bankruptcy as well as clients not been indemnified when due which can lead to lack of interest to potential policyholders affecting the market. As before, where insurance activities are carried out by the Bank it is in a limited form. This implies an association with the bank somehow, where it is not owned out rightly. Since client protection and satisfaction is one of the goals of every regulator, this area is not satisfactorily handled. The scale of operations of the insurance companies in Nigeria is yet to reach the optimum because of tardiness to settle claims where interest is shown. For example, records from Hong Kong Insurance Complaints Bureau (2007) shows that a myriad of complaints can arise between the insurance companies and clients. These include application and policy terms (31%), non disclosure (29 %) amount of indemnity (14%) excluded items (14%) breach of warranties (3%) and others (9%). This however is lacking in the Nigerian insurance industry as in other sectors.

### **Other Financial Institutions**

Other Financial Institutions Department (OFID) in the CBN deals with non banking institutions like primary mortgage institutions, finance companies, discount houses, and bureaux de change who all operate and are regulated by the CBN.

Discount Houses intermediates fund between the CBN and the Banks but is seen as well in the money market where it is a strong participant. The 5 discount houses in Nigeria are all reporting and are closely monitored since all are owned by banks.

The Primary Mortgage Institutions present a different scenario since their set up in the late 1980s via Decree 53 Of 1989, the sector has not known tranquility via a legion of factors. With the initial licensing by the Federal Mortgage Bank of Nigeria the operators found it difficult to keep within the rules as a result of lack of understanding of the mortgage market and ineffective supervision that led to establishment of many PMIs who concentrated their activities mostly in Lagos in the short term market of finance house functions. Revocation of 220 licenses in one swell swoop reduced their number drastically in 1994. About 78 are reporting with most being owned or affiliated to one other financial industry participant especially banks. This is a sector that needs support even in the developed economies to perform its expected rôles. That should be available from the National Housing Fund.

Finance Houses are mostly operators in the short term financial market. Actual operators are not known as the number reporting is not regular and actual market

S/N	Regulator	Financial Institutions Covered
1	Central Bank of Nigeria	Banks, Discount Houses, primary Mortgage Institutions, Microfinance BDC, Finance Houses
2	Security and Exchange Commission	Stock broking firms, Issuing houses, Registrars, Portfolio Institutions (mutual funds).
3	National Insurance Commission	Insurance Companies, Reinsurance Companies Agents and Brokers
4.	Pension Commission	Pension Fund Administrators, Pension Fund Custodians, Closed Pension Fund Administrators

### **The Financial Services Regulation Coordination Committee**

The committee was constituted in April 1994 long before the adoption of the universal banking system in the country in 2000, comprising of the Security and Exchange Commission, NAICOM the Corporate Affairs Commission and the Federal Ministry of Finance. The NDIC, NSE and the National Board for Community Banks were co-opted as observers. The Committee has (or had) the regulators as members with the CBN as Chairperson. Its functions were set to discuss issues of common concern to regulatory and supervisory bodies. The Committee was empowered through the section 38 of the CBN Act, and was formally inaugurated in May 1999. Basic objectives of the Committee were to coordinate the supervision of financial institutions, eliminate the opportunities for arbitrage, eliminate the information gap between the regulators and articulate the strategies for the promotion of safe and efficient practices by financial intermediaries. Important regulatory committees such as distress, harmonization, information sharing, legal enforcement and market development were set up. Since the setting up of these committees not much has been heard from the committee.

### Rationale for a Single Regulator

Theories of regulation emphasize that two main areas of regulation are in existence and of deep interest to the system, the institution and the consumer or client. Different from self regulation which arises from self-imposed actions of codes of conduct and world ethics, external regulation is imposed which could be for the purposes of tax administration. Theories of financial regulation concern the captive theory and competition for regulation theory where the beneficiaries of regulation attempt to control the system. Deregulation on the other hand may allow the public interest to suffer. Therefore the public interest theory that ensures the consumer is not made to suffer problems due to the inaction of the regulators, which is the main reason why these institutions are regulated for capital adequacy and other minimum requirements (Dale, 1996). On the basis of the public interest Sheng (1997), found four grounds for regulation as follows: moral hazard, widows and orphans, public policy and the systemic risk arguments. The convergence in the financial market means that various section of the financial market are selling homogenous products or services of different hues to same persons and units. However, the two groups are the institutions and the customers which might be regulated differently, through different and autonomous commissions known as the Twin peaks (this has been criticized by Goodheart *et al* (1998)) taking charge of the institutions and customers or clients or whole and retail markets of the institutions. The twin peaks have its advantages among which are focus and specialization. Regulation is an art and a matter of convenience the method a country or economy chooses to adopt, but the essentials of regulation must be fully covered as to the benefit for the economy and the consumer or the public.

