Understanding
NIGERIAN
FINANCIAL
System

Understanding
NIGERIAN FINANCIAL System

Theresa Udenwa, *Ph.D*

&

Uche Uwaleke, Ph.D



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This work is dedicated to God
the fount of all wisdom.

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LIST OF ABBREVIATIONS

ACH	-	Automated Clearing House
AIHN	-	Association of Issuing House of Nigeria
AMCON	-	Asset Management Corporation of Nigeria
ASCE	-	Abuja Securities and Commodity Exchange
ASI	-	All Share Index
ATM	-	Automated Teller Machine
BOFIA	-	Bank & Other Financial Institution Act
BOI	-	Bank of Industry
CAMA	-	Company and Allied matters Act
CAMEL	-	Capital, Assets Quality, Management, Earnings and Liquidity
CBN	-	Central Bank of Nigeria
CD	-	Certificate of Deposit
CMO	-	Capital Market Operator
CIS	-	Chartered Institute if Stockbrokers
CSCS	-	Central Security Clearing System
DFI	-	Development Finance Institution
DMB	-	Deposit Money Bank
DMO	-	Debt Management Office
EFT	-	Electronic Funds Transfer
FDI	-	Foreign Direct Investment
FIRS	-	Federal Inland Revenue Service
FMBN	-	Federal Mortgage Bank of Nigeria
FMDQ	-	Financial Markets Dealers Quotation
GDR	-	Global Depository Receipt
IFRS	-	International Financial Reporting Standards
IPO	-	Initial Public Offering
ISA	-	Investments and Securities Act
IST	-	Investments and Securities Tribunal
KYC	-	Know Your Customer
MFB	-	Micro-Finance Bank
MFI	-	Micro-Finance Institution
MOU	-	Memorandum of Understanding
NAICOM	-	National Insurance Commission

NASD	-	National Association of Securities Dealers
NBFI	-	Non Bank Financial Institution
NDIC	-	Nigeria Deposit Insurance Corporation
NEXIM	-	Nigeria Export – Import Bank
NSE	-	Nigeria Stock Exchange
OFISD	-	Other Financial Institutions Supervision Department
PAR	-	Portfolio At Rick
OTC	-	Over the Counter
PenCom	-	National Pension Commission
PFA	-	Pension Fund Administrators
PIN	-	Personal Identification Number
PMI	-	Primary Mortgage Institution
POS	-	Point-of-sale
REIT	-	Real Estate Investment Trust
S & P	-	Standard and Poor's
SEC	-	Securities and Exchange Commission
SME	-	Small and Medium Enterprises
SRO	-	Self Regulatory Organization
SWIFT	-	Society for Worldwide Interbank Financial Telecommunications

PREFACE

A financial system is one which enables the transfer of money between investors and borrowers and is crucial to the allocation of resources in a modern economy. An understanding of the interconnectivity between financial institutions and instruments is vital for any meaningful participation in financial markets.

A major challenge facing the financial authorities in Nigeria today is the development of financial markets through financial inclusion. To this end, both the Central Bank of Nigeria and the Securities and Exchange Commission have embarked on vigorous financial literacy programmes requiring relevant materials. This book is therefore motivated by the desire to complement the efforts of the financial authorities by providing a comprehensive and up-to-date work on the Nigerian financial system which is currently in short supply.

The twenty-six chapter book reflects current developments in the Nigerian financial system. The contents are well organized in a logical sequence of four sections beginning with an introduction to the subject in section one which is followed by a description of the money market, the short-end of the financial market, in section two. The market for medium to long term funds (capital market) is explained in section three while the fourth section is devoted to the Nigerian financial system and its connection with the outside world. The concluding chapter examines the effect of the global financial crisis on the Nigerian financial system. A key feature of this book is the discussion of electronic products in both the money and capital markets.

The comprehensive coverage and progressive presentation of contents will appeal to undergraduate and post graduate students especially in the social and management sciences and to those undergoing professional programmes such as ***CIBN, CIS, ICAN, ANAM***, etc. It would also be useful to professionals in financial

institutions such as banks and insurance companies as well as investors in the securities market.

While every effort has been made to ensure accuracy of the contents, we however regret any error contained in this book. Any suggestions for improvement will be warmly appreciated.

In writing this book, we benefited from the feedback and suggestions of colleagues in Nasarawa State University, to whom we offer our thanks. Our profound gratitude also goes to His Excellency Chief Achike Udenwa for his tremendous support.

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SECTION ONE:

INTRODUCTION

CHAPTER 1

OVERVIEW OF FINANCIAL SYSTEM

INTRODUCTION

A financial system refers to a system which enables the transfer of money between investors and borrowers. The term "system" in "Financial System" indicates a group of closely linked institutions, products, operators, procedures, and transactions that interact within an economy to provide financial services. Gurusamy (2008) describes it as comprising "a set of complex and closely interconnected financial institutions, markets, instruments, services, practices, and transactions." According to Allen and Gale (2001) "Financial systems are crucial to the allocation of resources in a modern economy. They channel household savings to the corporate sector and allocate investment funds among firms; they allow inter temporal smoothing of consumption by households and expenditures by firms; and they enable households and firms to share risks".

Financial systems depend on the countries viewpoint on freedom of trade. Some countries like Russia, have socialist financial systems because they value centralized organized state funded trading rather than freedom of trade by everyone. Regardless of the type adopted, the economic development of any country is dependent on its financial system. The lack of a strong, sound financial system generally work against the national economy.

COMPONENTS OF THE FINANCIAL SYSTEM

The five basic components of a financial system are: financial institutions; financial markets; financial instruments; financial services; and money.

Financial Institutions

Financial institutions facilitate smooth working of the financial system by making investors and borrowers meet. They mobilize the savings of investors either directly or indirectly via financial markets, by making use of different financial instruments as well as in the process using the services of numerous financial services providers. They could be categorized into Regulators,

Table 1.1: Financial Institutions in Nigeria as at end of June 2012

S/No	INSTITUTIONS	No
1.	Deposit Money Banks (DMBs)	21
2.	Discount Houses (DHs)	5
3.	Private Credit Bureaux (PCBs)	3
4.	Development Finance Institutions (DFIs)	5
5.	Primary Mortgage Banks (PMBs)	84
6.	Microfinance Banks (MFBs)	870
7.	Finance Companies (FCs)	108
8.	Bureaux de Change (BDCS)	2,052
9.	Pension Fund Custodians (PFCs)	5
10.	Pension Fund Administrator (PFAs)	30
11.	Stock Exchange	1
12.	Securities and Commodity Exchange	1
13.	Securities Brokerage Firms	690
14.	Registrars	34
15.	Insurance Companies	59
16.	Reinsurance Companies	2
17.	Insurance Brokers	542
18.	Loss Adjusters	48
19.	Asset Management Corporations of Nigeria	1

Source: CBN Financial Stability Report 2012

intermediaries, Non-intermediaries and others. They offer services to organizations looking for advice on different problems including restructuring to diversification strategies. They offer complete array of services to the organizations who want to raise funds from the markets and take care of financial assets.

Financial Markets

A financial market is the place where financial assets are created or transferred. It can be broadly categorized into money markets and capital markets. Money market handles short-term financial assets (less than a year) whereas capital markets take care of those financial assets that have maturity period of more than a year. The key functions are: (1) assist in creation and allocation of credit and liquidity; (2) serve as intermediaries for mobilization of savings; (3) help achieve balanced economic growth; and (4) offer financial convenience.

Financial markets can also be classified into primary market and secondary market. The primary market handles new issue of securities while the secondary market takes care of securities that are already available in the market. Financial markets catch the attention of investors and make it possible for companies to finance their operations and attain growth. Money markets make it possible for businesses to gain access to funds on a short term basis, while capital markets allow businesses to gain long-term funding to aid expansion. Without financial markets, borrowers would have problems finding lenders.

Financial Instrument

Financial instrument is an important component of the financial system. The assets that are traded in a financial market are financial assets, commonly known as some type of financial instruments. There is a wide variety of securities in the markets since the needs of investors and borrowers are different. They indicate a claim on the settlement of a debt or the payment of a regular amount by means of interest or dividend. Equity shares, debentures, bonds, etc are some examples.

Financial Services

Financial services consist of services provided by Asset Management and Liability Management Companies. They help to get the necessary funds and also make sure that they are efficiently deployed. They assist to determine the financing combination and extend their professional services up to the stage of servicing of lenders. They help with borrowing, selling and purchasing securities, lending and investing, making and allowing payments and settlements and taking care of risk exposures in financial markets. These range from the leasing companies, mutual fund houses, merchant bankers, portfolio managers, bill discounting and acceptance houses.

The financial services sector offers a number of professional services like credit rating, venture capital financing, mutual funds, merchant banking, depository services, book building, etc. Financial institutions and financial markets help in the working of the financial system by means of financial instruments.

Money

Money is understood to be anything that is generally accepted for payment of goods and services or for the repayment of debt. It is a medium of exchange, a unit of account and serves as a store of value as well as a standard for deferred payment. The Nigerian currency is the naira and is mostly paper money as coins have virtually disappeared from circulation largely on account of low purchasing power.

FUNCTIONS OF THE FINANCIAL SYSTEM

The basic functions of a financial system are essentially the same in all economies. However, for reasons involving differences in size, complexity, and available technology, as well as differences in political, cultural, and historical backgrounds, the institutional mechanisms by which these functions are performed vary considerably among economies. The financial system should provide at least the following core services:

1. **Liquidity:** a means of converting assets into cash without undue loss of value.

2. **Intermediation:** a way of transferring resources between savers and borrowers.

3. **Value exchange:** a way of making payments.

4. **Risk transfer:** a means for pricing and allocating certain risks.

The provision of these core functions can overlap and interact in important ways, for example, some financial products such as deposits, combine value exchange, intermediation, risk transfer and liquidity services. With these interactions in mind, each core function is considered in more detail below.

Liquidity

The financial sector provides liquidity. If the financial system is working well, individuals, businesses, and governments are able to convert their assets into cash at short notice, without undue loss of value.

The provision of liquidity is useful to individuals for meeting unexpected obligations. It is also critical to society at large. Access to liquidity allows businesses to deploy their capital in ways that increase the productive capacity of the economy. Without it, individuals and businesses would be forced to hold larger sums of cash to protect against unforeseen events. The result would be fewer resources for investment and the provision of fewer goods and services to consume.

Intermediation

The financial system acts as a link between savers and borrowers: it takes funds from savers (for example, through deposits) and lends to those who wish to borrow, be they individuals, businesses or governments.

Intermediation can take many forms beyond the traditional banking service of taking deposits and making loans. For example, investment banks intermediate between investors and bond issuers. Brokers perform a similar function in connecting the buyers and sellers of equities. What is important is that a financial institution stands between the counterparties to a transaction. Depending on the nature of the transaction, a number of supplementary functions may be required to intermediate between savers and borrowers, including:

1. ***Pooling resources***: for example, a bank can combine a number of small deposits to make a large loan.
2. ***Asset transformation***: financial intermediaries provide a link between the financial products that firms want to issue and the ones investors want to buy. This includes issuing securities to savers at short maturities, while making loans to borrowers at long maturities – a process known as maturity transformation.
3. ***Risk assessment and information processing***: financial intermediaries have expertise in screening potential borrowers to identify profitable lending opportunities, taking into account the risks that these entail.
4. ***Monitoring borrowers***: financial institutions take steps to limit the misuse of savers' assets. This function is critical to the decision by savers to lend their money in the first instance, and hence for facilitating investment in the economy.
5. ***Accurate accounting***: together with a legal system that enforces property rights, prudent measurement is vital in enabling depositors, shareholders and investors to be paid what they are entitled.

Effective intermediation requires a number of the qualities listed above in the context of an efficient payments system; it should be accessible and reliable, for instance. If the financial system is working well, it allocates funds to their most productive use. This

benefits society by expanding the productive capacity of the economy, hence raising living standards.

Value exchange

The payment system in Nigeria has improved significantly following the introduction of the cashless policy by the *CBN*. An efficient payment system is essential to support the day-to-day business of the Nigerian economy. Some of the desirable qualities of an efficient payment system are:

1. **Timely:** while not all transactions are urgent, the possibility of giving recipients timely access to funds is useful.
2. **Accessible:** everyone who needs to make and receive payments should have ready access to the payments system.
3. **Easy to integrate with other processes:** this includes the reconciliation and recording of information by the parties involved (which should also be timely and accessible).
4. **Easy to use:** this is not only an issue of convenience but also of minimizing errors.
5. **Safe and reliable:** end users of a payments system need to be confident that the system is secure; that is, that their confidential information is protected. They also need to have confidence that the system will be available when needed.
6. **Affordable and transparent:** users can make well-informed choices about payment methods according to their cost and convenience.

There can be conflicts between these objectives. For instance, making a payments system fully accessible and easy to use absorbs resources that might increase its cost.

Risk transfer

A well functioning financial system also facilitates the pricing and allocation of certain risks. These risks include the possibility that

borrowers will default on their obligation (credit risk), that an asset's value will fluctuate (market risk), or that an income stream will be required for longer than expected (longevity risk). Financial contracts may also alter the financial implications of physical risks, by providing insurance against flood or fire damage to property, for example (insurance risk), or against legal liability and similar costs (operational risk).

The financial system allows individuals to tailor their exposure to risk to suit their preferences. A younger person, for instance, may have more scope to adjust to a sharp fall in the value of their assets than an older person, who would have less time to build up assets to fund their retirement. Given this, a younger person may choose to invest in a riskier portfolio of assets, with the prospect of higher returns. So, the financial system facilitates the transfer of risks to those best placed to manage them.

STRUCTURE OF THE NIGERIAN FINANCIAL SYSTEM

The Nigerian financial system comprises bank and non-bank financial institutions which are regulated by the Federal Ministry of Finance (***FMF***), Central Bank of Nigeria (***CBN***), Nigeria Deposit Insurance Corporation (***NDIC***), Securities and Exchange Commission (***SEC***), National Insurance Commission (***NIAICOM***), the National Pension Commission (***PENCOM***), the Federal Mortgage Bank of Nigeria (***FMBN***), and Other financial institutions such as microfinance banks, Bureau De Change and Development finance institutions.

There are also Self-Regulatory Organizations (***SROs***) such as the Nigerian Stock Exchange, the Abuja Securities and Commodities Exchange as well as several trade groups and professional bodies such as the Chartered Institute of Stockbrokers. These organizations and bodies are examined in details in subsequent chapters of this book.

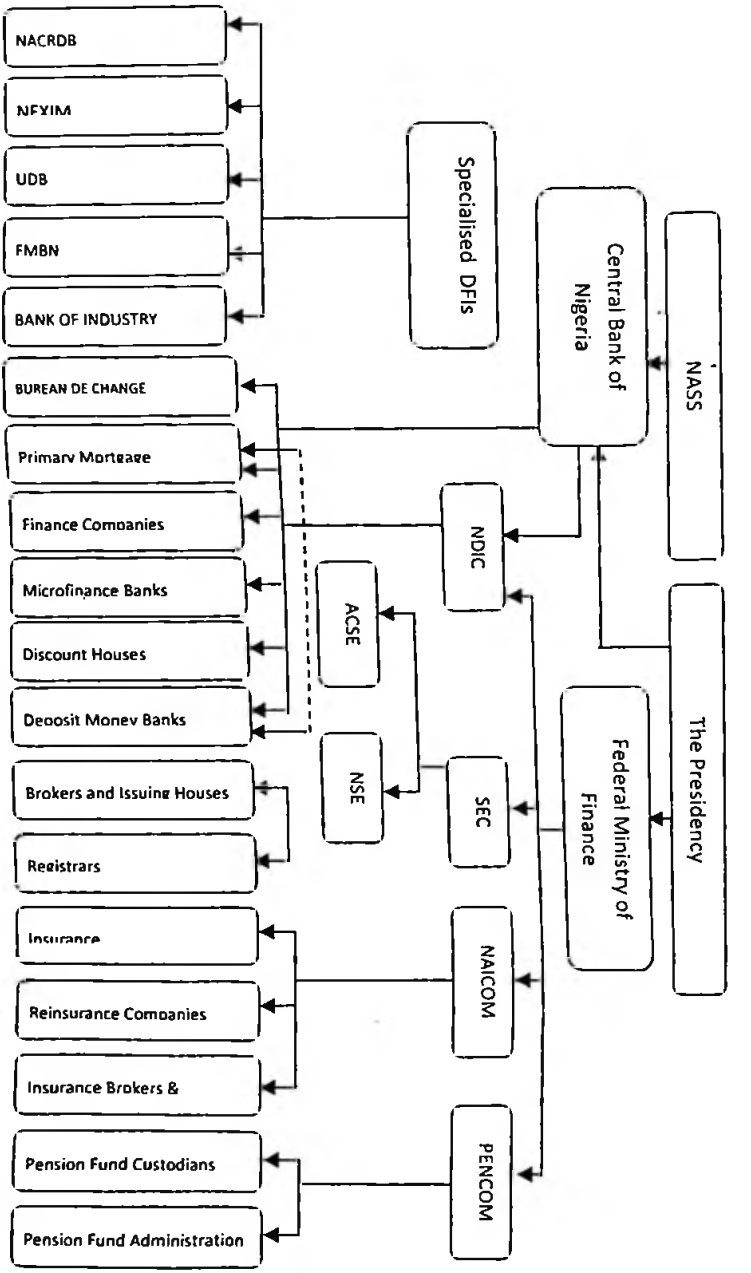


Figure 1.1 Structure of the Nigerian Financial System
Source: CBN Financial Stability Report 2012

Key:
NASS- National Assembly, *NDIC*- Nigerian Deposit Insurance, Corporation, *SEC*- Securities and Exchange Commission. *NAICOM*- National Insurance Commission, *PENCOM*- Pension Commission. *ACSE*- Abuja Commodities and Securities Exchange, and *NSE*- Nigerian Stock Exchange

SUMMARY

A financial system refers to a system which enables the transfer of money between investors and borrowers. The five basic components of a financial system are Financial Institutions, Financial Markets, Financial Instruments, Financial Services and Money. The core services provided by the financial system are Liquidity (a means of converting assets into cash without undue loss of value); Intermediation (a way of transferring resources between savers and borrowers); Value exchange (a way of making payments) and Risk transfer (a means for pricing and allocating certain risks).

REVIEW QUESTIONS

1. What do you understand by a country's financial system?
2. Explain the basic components of a financial system
3. Discuss briefly the core services provided by the financial system
4. Illustrate the structure of the Nigerian financial system

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SECTION TWO:

THE MONEY MARKET

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SECTION TWO:

THE MONEY MARKET

CHAPTER 2

MONEY MARKET INSTRUMENTS

INTRODUCTION

A money market like all financial markets is a mechanism which makes it possible for borrowers and lenders to come together. Essentially it refers to a market for short-term funds. The money market is the mechanism through which holders of temporary cash surpluses meet holders of temporary cash deficits. It is designed on the one hand to meet the short-term cash requirements of corporations, financial institutions and governments, providing a mechanism for granting loans as short as overnight and as long as one year to maturity. On the other hand it also provides an investment outlet for those spending units (corporations, financial institutions and governments) that hold surplus cash for short periods of time and wish to earn at least some return on temporarily idle funds. The essential function of the money market therefore is to bring these two groups into contact with each other in order to make borrowing and lending possible.

Thus the term money market does not necessarily refer to any specific place where money is lent or borrowed but as a matter of fact, it is a mechanism through which short-term funds are loaned or borrowed. Fig. 2.1 shows the structure and organization of the money market.

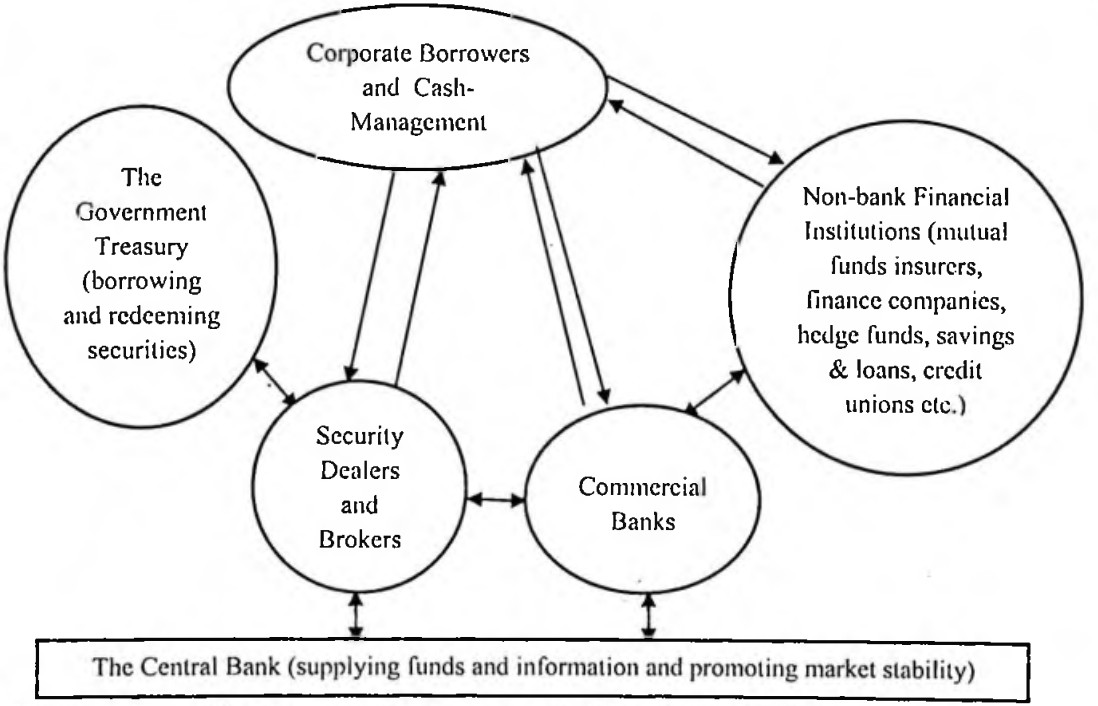


Figure. 2.1 The Structure and Organization of the Money Market

Source: Rose P.S & Marquis M.N; Money & Capital markets

Debt instruments which have a maturity of less than one year at the time of issue are called money market instruments. They are highly liquid and have negligible risk. Their supply comes mainly from lenders comprising the Central bank, Commercial banks, other financial institutions and stock exchange dealers. Also, their demand comes from the borrowers comprising the government, corporate entities, commercial banks, stock exchange dealers and other financial institutions. The major money market instruments are Treasury bills, Certificates of deposit, Commercial paper, Bankers Acceptances and Repurchase Agreement (Repo). These can be classified into two broad categories namely coupon-bearing and discount instruments.

Coupon-bearing instruments are instruments or securities on which interest is payable at a stated interest rate (or 'coupon') on a fixed amount of principal. When the instrument or security reaches its maturity date, its holder receives the initial principal plus interest in settlement. An example of coupon-bearing instrument is certificate of deposit. On the other hand, discount instruments are instruments or securities where the borrower undertakes to pay a fixed amount of principal at maturity, and the instrument is issued at a discount to its 'face value'. The difference between the discounted issue price and the eventual redemption price (face value) represents interest on the borrowing. Examples of discount instruments are Treasury bills, Bankers Acceptances and Commercial paper.

TREASURY BILLS

These are promissory notes of short-term maturity issued by the government to meet its short-term financial needs. Treasury bills are the most important financial market instruments because they represent the obligations of government which have a primary tenor of 3 months, 6 months or 12 months. Treasury bills are sold at a discount and redeemed at par. For example, the government might issue a 91-day Treasury bill with a face value of N100 million at a price of say, 98.75. It would raise N98.75 million from the issue and at the end of the 91 days it would pay N100 million to

the holders of the bills. Interest for the three-month period would be N1.25 million on the N98.75 million raised, which is an interest rate of about 5% (annual).

Thus, the implicit yield of a Treasury bill is a function of the size of the discount and the period of maturity. Though the yield on Treasury bills is somewhat low, they still have appeal because they can be transacted readily and there is very active secondary market for them since buyers of Treasury bills can re-sell them before they mature to other investors or banks. Also Treasury bills have nil credit risk and negligible price risk due mainly to their short tenor.

CERTIFICATE OF DEPOSITS (CDs)

A certificate of deposit is a certificate issued by a bank stating that the bank is holding a specified quantity of money as a term deposit, on which interest is being earned at a specified rate. The deposit cannot be removed from the bank until the end of the stated term but it can be sold in a money market for ***CDs.*** For example, an investor might place a deposit of N10 million with a bank for a fixed term of six months and receive interest at 5.5% on the deposit. It might be agreed that the bank should issue a certificate of deposit which the depositor holds. If the depositor needs money before the end of the six months, he can sell the ***CD*** to another investor or a bank and receive immediate cash.

CDs represent short term deposits which are transferable from one party to another. The major issuers of ***CDs*** are banks and financial institutions while the principal investors are banks, financial institutions, corporate entities and mutual funds. ***CDs*** are issued in bearer or registered form and they generally have a maturity of 3 months to 1 year. ***CDs*** are popular forms of short-term investment for mutual funds and companies because banks are normally willing to tailor the denominations and maturities to suit the needs of the investors. They are generally risk-free; are transferable and they offer higher rate of interest than Treasury bills or term deposits.

COMMERCIAL PAPER (CP)

This represents short-term unsecured promissory notes issued by firms considered to be financially strong. Commercial paper usually has a maturity period of 90 days to 180 days. It is sold at a discount and redeemed at par hence the implicit rate is a function of the size of discount and the period of maturity. Non-financial companies issue ***CP*** through a bank. The bank issues the ***CP*** on behalf of the company and sells it to investors. As a negotiable instrument, it can be sold in the money market. In practice however, investors buying ***CPs*** normally hold them to maturity when they receive the face value of the paper they have bought. The company issuing the ***CP*** therefore receives immediate cash (at a discount to the face value of the paper) and makes a payment when the paper reaches maturity. Since Commercial Paper is an instrument not backed by any collateral, only companies with good credit rating are in a strong position to raise money through this means. Commercial paper is normally given a credit rating by a credit rating agency such as Moody's, Standard & Poor's, Fitch and Augusto rating services based in Nigeria.

CP is usually issued for financing of debtors (receivables), stocks (inventory) and for meeting short term liabilities. For example, suppose a company has debtors of ₦1million with credit period of six months and is in need of funds now. Since it will not be able to liquidate its debtors before six months, it can issue commercial papers in form of unsecured promissory notes at a discount of 10% on face value of ₦1million to mature after six months. Because the company has strong credit rating, it finds buyers easily. It is able to liquidate its debtors immediately while the buyer is able to earn interest of ₦100,000 over a period of six months. Investors buying the ***CP*** are able to re-sell it if they wish to do so at any time before maturity through a bank that deals in the ***CP*** market.

REPURCHASE AGREEMENT (Repo)

Repurchase Agreement (Repo) or Ready forward involves a simultaneous "sale and repurchase" agreement. It works as

follows:- Party A needs short-term funds and Party B wants to make a short-term investment. Party A sells securities to Party B at a certain price and simultaneously agrees to repurchase the same after a specified time at a slightly higher price. The difference between the sale price and the repurchase price represents the interest cost to Party A and conversely the interest income for Party B. For example, Bank A might arrange a repo transaction with Bank B, in which Bank A sells a quantity of money market securities to Bank B for N20 million and agrees to buy them back after 14 days for N20.046 million. In this example, Bank B is effectively lending N20 million to Bank A for 14 days with money market securities as collateral for the loan. When the repurchase takes place after 14 days, Bank B receives N46,000 more than it lent, which is the interest on the loan.

A "reverse repo" is the opposite of a "repo" which involves an initial purchase of an asset followed by a subsequent sale. It is a safe and convenient form of short-term investment.

BANKERS ACCEPTANCE (BA)

These are bills of exchange accepted by commercial banks on behalf of their customers. A bill of exchange is a form of promise to pay a stated amount of money at a date in the future (usually in several months' time). A bill has a drawer and a drawee. The bill is issued by the borrower and is 'drawn on' the drawee. When the bill is drawn, it is a form of 'You Owe Me'. With the bill the drawer is stating that the drawee owes a specified amount of money. The bill is then 'accepted' by the drawee who signs the bill to indicate acceptance. An accepted bill becomes an undertaking by the drawee to pay the specified amount of money at the specified date. A bill of exchange that is drawn on and accepted by a bank is called a bank bill or Bankers Acceptance. The fact that a bill is accepted by a commercial bank increases its creditworthiness which in turn means that it can easily be discounted.

A company that intends to borrow amounts of money for a short-term over a period of time in the future might arrange a BA programme with a bank. Under the terms of the agreement, the

bank undertakes to accept bills of exchange that are drawn on it by the company up to a maximum amount. When the company needs short-term funding, it draws a bill on the bank. The bank accepts it and then sells it in the money market on behalf of the company at a discount. The company therefore receives the money 'now' and must also pay the bank the face value of the bill when it reaches maturity to enable the bank to settle the bill. The bill is therefore a form of short-term finance, and the interest cost is the difference between the discounted value of the bill when it is sold and the face value of the bill that must be paid in settlement. To illustrate, suppose ABC Plc has arranged a bankers' acceptance programme with its bank. Under the terms of the arrangement which lasts for one year, the company is able to draw bills on the bank up to a total value in issue at any time of N20 million.

The company might draw a bill on the bank for N1,000,000 with a settlement date in three months' time. The bank accepts the bill and sells it for the company in the money market. The company might receive say, N985,222, so that the discount on the bill is N14,778 which implies that the rate of interest for the three months is about 6 percent (ie N14,778/N985,222 × 12/3). After three months when the bill reaches maturity, the bank pays the bill and the company pays N1,000,000 to the bank.

An advantage of BAs for a company is that if it is arranged with a highly rated commercial bank, the discount rate (interest rate) on the accepted bills might be relatively lower than those on other forms of money market borrowing.

IMPORTANCE OF THE MONEY MARKET

The money market plays a vital role in the financial market of every economy as such its importance cannot be overemphasized. First, for most individuals and institutions, inflows and outflows of cash are rarely in perfect harmony with each other. Government for example collects taxes from the public only at certain times of the year, while disbursements of cash are made throughout the year. When taxes are collected, government usually has funds that far exceed their immediate cash needs and so at such times they enter

the money market as lenders and purchase Treasury bills, Certificates of deposit (***CDs***) etc. Later, however as cash runs low relative to current expenditures, the same government enters the money market this time as borrowers of funds, issuing short-term notes attractive to money market investors.

Firms too collect sales revenues from customers at one point in time and dispense cash at other points in time. A surplus cash position frequently brings a firm into the money market as a net lender of funds, investing idle funds in the hope of earning at least a modest rate of return while cash deficits force it into the borrowing side of the money market seeking other institutions with temporary cash surpluses.