Of late there has been the trend to constitute a single regulator for the entire financial services market. Countries have given up traditional practices and have imbibed new ideas in the name of globalization, modernity and exigency. The rationale for constituting single regulators is different in each case, but with one central focus: the public interest. From all indications the practice of universal banking, emergence of financial conglomerates and holding companies have brought about the need to establish a single regulator. It has also been assisted by integration of economies (Brauilt, 1999). In all of these, the consumer protection argument is paramount and accountability as the regulator becomes stronger. Mention is also made of the economies of scope and scale that attend to the regulator's functions in the market. The regulator not only saves so many resources in labor and capital but also in time. It can deal with many financial institutions and save time by dealing across financial institutions.



**Table 2 Some of the countries that have adopted the Single Regulator Model**

No	Country	Year Established
1	Norway	1986
2	Canada	1987
3.	Denmark	1998
4	Japan	1998
5	South Korea	1998
6.	Iceland	1997
7	Australia	1998
8.	Luxembourg	1999
9	England	1997
10.	South Africa	2003

**From various sources**

### **Models in Other Countries**

A number of countries have adopted the single regulator mode wholly, while some have adopted it with modifications to suit their level of development and transparency. From various studies, the first country to adopt the single regulation method is Norway in 1986. England adopted in 1999. Between these dates, a number of Organization for Economic Cooperation and Development (OECD) countries introduced the practice and have maintained it. Also, medium income countries and emerging economies have also introduced the practice in their financial system. India is interested; Jamaica, United Arab Emirates and Bahrain are considering it while the continent of Europe through the EU has adopted it. New York State in the United States is considering the single regulator (Federating states are allowed autonomy to this extent!). Most worthy of note in all of these countries is South Africa who adopted the single regulator mechanism to regulate the non-bank financial institutions, insurance companies and stock and bonds market. Below is the table of the countries practicing regulation by a single institution or its variety.

**United Kingdom** established a single financial regulator that began operate before it was legally empowered. It covers virtually all the sectors of the financial services industry. A period of transition was put in place to during the transition to enable the banks especially to set industry standards supervise individual firms and handle industry wide issues. It meets with the Treasury (equivalent of Ministry of Finance in Nigeria) and the Bank of England on regular basis to discuss the financial matters concerning the country. The role of the Financial Services Authority of the United Kingdom covers the whole gamut of the financial system. Thus, UK single regulation is total.

**South Africa** has a modified form of broad based financial services regulator that does not cover the banking industry, but every other sector in the country. Its main aim is to ensure an efficient running of the financial system in the country with in-built mechanism to encourage and promote investor protection. The Financial Services Board of the South African financial system therefore covers only a part of the financial system. The banking sector is being supervised by the Reserve Bank of South Africa.

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### Recommendation: The Nigeria Format

The Nigeria financial system has become integrated since the introduction of universal banking that allowed the banks to have other functions apart from banking function they had before. This became more accentuated after the recent capitalization. Banks now have insurance affiliates, aside from capital market operations arm and mortgage companies within one group. At least three regulators are involved in this group. With this it is difficult to effectively coordinate the activities where any of the institutions is involved in the malpractices. Illegal movement of funds within the groups can easily be traced. A particular sharp practice might be prevalent in a member and a warning or sanction may be more respected as it sends warning signal to other firms in the group. An integrated approach to regulation would be more useful here. A check at the capitalization level of the respective companies' would easily be monitored. An important area to look at on integrated basis is the role of a financial ombudsman who would look into the complaints of financial products consumers and adjudicate between financial institutions and the consumers. In this way reports can be generated of the malpractices by institutions and other relevant information can be stored. This is an expected innovation on this area.