The money market therefore serves to bridge the gap between receipts and expenditures of funds, covering cash deficits with short-term borrowing when current expenditures exceed receipts and providing an investment outlet to earn interest income for units whose current receipts exceed their current expenditures. Also investors in the money market while seeking for safety and liquidity do have the opportunity to earn some income. This is because funds invested in the money market represent only temporary cash surpluses and is usually needed in the near future, and for this reason money market investors are especially sensitive to risk.

SUMMARY

Money market is the mechanism through which holders of temporary cash surpluses meet holders of temporary cash deficits. The major money market instruments are Treasury bills, Certificates of deposit, Commercial paper, Repurchase Agreement and Bankers' Acceptances. The importance of the Money Market cannot be overemphasized as it serves to bridge the gap between receipts and expenditures of funds.

REVIEW QUESTIONS

1. Define "Money Market".
2. What are the principal financial instruments traded in the Money Market?
3. Briefly describe a "Repo".
4. Of what use is the Money Market to any economic system?

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CHAPTER 3

COMMERCIAL BANKING

INTRODUCTION

Commercial banks activities lie at the heart of most financial systems of modern economies as their importance to the smooth functioning of these economies cannot be overemphasized. The dominant privately owned financial institution in most economies is the commercial bank, which offers the public both deposit and credit services as well as a growing list of newer and more innovative services. Some of these services include investment advice, security underwriting, insurance and financial planning.

The name commercial implies that these banks devote most of their resources to meeting the financial needs of business firms. In recent times however, commercial banks have expanded their financial services to individuals and families and to governments around the world. The result is the emergence of a financial institution that has been called a "financial department store" because it satisfies the broadest range of financial service needs in the world economy.

IMPORTANCE OF COMMERCIAL BANKS

The importance of commercial banks may be measured in a number of ways:-

1. They are still the principal means of making payment through the use of cheques, credit and debit cards and electronic transfer services.

2. Commercial banks are important because of their ability to create money from excess reserves emanating from deposits from their customers.

3. Commercial banks are today the principal channels for executing government policies. For example, Central Bank of Nigeria (CBN) implements policies to affect interest rates and the availability of credit in the economy mainly through altering the level and growth of reserves held by commercial banks and other depository financial institutions.

4. Commercial banks are major buyers of debt instruments issued by both Federal and State governments.

For all of these reasons, commercial banks play a dominant role in the money and capital markets of any economic system.

COMMERCIAL BANKS IN NIGERIA

Commercial banking in Nigeria has undergone some changes in recent years. Following the consolidation programme of the CBN in the banking industry which commenced on the 6th of July, 2004 and ended on 31st December, 2005, the number of commercial banks in the country was reduced from 89 to 25 mega banks through offers for public subscription of shares, mergers and acquisition involving 75 banks while the remaining 14 banks had their licenses revoked. The list is as follows:-

List of Commercial Banks in Nigeria as at July 2008

1. Access International Bank Plc.
2. Afribank Nigeria Plc. (Mainstreet)
3. Diamond Bank Plc.
4. Ecobank Nigeria Plc.
5. Equatorial Trust Bank Plc. (Acquired by Sterling Bank)
6. First City Monument Bank Plc.
7. Fidelity Bank Plc.
8. First Bank Plc.
9. First Inland Bank Plc. (Acquired by FCMB)
10. Guaranty Trust Bank Plc.
11. IBTC Chartered Bank (merged with Stanbic Bank Plc.)

12. Intercontinental Bank Plc. (Acquired by Access Bank)
13. Nigerian International Bank Plc.
14. Oceanic Bank International Plc. (Acquired by Ecobank)
15. Bank PHB Plc. (Keystone Bank)
16. Skye Bank Plc.
17. Spring Bank Plc. (Enterprise Bank)
18. Stanbic Bank Plc. (merged with IBTC as Stanbic IBTC)
19. Standard Chartered Bank Nigeria Plc.
20. Sterling Bank Plc.
21. UBA Plc.
22. Union Bank Plc.
23. Unity Bank Plc.
24. WEMA Bank Plc.
25. Zenith International Bank Plc.

Source: Central Bank of Nigeria (CBN) Statistical Bulletin 2012.

Following further consolidation in the banking industry between 2009 and 2010 the number of banks were reduced further from 25 to 20 as listed below:

List of Commercial Banks in Nigeria as at December 2011

1. Access International Bank Plc.
2. Diamond Bank Plc.
3. Ecobank Nigeria Plc.
4. Enterprise Bank
5. First City Monument Bank Plc.
6. First Bank Plc.
7. Fidelity Bank Plc.
8. Guaranty Trust Bank Plc.
9. Keystone Bank
10. Mainstreet Bank
11. Nigerian International Bank Plc.
12. Skye Bank Plc.
13. Stanbic IBTC Bank Plc.

14. Standard Chartered Bank Nigeria Plc.
15. Sterling Bank Plc.
16. UBA Plc.
17. Union Bank Plc.
18. Unity Bank Plc.
19. WEMA Bank Plc.
20. Zenith International Bank Plc.

Source: Central Bank of Nigeria (CBN) Statistical Bulletin 2012.

STRUCTURE OF NIGERIAN COMMERCIAL BANKS

Commercial banks in Nigeria operate the branch banking system which is like what obtains in the United Kingdom as against the Unit banking system of the United States of America. Branch banking is characterized by a few large banks with very many branches in different parts of the country. For example in England most part of the banking business is in the hands of four major banks which are popularly known as "the Big Four" namely Midlands, Lloyds, Barclays and National Westminister with their branches extending to all parts of England. In Nigeria after the reforms and consolidation of 2010 they were 20 commercial banks operating in the system with so many branches throughout the country.

Unit banking system on the other hand is dominated by individual units or local banks. It allows banking services to be provided by single office institution. In the United States of America for example, Unit banks are generally linked by a correspondent bank. Under the correspondent banking system, the local banks deposit money with the city banks and the city banks in turn deposit same with the Reserve city banks. This arrangement helps each bank to make remittances through the correspondent banks. It should be noted however that currently in the USA some states allow state wide branch banking, others limited area branch banking while still others specifically prohibited branch banking.

ADVANTAGES OF BRANCH BANKING SYSTEM

The advantages of branch banking system include the following:

1. Branch banking system helps provide better facilities to bank customers when compared to the Unit banking system because at any given time each branch has a limited number of customers and so can achieve efficiency through large scale operations.

2. Through the economies of large scale operations also management in the branch banks can be made more efficient by proper staff selection, training and appointment of the right persons in the right positions.

3. Any given branch of a bank need not keep large amounts of idle cash reserves because when necessary the resources of one branch could be transferred to another to solve liquidity problems.

4. Industrial and geographical diversification of loan risks is possible through branch banking such that when a branch suffers a loss as a result of decline of the industries in that locality, the profits earned by the other branches will make up for such a loss.

5. In the branch banking system, remittance facilities can be provided to the customers cheaply because it is quicker and cheaper to adjust inter-office indebtedness than adjusting inter-bank indebtedness.

6. Finally, it could be argued that branch banks provide their customers with the services of more powerful and solvent banks since a branch does not only have the assets of a particular branch behind it but the assets of all the branches of the bank.

ADVANTAGES OF THE UNIT BANKING SYSTEM

The advantages of the Unit banking system include:

1. In terms of granting loans to their customers the manager of a Unit bank has an advantage over the manager of a Branch bank because he will have a personal knowledge of the borrowers and can easily take decisions in that regard while the Branch manager will have to get the permission of the head office. This will normally involve delays and red-tapeism.

2. It is easier to exert a very effective control over Unit banks than Branch banks especially when a bank grows beyond the optimum size. Consequently, mismanagement on a large scale is more likely under Branch banking than under Unit banking system.

3. Unlike Unit managers, Branch managers are transferred too frequently and they are liable to be unsympathetic to local needs.

4. The failure of a Unit bank will not have a nation-wide repercussion since it is localized, whereas the failure of a bank with many branches spread throughout the country will have enormous repercussions throughout the country.

5. Finally, it could be argued that given that market conditions are sometimes localized, then Unit banking becomes more appropriate for such localities than Branch banking system.

ORGANIZATION OF A TYPICAL NIGERIAN BANK

One common feature in the organization of all major banks in Nigeria is the fact that their Head Offices are located in Lagos or Abuja, Area/Regional offices in state capitals and other major cities. The Area offices have a number of branches under their control.

As in any other company, the shareholders are the owners of the bank. The Chairman and the other directors of Banks are appointed by the shareholders. The directors usually meet periodically to formulate the policy of the bank. This includes discussing management reports, approving changes in top management personnel, approving budgets and large loans and discussing other problems and policies with the management of the bank.

The Managing Director and the Executive Directors are usually the top management of the bank. They conduct the day-to-day affairs of the bank. Other members of the Board of Directors are not full-time employees of the bank. There is normally one Managing Director assisted by 2 to 4 Executive Directors depending on the size of the bank. Most banks in Nigeria have Area Offices headed by Area Managers who have higher lending authorities than Branch Managers to facilitate the processing and approval of loans.

After the Managing Director and the Executive Directors come the Heads of Departments who report to the appropriate Executive Directors. (Heads of Departments are called Assistant or Deputy General Managers in some banks.) Examples of Heads of Departments are: The Financial Controller or Assistant General Manager (Finance), The Chief Inspector, The Credit Administrator or Head of Advances Department, The Head of Operations Administration, The Chief Personnel Manager, and the Assistant General Manager (Computer). Each Head of Department has a responsibility for a specific function in the bank as follows:

Financial Controller or Chief Accountant's Department

This department is responsible for the preparation of the bank's monthly consolidated Profit and Loss Account and Balance Sheet. Quarterly, half-yearly and annual accounts are also prepared. The External Auditors come in once or twice a year to audit the books of the bank and the draft accounts prepared by the department. In most banks the department is responsible for asset and liability

management, financial analysis, budgeting and planning. In some banks the Head of this Department is called Deputy Assistant General Manager (Finance).

Chief Inspector's Department

It is essential to ensure that each branch of the bank operates in accordance with the instruction laid down by Head Office in order to safeguard the asset of the bank. Branches are, therefore, inspected periodically to achieve the above objectives. The Chief Inspector takes responsibility for this function.

Credit Administration or Advances Department

All advances exceeding the delegated authority of a Branch Manager and Area Manager are sent to the Credit Administrator or Head of Advances or Assistant General Manager (Advances) for approval or for concurrence and subsequent approval by a higher authority. Branch Managers' credit reports are prepared in a very comprehensive manner to facilitate the decision-making process.

Head of Operations Department

Its functions include branch administration, operations and control, branch expansion, stationery supplies and purchasing, maintenance and security. The Operations Department ensures that branches operate in accordance with standard banking practices, principles and the Nigerian Law.

Human Resources Department

This department is concerned with recruitment, training and deployment of staff.

Information Technology (IT) Department

All banks in Nigeria have introduced Electronic Data Processing Systems into their operations in order to enhance efficiency and, as a result, computer/IT departments have become very important.

Closely following the Heads of Departments are the Heads of some specialist services units like foreign, corporate finance, legal and public relations some of whom report to Heads of Departments, while some have direct reporting relationship with the Executive Directors.

BRANCH ORGANIZATION

A typical branch of a commercial bank will have the following key officers:

Branch Manager

At branch level, the most senior official of any bank is the Branch Manager. The Branch Manager is usually an experienced banker, versatile in banking operations generally and credit analysis and appraisal in particular. Apart from receiving funds from and lending money to deserving customers of the bank, every Branch Manager is a potential salesman for his bank. Today's business environment and keen competition in banking compel the Branch Manager to go outside and actively solicit business, visit factories and speak to varied groups.

Another important role which every Branch Manager is expected to play is that of adviser. As the branch manager's daily routine brings him into close contact with all classes of people and all trades and professions, his views are likely to be more broadly based and in better perspective than those people with narrower interests and responsibilities. Apart from his own knowledge and experience, the Branch Manager relies on a number of experts in the Head Office, subsidiaries, affiliates and associated banks and companies to help him advise his customers. Areas where the Branch Manager has traditionally given advice to his customers include other sources of finance, (especially when the bank itself cannot grant a request), maximum utilization of surplus funds, investments and portfolio management, wills and trusts, insurance, and tax matters. In addition to the above, corporate customers may seek advice on recapitalization, balance sheet structure, mergers, lending limit and international trade etc.

Depending on the size of the branch and the experience of the Branch Manager, a lending limit is given up to which he can lend without reference to his Regional, Area or Head Office. Thus, the Branch Manager is able to approve certain loans on the spot, so the customer is not kept waiting anxiously for an Area Office or Head Office decision. The overall responsibility for the running of a branch in accordance with Head Office instructions lies with the Branch manager.

The Accountant

In some banks this official is called the Operations Officer. His area of responsibility is restricted to branch operations and the accounting side of the branch. He is usually not involved with credit matter, except requests for small loans and overdrafts from personal rather than business customers. Thus, his main responsibility is to assist the branch manager in ensuring the smooth and efficient running of the branch. To achieve this objective, he is usually responsible for staff recruitment and training and the preparation and balancing of the branch books. He may have one or more assistant accountants, depending on the size of the branch.

Other Staff

The other staff in a branch include security clerks who are responsible for the processing of security for bank loans and advances and investments for customers, foreign clerks who handle foreign exchange, travellers' cheques, remittances, Letters of Credit etc., the cashiers who receive and payout funds and the accounting staff who carry out the accounting functions of the branch.

FUNCTIONS OF COMMERCIAL BANKS

Broadly speaking, commercial banks perform two main functions namely:- Receiving/Accepting deposits and Extension of credits to their customers.

Accepting Deposits

This function is important given that banks depend mainly on funds deposited with them by the banking public for their own operations. There are three main types of deposits namely: current or demand deposit; fixed or time deposit and savings deposit. Current or Demand Deposit can be withdrawn in part or in full at anytime by using a cheque. Fixed or Time Deposits are left with the bank for a given period of time until maturity. They attract higher interests than saving deposits and can only be withdrawn after due notice from the customer. Savings Deposit on the other hand can be withdrawn subject to certain limitations regarding the amount withdrawn or the frequency of withdrawal and it attracts lower interest when compared to fixed deposit. In actual fact, only a small percentage of savings is withdrawn at any particular time, but since withdrawals can and do take place, the bank has to keep a certain proportion of its assets in liquid form to be able to satisfy its customers demands.

Extension of Credit Facilities

In accepting deposits, commercial banks help mobilize the savings of the society and this then are made available to those who need these funds for investment purposes through overdrafts, term loans, discounting bills of exchange and promissory notes. Since banks deal in other people's funds it has to keep ready cash always to meet depositors demands. Therefore great care has to be exercised by the bank in the matter of lending and keeping reserves. The bank must strike a fine balance between liquidity and profitability because if it keeps its assets in too liquid a form it loses profit and if it over lends in order to make too much profit it may not be able to meet depositors demands. Therefore the distribution of a commercial bank's assets is determined by a balance between the needs of liquidity and profitability. It should be noted that the bank does not merely lend funds deposited with it by its clients but can itself create deposits and thus make advances considerably in excess of the sums deposited with it.

Discounting Bills

This practically speaking is lending for short periods. A merchant for instance who does not wish to lock up large funds in trade credits may draw a bill of exchange on his debtor and after it has been accepted by or on behalf of the debtor get it discounted by his bank. This gives the merchant immediate possession of the money due to him less a deduction for the loss of interest and for the commission of the bank. These bills are usually for three months and when they mature, the bank realizes the face value of the bills, thereby earning a profit as well as facilitating trade.

Other Functions of Commercial Banks

Apart from the two main functions mentioned above, commercial banks perform other functions which may broadly be grouped into two as agency services where commercial banks act as agents to their customers and general utility services. These include:-

Brokerage Services

Following the development and growth of the Nigerian financial market, commercial banks can and do render brokerage services to their customers. Here, the bank's brokers order for the purchase or sale of stock exchange securities for their customers. Also banks do make applications on behalf of their customers for allotments arising from new capital issues. This forms part of their agency services.

Transfer of Funds

Through the use of cheques commercial banks help their customers to transfer funds from one individual to another or from one area to another. Fund transfers could also be effected through Standing Orders, direct debiting of accounts and electronic transfers, including internet transfers.

Facilitating International Trade

Commercial banks facilitate international trade between countries by rendering financial services to their customers. Such services

like accepting bills for collection and granting documentary credits all help in facilitating international trade. The recognition of international trade has encouraged modern commercial banks to set up branches or departments specializing in the finance of foreign trade. With the help of banks affiliated to them in overseas countries, commercial banks are able to provide a comprehensive network of services for foreign banking business.

Safe-keeping of valuables
Commercial banks also render safe-keeping services to their customers. This is because the strong rooms of commercial banks are considered safe for such items as negotiable securities, jewellery, certificates of occupancy, life assurance policies, deeds of conveyance, wills and other documents of title that customers will like to deposit with their banks.

Night Safes
Most banks provide this service for their customers to keep their deposits after normal banking hours especially for those customers who handle large sums of money after banking hours.

Referee to their Customers
Another function of great value to banks and businessmen and women, is that of the bank acting as a referee as to the respectability and financial status of the customer.

COMMERCIAL BANK'S CREATION OF CREDIT

Creation of credit is one of the most peculiar functions of commercial banks and this is made possible because the public readily accepts claims on bank deposits (mainly cheques, credit and debit cards) in payment for goods and services. In addition, the law requires individual banks to hold only a fraction of the amount of deposits received from the public as cash reserves, thus freeing up more of the incoming funds for purposes of advancing loans.

When money is deposited in a bank some is kept in reserve and the rest is given out as loan, thereby increasing the money supply in the economy and this is known as "Credit Creation". This is possible because all depositors do not withdraw money at the same time. While some are depositing, others are withdrawing. The bank can therefore erect a vast superstructure of credit on the basis of a small cash reserve. In fact, it is the reserve ratio that determines the volume of credit created since it determines the value of the multiplier.

Actual Process of Credit Creation

To explain the process of credit creation we have to make some basic assumptions:-

1. There are several banks within the banking system.
2. There is no cash drain or leakage in the banking system.
3. There are enough bank customers willing to borrow as much as the banks are able and ready to lend.

Thus, if a customer deposits ₦10,000 with bank A and the statutory reserve is 20%, the banks keeps ₦2,000 in reserve and lends ₦8,000 to its customer. The customer uses the money to pay for merchandise or any other investment and again it is paid into bank B. Bank B keeps a reserve of ₦1,600 and lends out ₦6,400. This process continues until the money is exhausted and the total amount of credit created is as follows:-

1. Bank A Receives New Deposit	
Assets	**Liabilities**
Required reserves 2,000	Deposits 10,000
Cash 8,000	

2. Loan Made by Bank A	
Assets	**Liabilities**
Required reserves 2,000	Deposits 10,000
Loans 8,000	

3. Deposit of Loan Funds in Bank B	
Assets	**Liabilities**
Required reserves 1,600	Deposits from Bank A 8,000
Cash 6,400	

4. Loan Made by Bank B	
Assets	**Liabilities**
Required reserves 1,600	Deposits 8,000
Cash 6,400	

5. Deposit of Loan Funds in Bank C	
Assets	**Liabilities**
Required reserves 1,280	Deposits from Bank B 6,400
Cash 5,120	

6. Loan Made by Bank C	
Assets	**Liabilities**
Required reserves 1,280	Deposits 6,400
Loans 5,120	

By advancing loans whenever there are excess reserves, the banking system can generate a volume of deposits larger than the amount of the initial deposit received by Bank A. In this case a deposit of N10,000 with a statutory reserve of 20% creates a total sum of N50,000.

Transactions within the Banking System			
Name of Bank	Deposits Received (₦)	Loans Made (₦)	Required Reserves (₦)
A	10,000	8,000	2,000
B	8,000	6,400	1,600
C	6,400	5,120	1,280
D	5,120	4,100	1,020
-	-	-	-
-	-	-	-
Final amounts for all banks in the System	**50,000**	**40,000**	**10,000**

Since the reserve ratio determines the value of the multiplier, then if we know what the reserve ratio is, we can calculate the multiplier as follows:-

$$\text{Multiplier } K = \frac{1}{MPS} = \frac{1}{r}$$

Where MPS = Marginal Propensity to Save

r = reserve ratio

In the above example:-

$$K = \frac{1}{20\%} = \frac{1}{1/5}$$

$$K = 5$$

If the Multiplier is 5, then the multiplier effect is 5 x 10,000 (Initial Deposit)

$$= ₦50,000$$

Also given that MPS + MPC = 1

Then, MPS = 1 – MPC

$$K = \frac{1}{MPS} \qquad \frac{1}{1\text{-}MPC}$$

Where MPC = Marginal Propensity to Consume

Alternatively, the multiplier can be calculated if we know the amount of new deposit created, thus:-

$$\text{Multiplier (K)} = \frac{\text{Total amount of new deposit}}{\text{Original deposit}}$$

In the above example,

$$K = \frac{50.000}{10,000}$$

$$K = 5$$

COMMERCIAL BANKS' USES AND SOURCES OF FUNDS

Uses of Fund

The following are the important items seen on the asset side of the balance sheet of a commercial bank in order of liquidity.

Cash

This is the amount held in the vaults of each branch of the bank. It also includes cash reserves at the CBN and demand deposits with other banks. This is the most liquid of all assets. From the point of view of profitability, a banker is tempted to minimize his cash holdings, while from the point of view of liquidity he is tempted to maximize his cash holdings.

Money at call and short notice

This represents largely the amount lent to the discount market which is recoverable either on demand or on serving a short notice. It has an advantage over cash reserves since it is liquid because it is recoverable at short notice and it is also profitable because it earns interest.

Bills (discounted) of Exchange

This is considered as a highly liquid asset and is included among the money market assets. It is considered to liquidate itself automatically out of the sale of the goods covered by such a bill. Also it is readily shiftable to the Central Bank without much loss because of the very short nature of such a bill which is normally three months.

Investments

These include commercial banks investment in Stock Exchange Securities like government bonds and industrial securities. They help the banks to earn more than what they earn from "Money at call" and "Bills of exchange" although they are less liquid. Also the

banks give importance not only to the safety of the investment but also to the possibility of easy conversion into cash without loss.

Loans and Advances
These are the most profitable of a bank's assets because most bank earnings are derived from loans and advances. Commercial banks as a rule lend only for short-term commercial purposes, while long-term loans for investment purposes are provided by specialized agencies like Industrial or Investment banks. In giving out loans banks generally follow the cardinal principles of lending i.e. "Character", "Capacity" and "Capital" usually referred to as the 3Cs or the principles of "Reliability", "Responsibility" and "Resources" popularly known as the 3Rs.

Sources of Funds
Commercial banks sources of funds or liabilities include:-

Share Capital or Equity
This comprises the issued and paid-up capital as held by individual investors and organizations.

Statutory Reserves
These are the reserves maintained by commercial banks as required by law.

Undistributed profit
These include retained earnings, share premium account and general reserve.

Loan Capital or Debentures
These are medium–term bonds made to a bank at a fixed rate of interest and repayable over a fixed period of time. They are used to finance given capital projects.

Deposits
Customers deposits represent the largest liability on a bank's balance sheet.

PROFITABILITY AND LIQUIDITY

Commercial banks act as financial intermediaries between depositors of funds and investors. Thus while banks pay interest to depositors, they earn interests from their borrowers or investors, thereby making their profit. In order to perform this function of being an intermediary effectively, a Commercial bank has to strike a balance between being liquid and making profit. This is because the bank has to be liquid so as to meet up with its responsibility to its depositors, while on the other hand it has to have enough earning assets like loans and investments to be able to make enough profit. Liquid assets like vault cash are non-earning assets while others like call money, treasury bills and treasury certificates yield very low income. Therefore the distribution of a commercial bank's assets is determined by a balance between the needs of liquidity and profitability.

SUMMARY

Commercial bank activities are important as they help in the smooth functioning of many economies. Commercial banks in Nigeria operate the branch banking system characterized by a few large banks with very many branches. Broadly speaking commercial banks perform two main functions of Receiving or accepting deposits and extending credits to their customers. Besides these two functions however they also provide agency and general utility services. Also, Commercial banks perform the peculiar function of creating credit. In performing these functions however, Commercial banks have to always strike a balance between profitability and liquidity. This is because if they remain too liquid they may not make enough profit and if they aim at making much profit they may not be liquid enough to meet their obligations to their depositors.

REVIEW QUESTIONS

1. What are the advantages of the Branch Banking System?

2. What are the functions of a Commercial bank?
3. Explain the process of Credit Creation by Commercial banks.
4. Briefly explain the sources and uses of funds by Commercial banks.
5. How do commercial banks reconcile the conflicting aims of liquidity and profitability in their operations?

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CHAPTER 4

MERCHANT BANKING

INTRODUCTION

A merchant bank sometimes referred to as a wholesale bank engages in medium and long-term financing involving equipment leasing, debt factoring, investment management, issue and acceptance of bills and the management of unit trusts. Merchant banks known as Acceptance Houses in the United Kingdom and Investment banks in the United States of America have been in existence in the country since 1960 but were phased out following the introduction of universal banking with the banking guidelines issued by the Central Bank of Nigeria (*CBN*) in December 2000. A universal bank is a bank that engages in both commercial and merchant banking activities. However by 2010 the *CBN* repealed the universal banking guidelines and issued a guideline for merchant banking in Nigeria leading to the re-introduction of merchant banking in the Nigeria financial system.

FUNCTIONS OF MERCHANT BANKS

The basic rationale for the existence of merchant banks is the need to bridge the gap in the term structure of credit provided by commercial banks which tend to be short-ended. Therefore while commercial banks deal in off-the-peg or retail banking, merchant banks engage in made-to-measure or wholesale banking. Also, the sources and uses of funds of merchant banks differ remarkably from those of the commercial banks. While the commercial banks accept deposits from a wide variety of individuals and institutions both private and public, merchant banks apart from their own paid-

up capital, rely on other banks and institutional investors. Merchant banks specialize primarily in the provision of corporate finance services and banking services as well. These range from provision of term loans through rendering of foreign exchange services to equipment leasing, debt factoring, loan syndication and rendering of advisory services among others. In addition they also provide a number of other services through associated stockbroking/securities firms owned and managed by them.

FUNCTIONS OF MERCHANT BANKS

The functions of merchant bank include: deposits, loan and advances, acceptances, foreign exchange services, portfolio management, treasury management services, and equipment leasing.

Deposits

According to the 2010 ***CBN*** guideline merchant banks are permitted to take deposits from any natural or legal person in an amount not below the sum of ₦100 million per tranche, or such other minimum amount as may be prescribed by the ***CBN*** from time to time. In this wise, merchant banks are permitted to operate chequing accounts for their Corporate clients, but these deposit are used for interbank transactions. Call or fixed-term deposit accounts can also be operated for both corporate and non-corporate clients provided the sum being deposited is not less than ₦100 million. It should be noted that the sources of these deposits are institutional investors like pension funds and insurance companies.

Loans and advances

Merchant banks provide finance and credit facilities to non-retail customers. This is a very important function of merchant banks in the country. They provide loans and advances of medium and long-term nature to industry and commerce. Sometimes the size of the loan required is quite large such that an individual bank will not be able to provide it alone. In this situation, two or more banks may

come together as a syndicate to raise such a loan with a lead bank to manage the loan and this is referred to as loan syndication.

Acceptances
Merchant banks issue, discount and rediscount negotiable instruments. This acceptance function is used mostly to finance foreign trade.

Foreign Exchange Services
Merchant banks deal in foreign exchange and provide foreign exchange services subject to the requirements of the foreign exchange act. They are authorized by the Central Bank to provide foreign exchange services to their corporate clients which include such services as Correspondent banking which deals in the arrangement for the confirmation of lines for their client's letters of credit and also help in processing documents relating to foreign exchange allocation.

Portfolio Management
Merchant banks provide asset management services including fund and portfolio management services, act as a dealer of securities for its own account and for the account of its clients, or otherwise make or manage investments on behalf of clients. The services rendered here include arranging purchases and sales of securities as well as attending to registrations, rights and bonus issues.

Treasury Management Services
Merchant banks provide treasury management services including the provision of money market, fixed income and foreign exchange investment on behalf of their clients.

Equipment Leasing
Merchant banks render equipment leasing services to their clients. A lease is a contract between a Lessor and a Lessee for the hire of a specific asset from a manufacturer or vendor of such asset. The lessor retains ownership of the asset, while the lessee has

possession and use of the asset on payment of specified rental over a period. Leasing therefore is the hiring of an asset for the duration of its economic life. Leasing is suitable for costly assets and as such is attractive as a financing option to merchant bank clients.

Corporate finance services of merchant banks include among others:-

1. **Issuing House services**

These are services rendered by merchant banks to their clients wishing to raise funds from the capital market. In this regard merchant banks act as issuing house, or otherwise manage, arrange or co-ordinate the issuance of securities for or on behalf of any person subject to the provisions of ***BOFIA*** (Banks and Other Financial Institutions Act).

2. **Provide underwriting services**

As part of their issuing house services, merchant banks provide underwriting services with respect to equity issuance of securities subject to the provisions of ***BOFIA***.

3. **Advisory services**

Merchant banks provide financial, consultancy and advisory services to their clients for a fee. The advisory services could be in such areas as mergers, acquisitions, privatization and commercialization of public enterprises, and debt rescheduling among others. They also render investment advisory services to institutional funds managers and trustees of staff pension, endowment and unit trust funds in developing overall investment objectives and strategies.

4. **Engage in proprietary trading**

Merchant banks are allowed to engage in proprietary trading such as investing in debt instruments of any person and investing in equity or hybrid-equity instruments subject to the provisions of ***BOFIA***.

5. **Trading in fixed income securities**

Merchant banks are permitted to engage in the trading of fixed income securities where they are duly licensed to act as a primary dealer/market maker to trade in securities such as federal government bonds, treasury bills, treasury certificates and such other debt certificates as may be prescribed by the ***CBN*** from time to time.

6. Provide custodial services

7. Provide debt factoring services i.e. purchasing a company's debt at a discount; and

8. Such other activities as may be prescribed in writing by the ***CBN*** from time to time.

PROHIBITED ACTIVITIES OF MERCHANT BANKS

According to the Central Bank of Nigeria guidelines of 2010, no merchant bank shall be permitted to carry out the following business activities:-

1. Accept any deposit withdrawable by cheque.
2. Grant retail loans or engage in any form of retail banking.
3. Hold for more than six months any equity interest acquired in a company while managing an equity issue subject to the provisions of ***BOFIA***.
4. Provide insurance underwriting services, loss adjusting services, Re-insurance services and such other insurance related services; and
5. Any other business activities that may be restricted by the Central Bank of Nigeria from time to time.