The position of the single regulator in Nigeria has been carved out during the introduction of universal banking and by constituting of the Financial System Coordination Committee which was to oversee the universal banks as multiproduct channels in the financial system. The transformation of the Committee to a single regulator (with a name such as Financial Services Commission, FSC) is the next step to the single financial regulator which is the next level in the financial system upgrade the Vision 2020 is anticipating. It is not something to leave till 2020 before its adoption, but what needed to be adopted right away and be allowed to mature within this period for the country to be among the top 20 economies in 2020, the pessimisms expressed by the politicians, notwithstanding.

The process of the appointment of the head of the Financial Services Commission is as important as the person to be appointed. Two qualities that must be observable in potential appointees are integrity and experience as these will impact on the way and manner the commission will perform and its eventual success.

**Table 3. The New Proposed Regulators**

No	Regulator	Institutions Covered
1.	Central Bank of Nigeria	Deposit Money Banks
2	Security and Exchange Commission	Stock broking firms
3	Financial Services Commission (FSC)	Discount Houses, primary Mortgage Institutions, Microfinance BDC, Finance Houses, Issuing houses, Registrars, Portfolio Institutions (mutual funds), Insurance Companies, Reinsurance Companies Agents and Brokers, Pension Fund Administrators, Pension Fund Custodians, Closed Pension Fund Administrators.

Given the position of the banks as financial powerhouse and their importance to the economy it might be safe to allow the central bank to continue to regulate the banking sector because of the direct influence of the activities of the banks on the economy (this is the case in South Africa). The Discount Houses and the other financial institutions come directly under the Regulator. These institutions would include the MFBs, PMIs BDCs and the Finance houses. The new regulator, for now can effectively handle all the institutions under SEC but for the stock broking firms. The prevalence of parallel firm in the sector needs to be checked by a new method of registration which the SEC can handle. Other institutions within the framework of the Security and Exchange Commission can be effectively regulated by the regulator. With time and given and adequate guidance as has been in the last four years since the recapitalization started, it can be safely assumed that the banks will be able to self-regulate themselves and the central bank may hand over the regulation with time. As a result of the bent of the new regulatory environment, the presence of a financial ombudsman is needed who should be equipped with all necessary apparatus to properly adjudicate on cases of exploitation of consumers by the institutions. This would be a strong feature of the new regulator for it to be meaningful.

### **Conclusion and Summary**

It is safe to consider the fact that the current method of regulation does not allow an integrated approach towards the regulation of the financial system, bearing in mind that it is no longer the norm and the vogue the world over. The consumer is not protected by exploitative tendencies of financial services providers. Regulation as to capital adequacy and solvency may be adequate, but the marketplace integrity and transparency in the conduct of business is not in place. The various models of single regulation gives a choice of what to put in place to achieve a satisfied population of financial services consumers. The process of achieving single regulatory institution will, as expected pass through the process of legislative approval and adequate legal framework. As would be expected a process of transition would be normal when the old and current regulators would coalesce to form the new one, which in most countries have been less than one year. The technical staff of the old regulators could be maintained until all the structures are fully formed for a smooth take off. The role of the CBN in the new structure would at the initial stage be to regulate the banking sector until the institutions are able to self-regulate themselves, enough to come under the purview of the new regulator. In the meanwhile the consumers would be able to relate to the new regulator on consumer protection purposes. The SEC would be expected to regulate the stock broking firms in time being within a space of two years for total sanitation of the sector before it comes under the new regulator. In the meanwhile the other institutions can come under the regulator right away. The National Insurance Commission and the Pension Commission can immediately devolve their functions to the regulator.

This paper has dealt with the issue of a single regulator of the financial system as it



pertains to Nigeria adopting the model. It has looked at the inadequacy of protection the CBN as an example of a regulator and the need to adopt the model as the modern mode of regulation for the purposes of consumer in Nigeria. The various models have been examined as most countries have it in different forms with sole aim of maintaining prudential environment for the industry and promoting consumer protection and welfare within the industry. Nigeria can make a different model or adopt one of those that are on ground in any of the countries, and at the end the financial regulator assumes full control for all the sectors of the financial system.

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