MINIMUM STANDARDS FOR MERCHANT BANKS

These guidelines for merchant banks issued by the ***CBN*** in 2010 also prescribed the minimum standard for merchant banks as follows:-

1. To maintain a minimum paid-up capital of ₦15 billion or such other amount as may be prescribed by the ***CBN*** from time to time.

2. To comply with all prudential guidelines and regulations issued by the ***CBN*** on the required level of capital adequacy, liquidity and cash reserve.

3. To observe all applicable corporate governance standards as may be prescribed by the ***CBN*** and other financial service sector regulatory authorities in Nigeria.

4. To design, comply with and implement an internal central framework in accordance with the standard that the ***CBN*** may prescribe from time to time.

5. Through its board of directors report on the implementation and effectiveness of its internal control framework to the ***CBN*** within four months after the end of its financial year.

6. To design, comply with and implement a risk management framework which ensures that the merchant bank has an appropriate reporting structure, quality procedure and technology to effectively and adequately identify, measure, monitor and report risks to the ***CBN.***

7. Without prejudice to the standards prescribed from time to time by the Nigerian Accounting Standards Board, be required to maintain its book and financial statements in accordance with the ***IFRS*** (International Financial Reporting Standards) accounting standards, subject to the provision of section 28 of ***BOFIA***.

MERCHANT BANKS Vs COMMERCIAL BANKS

The structure and functions of merchant banks and commercial banks could be compared and contrasted as follows:-

1. Whereas merchant banks are known as wholesale bankers mobilizing deposits in large amounts from institutional depositors and lending in large amounts too to institutional investors, commercial banks are known as retail bankers mobilizing deposits in both small and large amounts from individuals and firms and lending in both small and large amounts to individuals and firms.

2. Merchant banks deal with a relatively small number of large accounts while commercial banks deal with a relatively large number of accounts.

3. Deposits with merchant banks are usually fixed and interest bearing while commercial bank deposits may be fixed or on demand with or without interest.

4. Merchant banks advance loans that are less of the overdraft type but more of term loans on long-term basis, whereas commercial bank loans are more of overdraft types on short term basis.

5. For merchant banks branch networks are less needed as their concentration is on industrial financial centres but for commercial banks branch networks are greatly needed as customers are widely spread.

6. Merchant bank customers are specialized and concentrated in given locations so their services are specialized too, but commercial bank customers are of various types and widespread and so their services are of more varied nature.

SUMMARY

Following the ***CBN'S*** merchant banking guidelines of 2010, merchant banking which was earlier phased out in the Nigerian

financial system was re-introduced into the system to carry on with their duties as wholesale bankers. The guidelines spelt out clearly the banking and corporate finance activities which merchant banks can undertake and those they are prohibited from participating in. Also the guideline contained the minimum standard required for the operation of a merchant bank. When compared with commercial banks, merchant banks operate as wholesale bankers that deal more with corporate entities as they give out loans on long-term basis while commercial banks operate as retail banks as they give out short-term loans that are more of overdraft types.

REVIEW QUESTIONS

1. Briefly describe the banking functions of a merchant bank.
2. What is equipment leasing?
3. What are the corporate finance services provided by a merchant?
4. What are the minimum standards expected for the efficient operation of a merchant bank?
5. Compare and contrast Merchant banks and Commercial banks.

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CHAPTER 5

MICROFINANCE BANKING

INTRODUCTION

Microfinance can be defined as a financial service rendered to the poor and low income clients. It could be seen as a developmental tool used to create access for the economically active poor to financial services at a sustainable and affordable price. In a broad sense Microfinance includes credit, savings, insurance, money transfers and all such financial services that the economically active poor need for their income-generating activities to build assets, to stabilize consumption and protect themselves against risks.

Recent studies have shown that microfinance has been of great help to poor households as they strive to meet their basic needs and protect themselves against risks. It has helped the poor to take advantage of economic opportunities to expand their business activities. Typically, microfinance clients are poor and low-income earners who are usually self-employed and household-based entrepreneurs involved in such micro-enterprises as distributive trades street vending, crafts manufacture and food processing. Microfinance could be distinguished from micro-credit in the sense that micro-credit refers to very small loans for unsalaried borrowers, while microfinance refers to micro-credit, savings, insurance, money transfers and other financial services targeted at the poor and low income earners.

MICROFINANCE INSTITUTIONS (MFI'S)

A Microfinance institution is an organization registered to provide microfinance services such as savings, loans and other financial

services. An ***MFI*** may therefore be defined as any organization that provides financial services to the poor such as Commercial banks, Credit Unions, Non-governmental financial organizations and credit cooperatives. Thus commercial banks which offer microfinance services may be referred to as *MFI's*, even though it is only a portion of their assets that may be committed to financial services to the poor and low income earners.

MICROFINANCE BANK (MFB)

A Microfinance Bank (***MFB***), unless otherwise stated shall be construed to mean any company licensed as defined by the regulatory and supervisory guidelines for Microfinance Banks in Nigeria to carry on the business of providing microfinance services, such as savings, loans, domestic funds transfer and other financial services that are needed by the economically active poor, micro, small and medium enterprises to conduct or expand their businesses. In December 2005, the Central Bank of Nigeria (***CBN***) introduced a microfinance policy framework to enhance the access of micro-entrepreneurs and low income households to financial services required to expand and modernize their operations to enable them contribute their own quota toward rapid economic growth. This policy framework was revised in April 2011 for effective operations of the Microfinance banks.

Prior to this, the Federal Government had in years past established other financial institutions designed to meet the credit needs of small borrowers who were unable to satisfy the stringent collateral requirements of commercial banks. Such other financial institutions included the Rural Banking System of 1977, Peoples Bank of Nigeria (***PBN***) of 1989 and Community Banks of 1992. Many Microfinance Banks in existence today in our Economy emerged from Community Banks. Also prior to the emergence of Microfinance banks and these other financial institutions, the people that were unserved or under-served by formal financial institutions usually found succour in Non Governmental Organization Microfinance Institutions (***NGO-MFIs***), money lenders, friends, relatives and credit unions like "Esusu" and

"Adashi". These informal sources of funds have helped to partially fill a critical void even though their activities were neither regulated nor supervised by the Central Bank of Nigeria.

Microfinance Bank Target Client

A Microfinance bank target client should include the economically active low-income earners, low income households, the un-banked and under-served people, particularly vulnerable groups such as women, physically challenged, youths, micro-entrepreneurs, informal sector operators, subsistence farmers both in urban and rural areas.

Microfinance Bank Loan

A Microfinance loan is granted to the operators of micro-enterprises such as peasant farmers, artisans, fishermen, youths, women, senior citizens and non-salaried workers in the formal and informal sectors. The loans are usually unsecured, but typically granted on the basis of the applicant's character and the combined cash flow of the business and household. The tenure of microfinance loans is usually 180 days (6 months). Tenures longer than six months are treated as special cases. In the case of agriculture, or projects with longer maturity period, a minimum tenure of twelve months is allowed and in housing microfmance, a longer tenure of twenty four months is permissible.

In terms of amount, the maximum principal amount of a microfinance loan shall not exceed ₦500,000.00 or one percent of the shareholders fund unimpaired by losses and/or as may be reviewed by the *CBN* from time to time. Microfinance loans may also require joint and several guarantees of one or more persons. The repayment may be on a daily, weekly, bi-monthly, monthly basis or in accordance with amortization schedule in the loan contract.

MICRO-ENTERPRISE

A micro-enterprise is a business that operates with very small start-up capital. The management is often built around the sole owner or

micro-entrepreneur. It provides employment for few people mainly the immediate family members and does not often require formal registration to start. The management and accounting requirements of the business are usually very simple and flexible. Generally, micro entrepreneurs work informally, without business licenses or formal records of theirs activities or earnings. The scope of economic activities of micro-enterprises typically includes primary production and crafts, value added processing, distributive trades and diverse services.

RATIONALE FOR THE ESTABLISHMENT OF MICROFINANCE BANKS (MFBs) IN NIGERIA

From the appraisal of microfinance oriented institutions in Nigeria between 1960 and 2004 (including the "Community Banking System" era) by the inter-departmental committee, designated as the Microfinance Policy and Programme Development Committee (*MPPDC*) in collaboration with the world bank, the following factors were unearthed as justifications for the establishment of Microfinance banks in Nigeria.

Easier Access to Financial Services for the Economically Active Poor

In most cases the economically active poor have limited access to formal financial services including credit, savings and insurance. They instead rely on a number of informal credit relationships with moneylenders, relatives and friends. They also indulge in a number of informal saving methods like participating in rotating savings associations or they keep their savings at home. These options are not reliable and therefore there was the need for the establishment of Microfinance Banks that they can rely on for efficient provision of such formal financial services.

Weak Institutional Capacity

Many of the Community banks that were in operation prior to the establishment of Microfinance banks performed sub-optimally due to incompetent management, poor corporate governance, weak

internal controls, lack of deposit insurance schemes, restrictive regulatory and supervisory requirements among others, thereby creating one of the reasons to disband them and establish Microfinance banks.

Weak Capital Base

The capital base of existing microfinance institutions were quite weak and could not adequately provide cushion for the risk of lending to micro clients. There was the need therefore to establish Microfinance banks with stronger capital bases.

Existence of Huge Un-served Market

The size of the un-served market by the existing financial institutions is large. By 2008, a survey by Enhancing Financial Innovation and Access (*EFInA)* estimated that about 79 percent of the total population in Nigeria is unbanked out of which 86 percent are rural dwellers. Also in 2005, the aggregate in micro-credit facilities in Nigeria accounted for about 0.2 percent of Gross Domestic Product (*GDP*) and less than one percent of total credit to the economy. This showed the existence of a huge gap in the provision of financial services to a large number of the economically active poor and low income households. The resultant effect of not addressing this situation properly will be the increase in poverty level and slowing down of economic growth and development. Therefore, there was the need to close this gap through the establishment of microfinance banks.

Employment Generation and Poverty Reduction

In all economic systems, micro, small and medium scale enterprises are known to contribute to poverty alleviation through their employment generating potentials. However in Nigeria, the employment generating potentials of the small scale enterprises have been hampered by lack of access to finance. To increase their ability to generate employment and reduce poverty will require

multiple channels of financial services which an improved system of microfinance banks can provide.

The Need for Increased Saving Opportunity

Contrary to generally held notions, poor people can and do save. However, their savings have continued to grow at a very low rate due to the inadequacy of appropriate savings opportunity and products especially in the rural areas. Microfinance banks therefore provide windows of opportunity and promote the development of appropriate savings products that are attractive to rural dwellers thereby improving the savings level in the economy.

Urban Bias in Banking Services in Nigeria

Most of the existing commercial banks in the country are located in urban centres and several attempts in the past by the ***CBN*** to encourage them to open branches in the rural areas did not yield satisfactory results. With a large proportion of the Nigerian population still living and operating their business ventures in the rural areas, it has become imperative for government to develop a financial institutional framework that will cater for their financial needs, hence the establishment of microfinance banks.

Interest of Local and International Investors in Microfinance Banks

Many local and International investors have expressed interest in investing in the country's microfinance sub-sector. Therefore, the establishment of microfinance banks in the country provides an opportunity for them to participate in financing the economic activities of low income households and the economically active poor that the microfinance sub-sector caters for.

STRUCTURE AND FUNCTIONS OF MICROFINANCE

In December 2005 the Central Bank of Nigeria introduced a microfinance policy framework to enhance the access of micro-entrepreneurs and low income households to financial services required to expand and modernize their operations to enable them contribute their own quota towards a rapid economic growth. Microfinance services refer to loan, deposits, insurance, fund transfer and other ancillary non-financial products targeted at low income customers. Three features distinguish Microfinance from other formal financial products namely: (1) smallness of loans and savings; (2) absence or reduced emphasis on collateral; and (3) simplicity of operations.

Before the emergence of Microfinance Banks under the Microfinance policy, Community banks were in existence and were mainly targeted at the low income earners to help sort out their financial problems but they encountered a lot of problems that resulted in many of them being distressed.

MICROFINANCE POLICY OBJECTIVES

The Microfinance Policy provides a platform to achieve the following specific objectives:

1. Provision of timely, diversified, affordable and dependable financial services to the economically active poor.

2. Creation of employment opportunities and increase the productivity and household income of the active poor in the country thereby enhancing their standard of living.

3. Promotion of synergy and mainstreaming of the informal Microfinance sub-sector in the formal financial system.

4. Enhancement of service delivery to micro, small and medium enterprises.

5. Mobilization of savings for intermediation and rural transformation.

6. Promotion of linkage programmes between Microfinance institutions, Deposit Money banks, Development Finance Institutions and specialized funding institutions.

7. Provision of dependable avenues for the administration of the micro credit programmes of government and high net worth individuals on a non-recourse basis and,

8. Promotion of a platform for microfinance service providers to network and exchange views and share experience

Policy Targets

Based on the objectives listed above, the targets of the microfinance policy are:

1. To increase access to financial services of the economically active poor by ten percent (10%) annually.

2. To increase the share of microcredit as percentage of total credit to the economy from 0.9% in 2005 to at least 20% in 2020 , and the share of microcredit as percentage of ***GDP*** from 0.2% in 2005 to at least 5% in 2020.

3. To ensure the participation of all states as well as at least two-thirds of all the Local Government Areas in Microfinance activities by 2015 and,

4. To eliminate gender disparity by ensuring that women's access to financial services increase by 15% annually.

DISTRESS IN MICROFINANCE BANKS

The Central Bank of Nigeria in 2010 revoked the licenses of 224 Microfinance banks out of the 820 in existence in the country for

according to the *CBN*, a significant number of Microfinance banks were deficient in their understanding of the Microfinance concept and the methodology for the delivery of microfinance services to the targeted groups. Many of them lost focus and were competing with regular commercial banks for customers and deposits, leaving the target market unattended.

According to the *CBN*, the factors that contributed to the unsoundness of the microfinance banks include:

1. High level of non performing loans resulting in high portfolio being at risk which had impaired their capital and gross under-capitalization in relation to the level of operation.

2. Poor corporate governance and incompetent boards, high level of non-performing insider related credit and other forms of insider abuse.

3. Heavy investments in the capital market with the resultant diminution in value of the investment after the melt down in the capital market.

Following this distress the *CBN* in 2011 reviewed the Microfinance banks policy. Under the new guidelines, the Microfinance banks would now operate under three categories which include Unit, State and National Microfinance Banks.

OWNERSHIP REQUIREMENTS

According to the 2005 *CBN's* regulatory and supervisory guidelines for microfinance banks in Nigeria as revised in 2012, a microfinance bank may be established by individuals, group of individuals, Community Development Associations, Private corporate entities and foreign investors. No individual, group of individuals, their proxies or corporate entities and/or their subsidiaries shall own controlling interest in more than one *MFB*,

except as approved by the ***CBN***. Also any Bank holding company that intends to set up any category of microfinance bank as subsidiaries shall be required to meet the prescribed capital and other requirement stipulated in the ***CBN's*** guidelines.

CATEGORIES OF MICROFINANCE BANKS

The three (3) categories of Microfinance Banks are as follows:-

Category 1: Unit Microfinance Bank

A Unit Microfinance bank is authorized to operate in one location. It shall be required to have a minimum paid-up capital of Twenty Million Naira (₦20m) and is prohibited from having branches and/or cash centres.

Category 2: State Microfinance Bank

A State Microfinance bank is authorized to operate in one state of the federation or the Federal Capital Territory (***FCT***). It shall be required to have a minimum paid-up capital of One Hundred Million Naira (₦100m) and is allowed to open branches within the same state or the ***FCT***, subject to prior written approval of the ***CBN*** for each new branch or cash centre.

Category 3: National Microfinance Bank

A National Microfinance Bank is authorized to operate in more than one state including the ***FCT***. It shall be required to have a minimum paid-up capital of Two Billion Naira (₦2bn), and is allowed to open branches in all states of the federation and the FCT subject to prior written approval of the ***CBN*** for each new branch or cash centres. Note that the prescribed minimum requirement for each category of Microfinance bank is not static and so may be reviewed from time to time by the Central Bank of Nigeria.

TRANSFORMATION PATH

A Unit Microfinance Bank that wishes to transform to a State Microfinance Bank shall be required to surrender its license and obtain a State ***MFB*** license, subject to fulfilling stipulated

requirements. A State ***MFB*** that wishes to transform to a National ***MFB*** must have at least five branches which are spread across the Local Government areas in the state of its original operation. This is to ensure that the ***MFB*** has gained the experience necessary to manage a National ***MFB***. It shall also be required to surrender its State ***MFB*** license and fulfill other stipulated requirements for a National ***MFB*** license. Note that no new promoter shall be allowed to apply directly for a National Microfinance Bank license. This means that a National Microfinance Bank shall emerge through organic growth from a State Microfinance Bank.

Transformation of other Institutions into Microfinance Banks (MFBs)

Any financial institution under the supervision of the Central Bank of Nigeria that intends to transform into Microfinance Bank shall apply to the ***CBN*** and ensure that the licensing requirements for microfinance banks are met.

1 **Deposit Money Banks (*DMBs*)**

A Deposit Money Bank wishing to engage in microfinance services could continue to do so through a designated department or unit and/or offer microfinance as a financial product. The department or unit shall be headed by a staff of not less than a Deputy General Manager or its equivalent and must meet the certification condition specified by the ***CBN***.

Any Deposit Money Bank that provides microfinance services as an activity or product shall be required to submit separate returns of its microfinance portfolio aside from its other lending activities as stipulated by the ***CBN*** guidelines.

2. **Financial Holding Companies**

A Financial Holding Company which has a Deposit Money Bank as a subsidiary may also invest in or own Microfinance Bank. For this to happen, the microfinance subsidiary of such a Holding Company shall be required to have:-

a. Qualified and experienced management team that have completed the mandatory certification programme.

b. Internal control, procedure and manuals of operations specifically designed for microfinance.

c. Management Information System (*MIS*) and loan tracking mechanism.

d. Dedicated unit at branch level that is equipped for deposit mobilization and credit monitoring.

e. Reporting formats and policy for income recognition for *MFBs* i.e. loan loss provision.

f. Any other condition that the CBN may specify from time to time.

3. **Non Governmental Organization Microfinance Institutions (*NGO-MFIs*)**

The *CBN* guidelines recognize the existence of credit-only, membership-based microfinance institutions, which are not required to come under the regulatory and supervisory purview of the *CBN* but are however, supervised by the appropriate Ministry. Such institutions shall engage in the provision of micro-credit to their targeted population but shall not mobilize deposits from the general public. Registered *NGO-MFIs* shall be required to forward periodic returns of their activities to the *CBN* primarily for statistical purposes.

4. **Community Banks**

All Community banks licensed prior to the approval of the *CBN's* regulatory and supervisory guidelines shall transform to Microfinance Banks on meeting the prescribed new capital and other conversion requirements within a period of 24 months from the date of approval of the guidelines. Any Community bank that fails to meet the new capital requirement within the stipulated period shall cease to operate as a Community bank.

PRUDENTIAL GUIDELINES OR REQUIREMENTS FOR MICROFINANCE BANKS IN NIGERIA

A). According to the regulatory and supervisory guidelines of the Central Bank of Nigeria, every microfinance bank shall comply with the following requirements:-

Compulsory Investment in Treasury Bills

All Microfinance Banks shall be required to maintain not less than 5% of their deposits in treasury bills, non-compliance shall attract a fine of 1% of the amount not invested. Investment in treasury bills by any ***MFB*** shall however, not exceed 10% of its deposits at any point in time.

Liquidity Ratio

The operation of an ***MFB*** requires the maintenance of liquid assets to meet frequent requests for funds from clients and for field operations. Every ***MFB*** shall be required to maintain a minimum ratio of 20% of its deposit liabilities in liquid assets, including the 5% compulsory investment in treasury bills.

Capital Funds Adequacy

The capital adequacy ratio of an ***MFB*** shall be measured as a percentage of the shareholders' funds unimpaired by losses to its weighted assets. The minimum capital adequacy ratio for ***MFBs*** shall be 10 percent. Also every ***MFB*** is expected to maintain a ratio of not more than 1:10 for its shareholders fund unimpaired by losses to the net credits.

Limit of Investment in Fixed Assets

The maximum amount which an ***MFB*** can invest in fixed assets is 20% of its shareholders' funds unimpaired by losses. This ratio must be maintained at all times. Any contravention shall attract a penalty of 1% of the excess investment in fixed assets and prohibition of further investment in fixed assets until the requirement is met.

Revaluation of Fixed Assets
All *MFBs* must obtain prior approval of the *CBN* before the recognition of the revaluation surplus on fixed assets in their books

Fixed/Long-Term Investment & Branch Expansion
No *MFB* shall be allowed to finance any of the following other than from the shareholders' funds unimpaired by losses: acquisition of fixed assets, equity Investments in permissible activities and investments in long-term debentures subject to *CBN's* approval in writing; and branch expansion

Maintenance of Capital Funds
MFBs are generally expected to pay less emphasis on collaterals in granting credits. The impact of delinquent risk assets which may result in capital erosion, calls for stringent maintenance of capital funds. Every *MFB* shall therefore maintain a reserve fund into which it shall transfer from its profit after tax for each year (before dividend) subject to certain provision from the *CBN* etc.

Restrictions on Declaration of Dividend
An *MFB* shall not declare or pay dividends on its shares until it has satisfied the following requirements:-

1. Completely written-off all its preliminary and pre-operational expenses.

2. Made the required provisions for non-performing loans and other erosions in asset values.

3. Satisfied the minimum capital adequacy ratio requirement.

4. Met all matured obligations.
   Where the payment of dividend would result in withdrawal of any part of the free reserves due to inadequacy of the profit for the year or where the statutory report of the auditors on the annual accounts of the bank is not

satisfactory, the ***MFB*** may declare any dividends on its shares, only after obtaining the prior approval of the ***CBN***.

Where an ***MFB*** declares or pays any dividend in contravention of the above mentioned provisions, the Directors and the Chief Executive Officer shall be liable to a penalty of 10% of the gross dividend paid and such other sanctions as may be deemed appropriate by the ***CBN***.

Limit of Lending to a Single Borrower & Related Party

The maximum loan by an ***MFB*** to any individual borrower, Director or related borrowers shall not exceed 1%, and in the case of group borrowers, a maximum of 5% of the ***MFB's*** Shareholders' funds unimpaired by losses or as may be prescribed by the ***CBN*** from time to time. In addition, aggregate insider-related lending at any time shall not exceed 5% of its shareholders' funds unimpaired by losses. For this purpose, loans under a staff scheme shall not apply, but shall be in accordance with the staff conditions of service. Any contravention will attract a penalty of ₦250,000.00 on the ***MFB*** and a letter of warning to the Managing Director, subsequent defaults will be a ground for the removal from office of the affected officers.

Loan Portfolio Composition

The value of the loan portfolio of an ***MFB*** shall at all times, be a minimum of 80% for micro loans and a maximum of 20% for small and medium enterprises (***SME's***).

Maximum Equity Investment Holding Ratio

The aggregate value of the equity participation of an ***MFB*** in all permissible enterprises shall not exceed 7.5% of its shareholders' funds unimpaired by losses.

Provision for Classified Assets

All performing risk assets by the ***MFBs*** shall attract 1% general provision. Provision for performing and non-performing risk assets and other assets shall be as stated hereunder:-

S/No	Days at Risk (No. of Days Missed Payment)	Description	Provision Requirement or Allowance for Probable Loss (%)
1.	0	Performing	1
2.	1-30 days	Pass and watch	5
3.	31 – 60 days	Substandard	20
4.	61 – 90 days	Doubtful	50
5.	91 or more days & for restructured loans	Lost	100

All ***MFBs*** shall be required to review their loans and advances and other assets at least once every thirty days and make appropriate provisions. As part of its monthly returns, every ***MFB*** shall send a schedule of loans/investments showing the provisions made for losses or deterioration in the quality of its risk assets to the ***CBN***.

Portfolio- at-Risk (PAR)

This is the outstanding amount of all loans that have at least one installment past due for one or more days. The amount includes the unpaid principal balance but excludes the accrued interest. Under ***PAR*** loans are considered past due if payment has fallen due and remained unpaid. Loan repayment shall apply first to any interest and then to any installment of principal that is due but unpaid beginning with the earliest installment. The number of days of lateness is based on the due date of the earliest loan installment that has not been fully paid.

1. **Limit**

It shall be required that PAR shall not exceed 5% at any given time for an ***MFB***.

2. **Past Due Microfinance Loans**

This is any loan which repayment is past due for at least one day in accordance with the agreed repayment term in the loan contract.

Such loans whether restructured or refinanced shall attract appropriate provision for loan loss. The past due microfinance loans shall remain in the account of the ***MFB*** until it is fully repaid or written off.

3. **Accrual of Interest Earned**

No accrual of interest to the income statement shall be allowed after the microfinance loan has become past due. Interest accrued shall not be recognized as income after the microfinance loan had become past due, rather it should be transferred to the interest-in-suspense account. All interests already accrued and/or backed shall be reversed from income and the accrued interest transferred to interest-in-suspense account.

4. **Restructured Microfinance Loans**

These represent microfinance loans that have been renegotiated or modified to either lengthen or postpone the original scheduled installment payments, or substantially alter the original terms of the loans. Restructured loans which shall include refinanced loans shall be treated as non-performing and the interest thereon shall be transferred to the interest-in-suspense account. No microfinance loan shall be restructured more than 2 times.

5. **Writing-Off of Microfinance Loans as Bad Debts**

Microfinance loans that have been fully provided for except director-related facilities may be written off in accordance with the ***MFBs'*** policy and communicated to the ***CBN***. Director-related facilities shall require prior approval of the ***CBN*** before such can be written off as bad debts.

Special Prudential Standards

Apart from the above mentioned prudential guidelines there are other Special Prudential Standards that ***MFBs'*** should comply with. Thus the following traditional banking requirements shall be adjusted from time to time at the discretion of the ***CBN*** to accommodate the peculiarities of microfinance:-

Unsecured Lending Limits
In accordance with the provisions of ***BOFIA*** section 20(2)(a), any unsecured advances or loans or credit facilities of an aggregate amount to an individual in excess of Fifty Thousand Naira (₦50,000.00) is not permitted. For the purpose of applying this regulation to Microfinance loans of ***MFBs***, group guarantees or third party guarantees of an individual acceptable to the ***MFB*** shall qualify as collateral.

Loan Documentation Requirement
Given the nature of Microfinance loan sizes and customers collateral registration, financial statements of borrowers or evidence that those businesses are formally registered shall not be required.

Restriction of Co-Signers as Borrowers
The restriction prohibiting a commercial bank from lending to someone who has co-signed or otherwise guaranteed a loan from the same bank shall not apply to group lending of an ***MFB.***

Cash Reserve Requirements
The mandatory cash reserve requirement for Deposit Money Bankers shall not apply to an ***MFB***; rather an ***MFB*** shall be required to have compulsory investment of 5% of its deposit liabilities in treasury bills which shall qualify as specified liquid asset in computation of its liquidity ratio.

Permissible and Prohibitive Activities of Microfinance Banks
According to the ***CBN's*** Regulatory and Supervisory Guidelines for Microfinance Banks there are quite a number of activities that Microfinance Banks are permitted to engage in and those they are prohibited from engaging in, these include:-

1) **Permissible Activities**

a) Acceptance of various types of deposit including savings, time, target and demand deposits from individuals, groups and associations except public sector deposits (Government).

b) Provision of credit to its customers, including formal and informal self-help groups, individuals and associations.

c) Promotion and monitoring of loan usage among its customers by providing ancillary capacity building in areas such as record keeping and small business management.

d) Issuance of redeemable debentures to interested parties to raise funds from members of the public with the prior approval of the ***CBN***.

e) Collection of money or proceeds of banking instruments on behalf of its customers including clearing of cheques through corresponding banks.

f) Act as agent for the provision of mobile banking and micro insurance services to its clients.

g) Provision of payment services such as salary, gratuity, pension for employees of the various tiers of government.

h) Provision of loan disbursement services for the delivery of the credit programme of government, agencies, groups and individuals for poverty alleviation on non-recourse loans.

i) Provision of ancillary banking services to its customers such as domestic remittance of funds and safe custody.

j) Maintenance and operation of various types of account with other banks in Nigeria.

k) Investment of its surplus funds in suitable instruments including placing such funds with corresponding banks and in Treasury bills.

l) Payment and receipt of interests as may be agreed upon between the ***MFB*** and its clients in accordance with existing guidelines.

m) Operation of micro leasing facilities, microfinance related hire purchase and arrangement of consortium lending as well as supervision of credit schemes to ensure access of Microfinance customers to inputs for their economic activities.

n) Receiving of refinancing or other funds from ***CBN*** and other sources, private or public, on terms mutually acceptable to both the provider of the funds and the recipient *MFB*.

o) Provision of microfinance related guarantees for its customers to enable them have better access to credit and other sources.

p) Buying, selling and supplying industrial and agricultural inputs, livestock, machinery and industrial raw materials to low-income persons on credit and to act as agent for any association for the sale of such goods or livestock.

q) Investment in shares or equity of a body corporate, the objective of which is to provide microfinance services to low-income persons.

r) Investment in cottage industries and income generating projects for low-income persons as may be prescribed by the ***CBN***.

s) Provision of services and facilities to customers to hedge various risks relating to microfinance activities.

t) Provision of professional advice to low-income persons regarding investments in small businesses, rendering managerial, marketing, technical and administrative advice to customers and assisting them in obtaining services in such fields.

u) Mobilize and provide financial and technical assistance and training to micro-entrepreneurs.

v) Provisions of loans to microfinance clients for home improvement, housing and consumer credits.

w) Performance of non-banking functions that relate to microfinance business development services such as co-operatives and group formation activities, rural industrialization and other support services needed by micro enterprises. Note that no ***MFB*** shall undertake business other than those permitted as stated above or such activities as may be prescribed by the ***CBN*** from time to time.

2) **Prohibited Activities**

Specifically no ***MFB*** shall engage in the provision of the following services:-

a) Acceptance of public sector (government) deposits except for the permissible activities as highlighted in g and h above.
b) Foreign exchange transactions.
c) International commercial papers
d) International corporate finance.
e) International electronic funds transfer.
f) Clearing house activities.
g) Collection of third party cheques and other instruments for the purpose of clearing through correspondent banks.
h) Dealing in land for speculative purposes.
i) Dealing in real estate except for its use as office accommodation.
j) Provision of any facility for speculative purposes.
k) Leasing, renting, and sale/purchase of any kind with its directors, officers, employees or persons who either individually or in concert with their family members and beneficiaries own 5% or more of the equity of the ***MFB***, without the prior approval in writing of the ***CBN***.

l) Financing of any illegal/prohibited activities such as gambling, drug-activities and firearms.
Note that the contravention of these regulations constitutes a ground for the revocation of the Microfinance Bank license.

Funding, Accounting and Related Matters

i) Sources of Funds
The sources of funds of a microfinance bank shall consist of the following:-

a) Shareholder's funds, paid-up shares capital and reserves.
b) Deposits/Savings of customers.
c) Debenture/Qualifying medium to long term loans.
d) Grants/Donations from individuals, organization, various tiers of government, and commercial funding from international sources with prior ***CBN's*** approval of the draft Memorandum of Understanding (***MOU***).
e) Fees and commissions; and
f) Interest income.

ii) Books of Accounts

a) The board of directors of a microfinance bank shall ensure that the institution keeps proper books of account with respect to all transactions at the principal administrative office and in all its branches in English Language only.

b) A proper book of accounts shall contain all information necessary to explain all transactions and give a true and fair view of the state of the affairs of the ***MFB*** and be presented in compliance with the Nigerian Generally Accepted Accounting Principle (***GAAP***) and accounting standards issued by the Financial Reporting Council (***FRC***). Every ***MFB***

must also comply with the transition roadmap for the adoption of the International Financial Reporting Standards (***IFRS***).

c) Where the books of accounts are not properly kept, the ***CBN*** shall penalize the ***MFB*** in accordance with the provision of Section 24(5) of ***BOFIA***, 1991 (as amended). Note: ***BOFIA*** means Banks and Other Financial Institutions Act.

d) If any person being a director, manager or officer of an ***MFB*** fails to take all necessary/reasonable steps to secure compliance with any of the above provisions, he or she shall be appropriately sanctioned in line with the provisions of the regulatory and supervisory guidelines.

iii) Rendition of Accounts

The following monthly returns shall be submitted by all ***MFBs***:-

a) Statement of Assets and Liabilities
b) Profit and Loss Account.
c) Schedule of Loans and Investment on sector basis (number and value).
d) Schedule of liabilities (deposits) on maturity basis (number and value).
e) Interest rate structure.
f) Schedule of balances held with banks and other financial institutions.
g) Returns on:-
   - Borrowings from other ***MFBs***, other financial institutions, individuals and non-financial institutions.
   - Credits to other ***MFBs***, other financial institutions, individuals/non-financial institutions, shareholders and affiliates.

- Credit to Directors, Management Staff and related parties.
- Non-performing credits.
- Off balance sheet engagements.
- Non-performing other assets; and
- Other items as may be specified by the ***CBN***.

All monthly returns must reach the Directors of Financial Policy and Regulation Department (***FPRD***) of the ***CBN*** and Special Insured Institutions Department (***SIID***) of the Nigeria Deposit Insurance Corporation (***NDIC***) not later than 14 days after the end of each month. The frequency of the returns may be reviewed from time to time by the ***CBN***. Deposit money banks currently engaging in microfinance services either as an activity or product shall be required to submit the returns on their microfinance activities separately.

iv) Compliance with Money Laundering (Prohibition) Act 2011, Terrorism (Prevention) Act 2011 and Know Your Customer (***KYC***) Circulars

Every ***MFB*** shall be required to comply with the Money Laundering (Prohibition) Act 2011, Terrorism (Prevention) Act 2011, the principles and procedures of Know Your Customer (***KYC***) and relevant circulars as issued by the ***CBN*** from time to time.

v) Publication of Audited Financial Statements – Procedures and Publication.

Every ***MFB*** shall submit its audited financial statements and the abridged version of the accounts to the Director, Other Financial Institutions Supervision Department (***OFISD***) for approval not later than four months after the end of the Company's financial year. The domestic report on the accounts from the external auditors shall be forwarded to the director, ***OFISD*** not later than three

months after the end of the accounting year. After approval by the ***CBN***, the ***MFB*** shall be required to display the abridged version of the audited financial statements in a conspicuous place at its head office and all its branches.

Any ***MFB*** that fails to comply with the above requirements shall be liable to a fine of ₦5,000.00 for each day during which the offence continues and instant display of the abridged audited accounts.

Penalties for Late/False/Inaccurate Accounts, Returns and Other False/Inaccurate Information

a) For lateness in submitting its audited annual accounts, returns or any other information as may be required by the ***CBN***, the penalty shall be a fine of ₦5,000.00 for each day during which such infraction occurs. Subsequent failure/refusal to render returns in the prescribed format shall be ground for the revocation of an ***MFB*** license. For submitting any false or inaccurate information to the ***CBN***, the penalty shall be a fine of ₦250,000.00 and a warning letter to the Managing Director of the ***MFB***. Subsequent rendition of false or inaccurate returns/information shall lead to the removal of the Managing Director. Persistent failure to render returns for a continuous period of 6 months in a calendar year shall be a ground for revocation of an ***MFB's*** license.

b) Where the ***CBN*** considers it necessary, it may appoint a firm of qualified accountants to prepare proper books of account or render accurate returns, as the case may be, for the ***MFB*** concerned. The cost of preparing the accounts or rendering the returns shall be borne by the ***MFB***.

c) If any director or officer of an ***MFB*** fails to take all reasonable steps to ensure that proper books of accounts are kept with respect to all transactions by the company at its

head office and/or at its branches, the ***CBN*** shall impose a fine of not less than ₦100,000.00 on the bank. In addition, a warning letter shall be served on the managing director of the affected bank. If any default in this respect is caused by the willful act of any director or officer of the ***MFB***, such director or officer shall be removed from office and blacklisted in order to protect the integrity of the financial system. In addition, the bank may impose on the ***MFB*** such other penalties as are deemed appropriate.

d) Where it is established that a director or an officer of an ***MFB*** provided false information to a third party, such director or officer shall be removed from office and blacklisted.

PROCEDURE FOR REVOCATION OF THE LICENSE OF AN MFB

1) The license granted to an ***MFB*** to operate may be revoked on any or all of the following grounds:-

a) Submission of false information/data during and/or after the processing of the application of license.
b) The use of proxies or disguised names to obtain a license to operate as an ***MFB***.
c) Engaging in functions/activities outside the permissible scope of its license as indicated in the prohibited activities earlier mentioned.
d) Persistent failure to comply with request for information/data in the form required/specified by the ***CBN***.
e) Engaging in activities prejudicial to Nigerian economy.
f) Failure to redeem matured obligations to customers.
g) Failure to render statutory monthly returns for a continuous period of 6 months or for a cumulative period of 6 months in a financial year.
h) Unauthorized shop closure.
i) Failure to comply with any directive issued by the ***CBN***.

j) Engaging in prohibited activities as listed in the ***CBN's*** guidelines.

k) Technical insolvency i.e. where an ***MFB's*** assets are insufficient to cover its liabilities.

l) Such other conditions applicable to banks and other financial institutions which constitute a ground revocation of license under ***BOFIA*** 1991 as amended.

m) Any other act which in the opinion of the ***CBN*** constitute a violation or a serious default.

2) Exit Conditions

The condition for exit of a licensed ***MFB*** shall be as prescribed by the relevant sections of ***BOFIA*** 1991 (as amended) as applicable to deposit taking financial institutions and the Companies and Allied Matters Act (***CAMA***) 1990.

Table 5.1: **Minimum Operational Template for Microfinance Banks in Nigeria as Recommended by the CBN**

MEASURES	ITEM	RECOMMENDED STANDARD FOR MFBs
Capital	Capital Adequacy ratio	10% minimum (S.8.1.3a of the Revised Guidelines)
	Adjusted capital to Net credits ratio	1:10 maximum (S.8.1.3a of the Revised Guidelines)
	Maintenance of capital funds	S.8.1.7 of the Revised Guidelines
	Maximum investments in Fixed Assets	20% of Shareholders' Funds unimpaired by losses (SHF) S.8.1.4 of the Revised Guidelines
	Maximum Equity Investment Holding ratio	≤ 7.5% of SHF (S.8.1.11 of the Revised Guidelines)
Asset	Maximum amount per micro loan	N500,000.00 or 1% of SHF (S.1.2.4 of the Revised Guidelines)
	Micro loans as a percentage of total loans	80% (S.8.1.10 of the Revised Guidelines)
	Portfolio at Risk (PAR)	≤ 5% (S.8.3 of the Revised Guidelines)
	Net loan portfolio as a	60% minimum

	percentage of total assets	
	Growth in outreach	> 20% annually
	Maximum aggregate insider related lending	≤ 5% of SHF (S.8.1.9b of the Revised Guidelines)
	Single obligor limit (Individual lending)	≤ 1% of SHF (S.8.1.9b of the Revised Guidelines)
	Single obligor limit (Group lending including cooperatives and corporate bodies)	≤ 5% of SHF (S.8.1.9b of the Revised Guidelines)
	Savings as a percentage of total deposits	60% minimum
	Percentage loans to deposits	80%
	Loan portfolio profitability (Group lending)	> 10%
	Loan Officer Productivity/Case Load (No. of active clients per Loan Officer)	25 - 300
	Provision for classified accounts	S.8.1.2 of the Revised Guidelines
	Adequacy of loan loss provisioning	100%
	Risk Management Framework (RMF)	RMF should be in place and operational
Management (Corporate, Government & Credit Administration)	Frequency of board meetings (minimum)	At least once per quarter
	Minimum Board Committees	Audit: Credit and Risk Management; and Finance & General purpose
	Minimum number of Unit Heads	Operations; Credit & Marketing; Finance & Admin.; and Internal Audit
	Minimum management committees	Finance & Admin.; Credit; and Assets & Liabilities
	No. of Loan Officer per branch	To be determined by the number of clients
	No. of members (clients) per group	Not less than 5 and not more than 30
	Loan purpose and repayment cash flow	Must be clearly stated and from verifiable income source(s)
	Lending methodology	• Group solidarity model is more cost effective and highly recommended. • Individual loan but group responsibility. • Repeat loan increment, say N10,000 –

		N20,000, should be based on past repayment records. • Cash collateral/contractual savings – not less than 10% of principal amount of loan and refundable.
	Lending / outreach to women	• Encourage formation of and linkage with women groups. • Annual incremental loans to women as a proportion of the bank's portfolio and client outreach.
	Micro loan tenure	6 months. For agriculture or projects with longer gestation a maximum tenure of 12 months is permissible. In housing microfinance, a maximum tenure of 24 months is permissible (S.1.2.4 of the Revised Guidelines)
	Follow up and collection of loan	7 days after disbursement, weekly collection
	First loan disbursement	Minimum of 4 weeks after enrolment as a client or member of solidarity group
	First repayment installment starts	15 days after loan disbursement
	Loan repayment frequency	Weekly, except agricultural loans
	No. of installment to complete loan repayment	Should depend on the duration of loan
	Group member's mandatory savings	Minimum of N100.00 per week
	Mandatory loan	Optional
	Service charge (Interest rate per annum)	Market determined but transparent
Earnings	Operational Self-sufficiency (OSS) – a measure of total operating income to total costs (operating costs + loan loss provision + financing cost), that is	> 100%

	OSS = Operating Income X 100 operating costs + loan loss provision + financing cost	
	Financial Self-sufficiency (FSS) – a measure of a MFB's adjusted operating income to adjusted direct and indirect costs (i.e. operating costs + loan loss provision + financing cost), that is FSS = Adjusted Operating Income X 100 Adjusted operating costs + loan loss provision + financing cost NB: Operating income and expenses are adjusted for inflation and low interest or concessional loans.	> 120%
	Financial sustainability	• Operate at full-cost recovery basis. • Maintain lean operational costs in order to record positive ROA and ROE
	Average percentage or interest income to gross income	80%
	Average percentage of non-interest income to gross income	20%
	Operating Expenses to Total Assets	≤ 15%
	Staff Costs to Total Assets	≤ 10%
	Administrative Expenses to Total Assets	≤ 5%
	Total Expenses to Total Assets	≤ 30%
Liquidity	Liquidity Ratio	20% (S.8.1.2 of the Revised Guidelines)
	Maximum investment in placements	15% of total deposit liabilities
	Minimum investment in Treasury Bills	Minimum of 5% and Maximum of 10% (S.8.1.1 of the Revised Guidelines)
Social Performance Measurement	Mission and vision	Should be clear and focused on the poor, women, or vulnerable groups

	Transparent and reasonable pricing	Prices, terms and conditions of financial products (including interest charges and all fees) should be clear, transparent, and adequately disclosed in a form understandable and affordable to the clients
	Avoidance of over-indebtedness	Reasonable steps should be taken to ensure that credit will be extended only if the borrowers have demonstrated adequate ability to repay and loans will not put borrowers at significant risk of over-indebtedness
	Disclosure of required information to Credit Reference Bureaux (CRBs)	Information on all credit clients should be supplied to licensed CRBs from time to time (S.12 of the Revised Guidelines)
Business Plan	Strategic Plan and Annual Budgeting	• Adherence to Board's approved strategic plan. • Board's approval of annual budget.
	Funding/Financial Strategy	Clear financial strategy evidenced by a diversified funding base.
Other Parameters	Office accommodation	Simple and cost effective
	Own office building	• Prior CBN's approval strictly required for construction. • At no time should depositors' funds be used for this purpose.
	Branch expansion (including meeting points, customer service point, cash centres and branches) – for State and National MFBs only	• Simple standardized and cost effective branch structure. • Prior CBN's approval strictly required. • At no time should depositors' funds be used for this purpose.
	Decision making hierarchy	Guided by authorization limits as approved by the Board of Directors
	Manning level	Lean middle and top management

	Management Informational System (MIS)	• Simple, robust with relevant modules, and e-FASS/FINA compliant. • Cost included in the prescribed 20% for fixed assets.
	Staff Training	• On-the-job at zero cost. • Low cost staff training budget as a function of net profit. • Microfinance Certification Programme (MCP) is compulsory for top management, that is, the Managing Director and Departmental Heads and highly recommended for other staff.
	Credit administration	• Regular review and monitoring of loans and advances by loan at least once every thirty days (S.8.1.12b of the Revised Guidelines). • Monitoring activities should be supported with periodic field visits (Places of business) to the clients.
	Key operational objective	Wide outreach at low operational unit costs and group solidarity model.

Source: CBN's Revised Regulatory and Supervisory Guidelines for Microfinance Banks in Nigeria.

SUMMARY

Microfinance can be defined as a financial service rendered to poor and low income clients, while microfinance banks are financial institutions registered to render such microfinance services as

saving, loans, domestic fund transfer and other financial services that are needed by the economically active poor. In December 2005, the Central Bank of Nigeria introduced a microfinance policy framework to enhance the access of micro-entrepreneurs and low income households to financial services. These policy guidelines were revised in 2011 and have since been helping the ***CBN*** in regulating the activities of Microfinance Banks in the Nigerian economy.

REVIEW QUESTIONS

1. What do you understand by Microfinance?
2. Distinguish between Microfinance and Micro-Credit.
3. What is the rationale behind the establishment of Microfinance banks in Nigeria?
4. Who are Microfinance banks target audience?
5. Briefly explain 10 permissible activities of Microfinance banks as stipulated by the ***CBN's*** regulatory and supervisory guidelines for ***MFB's***.

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CHAPTER 6

DEVELOPMENT BANKING

INTRODUCTION

The term development bank is a generic term used to describe a financial institution established to provide capital and other material assistance to aid development in a particular sector of the economy. With the establishment of the Central Bank of Nigeria, it became apparent that there was a need to create financial institutions to take care of long-term financing of developmental projects which were beyond the capability of commercial and merchant banks who provided mostly short and medium term financing, a function which the central bank itself also could not perform given the scope of its operations. Thus, the need for the establishment of development banks became expedient, and the first development bank – the Nigerian Industrial Development Bank (***NIDB***) was established in 1964. Other development banks which followed later included the Nigerian Bank for Commerce and Industry (***NBCI***) established in 1972, the Nigerian Agricultural and Co-operative Bank (***NACB***) 1973, and the Federal Mortgage Bank of Nigeria (***FMBN***) established in 1977.

Between 1977 and 2002 a lot of restructuring has taken place in the development banking industry in the country leading to the emergence of a few development banks namely:- (1) The Bank of Industry (***BOI***); (2) Nigerian Agricultural Cooperative and Rural Development Bank Limited (***NACRDB***); (3) Nigerian Export – Import Bank (***NEXIM***); and (4) Federal Mortgage Bank of Nigeria.

THE BANK OF INDUSTRY (BOI)

The Bank of Industry is a product of the merger of 3 development financial institutions in the year 2000 namely: The National Economic Reconstruction Fund (***NERFUND***), The Nigerian Bank for Commerce and Industry (***NBCI***) and Nigeria Industrial Development Bank (***NIDB***). ***NERFUND*** was an outreach programme that sought to empower the banking sector through the provision of small and medium scale industrial loans. ***NERFUND*** did not lend directly to the beneficiaries, it did so through participating commercial and merchant banks for onward lending to small and medium scale enterprises. It came into existence in January 1989 and commenced operations in September of the same year.

NBCI was set up in 1973 to promote the development of small and medium sized enterprises in the country. Until it was subsumed under the Bank of the North, its principal function had been the provision of long-term investment financing and equity funds to small and medium scale enterprises. ***NIDB*** was established in 1964 with the main objective of assisting enterprises engaged in industry, commerce, agriculture and exploitation of natural resources in the country. These three financial institutions were therefore merged to form Bank of Industry (***BOI***) which was launched on May 17, 2002 with the sole purpose of transforming Nigeria's Industrial sector and integrating same into the global economy through the provision of cheap financing and business support services to existing and new industries in order to achieve the attainment of modern capabilities to produce goods that are attractive to both the domestic and external markets.

Basically the bank is expected to assist in resuscitating ailing industries and promoting new ones in all the geopolitical zones of the Federation in such areas as Agricultural finance, Industrial and Commerce finance, Natural Resource Exploitation finance, Long-term investment financing and Equity funding of ***SME's*** and support of ***SME's*** through lending funds to commercial and merchant banks.

Structure of the Bank of Industry

The Bank of Industry (***BOI***) started off with an initial capital base of ₦50 billion and comprises four subsidiaries. They are:- (1) Leasing Company of Nigeria Ltd. (***LECON***); (2) ***NIDB*** Trustee Limited (***NTL***); (3) ***NIDB*** Consultancy and Finance Limited (***NIDB*** Consult); and (4) Industrial and Development Insurers Brokers (***IDIB***).

Objectives of Bank of Industry

The Bank of Industry (***BOI***) was established with the following objectives:-

1. To create an enabling environment for attractive investment opportunities for Nigerian industries and provide an outlet for productive investment for Nigerian savings.
2. To work closely with the various government development agencies so as to encourage growth and development in the economy.
3. To assist in import substitution and development of existing industries in Nigeria.
4. To appraise investment proposals and assist with the provision of funds for the financing of such projects.
5. To correct any observed inadequacies in the provision of medium and long-term financing to small and medium scale enterprises.
6. To provide loans to participating commercial and merchant banks for on-lending to small and medium scale enterprises.

Functions of the Bank of Industry (*BOI*)

The functions of the ***BOI*** include among others:-

Provision of Long and Medium term loans to industries
These loans are to be repaid on generous terms that will include concessionary interest rates.

Absorption of foreign exchange risks
The bank provides facilities that will encourage the absorption of foreign exchange risks encountered by fund users in respect of foreign denominated loans.

Financing commercially viable projects
BOI finances only projects that are commercially viable and sponsored by committed entrepreneurs with track records of prudence in loan servicing.

Resuscitating ailing industries
The bank helps to resuscitate ailing industries that can operate competitively in the economy.

Promotion of new industries
The bank promotes new industries that can offer complementary products and services thereby boosting industry capacity utilization and employment opportunities.

Project appraisal
The bank appraises project proposals with a view to determining their economic viability and feasibility before encouraging the industrialists to embark on them.

Investment supervision
BOI supervises projects funded by it to make sure that the funds it makes available to industrialists are actually applied to the projects for which they are meant. This helps to minimize loan diversion and subsequent bad debts.

Loan Recovery
Due to the huge debt of the former institutions that merged to form the Bank of Industry, it is the duty of the bank to use available legal and conventional techniques to recover outstanding loans,

which are to be ploughed back to the financing of industrial projects in the economy.

Venture Capital financing

Venture capital also known as risk capital is capital invested in a venture (usually a young company, often in high technology areas) that presents a risk. Therefore in this area, ***BOI*** helps in the formation, financing and the provision of technical personnel for new industries. When the industries are fully developed and can stand on their own, the bank will sell them out to industrialists especially the small and medium scale industries for ownership and management.

NIGERIAN AGRICULTURAL CO-OPERATIVE AND RURAL DEVELOPMENT BANK LTD (NACRDB)

This is a new bank which came into existence in 1999 following the merger of the defunct Nigeria Agricultural and Cooperative Bank (***NACB***), Peoples Bank of Nigeria (***PBN***), and the risk assets of the Family Economy Advancement Programme (***FEAP***). It will be recalled that ***NACB*** was established in 1973 for purposes of granting loans for agricultural production, while the Peoples Bank of Nigeria started operations in 1989 with the sole aim of improving the access of the nation's rural communities to banking and financial services.

Objectives of NACRDB

The objectives of Nigerian Agricultural Co-operative and Rural Development Bank include:-

1. Provision of affordable credit facilities to the less privileged who cannot readily access the services of other conventional banks.

2. Acceptance of saving deposits from customers and the repayment of same with accrued interest.

3. Provision of opportunities for self-employment in the rural areas, thereby reducing rural urban migration.

4. Enhance government efforts in the diversification of the productive base of the national economy.

5. Inculcation of banking habits at the grass root level of the Nigerian society.

6. Promotion of capacity building through the provision of relevant training and advisory services.

7. Fostering an accelerated growth and development of the agricultural rural economy.

8. Encouraging the formation of cooperative societies at all levels.

Functions of the Nigerian Agricultural Cooperative and Rural Development Bank

NACRDB provides the following services:-

1. It makes loans available to individual farmers and cooperative organizations, limited liability companies, as well as State and Federal government.

2. It provides direct financial investment in the form of equity capital to agricultural and agro-allied industries.

3. The bank provides guarantee for viable agricultural and agro-allied ventures to enable them raise finance from either a local source or from the international finance markets or agencies.

4. It provides loans to farmers, rural dwellers and to cooperative ventures that contribute to rural development and employment generation in the areas.

5. Export financing: the bank provides loans for processing and marketing of agricultural products especially for exports so as to enhance foreign exchange earning capacity of the country to improve the country's balance of payments.

6. It finances agro-allied projects such as tractor hiring operations, agricultural equipment leasing, and facilities for agricultural processing, preservation and storage.

7. The bank provides micro credit facilities to craftsmen and other small scale farmers and industrialists for the expansion, modernization and consolidation of their businesses.

NIGERIA EXPORT – IMPORT (NEXIM) BANK

NEXIM bank was established as an export credit agency to replace the Nigerian Guarantee and Insurance Corporation. It commenced operations in January 1991 with the following objectives:-

1. To establish and carry on the business of export credit guarantee and export credit insurance.

2. To design and implement schemes of export credit guarantee for parties carrying on export-import business in Nigeria.

3. To undertake and guarantee the insurance of export credit and for that purpose to enter with or for the benefit of parties carrying on business in Nigeria, contracts of insurance against risk of monetary loss etc.

4. To accept reinsurance of all kinds and to enter into reinsurance agreements with parties whether resident in or outside Nigeria against all or any risk or liability assumed by the bank under any agreement, insurance policy or other schemes entered into by the bank.

5. To enter into guarantee agreements with other parties to guarantee payment in specified circumstances.

6. To provide insurance against loss whether on the export of goods or the provision of services or on loans made to facilitate the export of such goods or the provisions of such services.

7. To lend and advance money or give credit to such persons or companies on such terms and conditions as may seem expedient and in particular to customers, companies, corporations, firms and other bodies which have dealings with the bank and to give guarantee or become surety and give security for any such persons or companies.

8. Subject to the provisions of any law in force, to buy and sell foreign currency and exchange and to accept money for remittance to all countries.

Functions of Nigeria Export–Import Bank
The functions of the bank include:-

1. The bank may for the purpose of recovering any sums owed it acquire such interests, rights, or property in the assets of any person connected in such transaction thereof and may retain, invest, sell or otherwise dispose of any interest, right or property so acquired.

2. The bank may receive or recover such submissions and fees as may be agreed upon in consideration of any guarantee or underwriting by the bank, invest and deal with the monies of the bank not immediately required upon such securities and in such manner as it may from time to time determine, establish and manage funds connected with the objects of the bank, acquire, hold and dispose of any movable or immovable property for the purpose of the bank's objects and functions.

3. Maintain diverse and relevant information to facilitate credit verification and exchange such information with comparable organizations on a reciprocal or other agreed basis and to cooperate with similar organizations within and outside Nigeria in the areas of provision of credit information, debt collection, reinsurance and training.

4. The bank may belong to any international or regional Association of Credit and Investment Insurers.

Any risk which can be insured or is normally insurable in commercial insurance market such as marine, fire and similar risks, are excluded from the facilities provided by the bank.

FEDERAL MORTGAGE BANK OF NIGERIA (FMBN)

The Federal Mortgage Bank of Nigeria was established by decree No. 7 of 1977 as a reconstitution of the Nigerian Building Society that was jointly established in 1957 by the Federal government and the Commonwealth Development Corporation. By 1990 the *FMBN* was restructured into Federal Mortgage Finance (***FMF***) and the new Federal Mortgage Bank (***FMB***) which is the supervisory organ of the Primary Mortgage Institutions (***PMIs***).

Functions of the Mortgage Bank

The functions of the Mortgage bank include:-

1. To provide long-term credit facilities to mortgage institutions in Nigeria at such rates and such terms designed to enable the mortgage institutions to grant comparable facilities to Nigerians desiring to acquire houses of their own.

2. To license and encourage the emergence and growth of the required number of viable secondary mortgage institutions to service the need of housing delivery in all parts of Nigeria.

3. To encourage and promote the development of mortgage institutions at rural, local, state and federal levels.

4. To supervise and control the activities of mortgage institutions in Nigeria.

5. To collect, manage and administer the National Housing Fund in accordance with the provisions of the National Housing Fund act.

6. To do anything and enter into any transaction which in the opinion of the board is necessary to ensure proper performances of its functions.

Powers of the Mortgage Bank

The bank has the power to:-

1. Accept deposits and savings from mortgage institutions and other institutional depositors.

2. Issue its own securities, including debentures and bonds under federal government guarantees and issue promissory notes and other bills of exchange for the purpose of raising funds from financial institutions.

3. Establish a sinking fund for the redemption of securities by the mortgage bank and provide for contributions by it to the sinking fund.

4. Carry out research aimed at improving housing patterns and standards in both urban and rural areas of Nigeria.

5. Carry our research on mortgage finance activities and the building construction industry in Nigeria.

6. Organize and operate in collaboration with reputable insurance companies, a mortgage protection system designed to guarantee liquidity to mortgage institutions as well as afford them the opportunity of having liberal premium terms.

7. Do anything and enter into any transaction which in its opinion is necessary to ensure the proper performance of its functions.

Funding of the Federal Mortgage Bank of Nigeria

The capital of the mortgage bank shall consist of equity and loan capital. The authorized capital shall be one hundred million naira which shall be divided into 1 million shares of ₦100 each and be subscribed and paid up at par by the Federal government, also the loan capital shall be provided by the federal government. The bank shall establish a general reserve fund to which shall be allocated from the net profits of the bank at the end of each financial year, 50% of the net profits of the bank for the year, when at the end of the year the fund is less than the authorized capital of the mortgage bank and 25% of the profits when the fund is equal to or exceeds the authorized capital of the bank.

The bank shall not borrow from any source any money exceeding its share capital except with the approval of the minister. The bank shall have power to secure the repayment of any money borrowed by it in such manner as it deems fit. Also the bank shall have power to receive grants, loans and advances and other monies on deposit from the federal government, the Central Bank of Nigeria and any licensed bank as well as from the public under approved conditions. Similarly, the federal government may guarantee foreign loans in such manner and on such terms as it may deem fit and ensure the redemption and the repayment by the bank.

SUMMARY

Development banks which provide capital to aid development in different sectors of the economy have been in existence in the country for quite some time. Following some restructuring in the recent past there are now a few of such banks in existence in the economy and they include: The Bank of Industry, Nigeria Agricultural Cooperative and Rural Development Bank Limited, Nigeria Export – Import Bank and Federal Mortgage Bank of Nigeria among others. Each of them has its stated objectives and so

performs its functions geared towards achieving these objectives which when put together leads to the overall development of the economy.

REVIEW QUESTIONS

1. "The Bank of Industry is a product of the merger of three development financial institutions". Explain
2. What are the functions of the Bank of Industry?
3. What are the objectives of Nigerian Agricultural Cooperative and Rural Development Bank Ltd.?
4. NEXIM bank was established as an export credit agency, how does it fulfill this obligation?
5. What are the functions of the Federal Mortgage Bank of Nigeria?

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CHAPTER 7

BANKING OPERATIONS

INTRODUCTION

A banker or a bank is a person or a company carrying on the business of receiving money and collecting drafts from customers subject to the obligation of honoring cheques drawn upon them from time to time to the extent of the amounts available on their current accounts. Following from this therefore, the basic function of a banker is the acceptance of deposit of funds withdrawable on demand. Therefore a person or institution that does not take cash deposits, issue and pay cheques crossed and uncrossed to his customers can not truly claim to be a banker or bank. Also if the banking business carried on by any person is subsidiary to some other businesses, then the person or institution cannot be regarded as a banker or a bank. A bank customer is a person who has some sort of an account, either deposit or current, or some similar relationship with a bank. It means that any person or corporate entity can become a bank customer by opening a deposit account or current account or loan account.

The relationship of banker and customer begins as soon as a deposit is made or first cheque is paid in and accepted for collection. The word "bank customer" therefore denotes a relationship in which duration or time is not of essence. A person whose money has been accepted by the bank with the understanding that the bank will honor cheques up to the amount standing to his credit is a customer of the bank irrespective of how

long he/she has been doing business with the bank. Therefore the mere opening of an account will automatically qualify one as a bank customer irrespective of whether his connection is of long or short term.

RELATIONSHIP BETWEEN A BANKER AND A CUSTOMER

The relationship between a banker and a customer is that of a debtor and creditor. The banker when he receives money from a customer does not hold the money in a fiduciary capacity, which means the banker does not hold it in trust rather money left with the banker is at his disposal subject to the obligation to honor the customers cheques up to the amount of any credit balance in his account or up to the limit of any overdraft which the banker has agreed to allow. Therefore when a customer pays money into the bank, the money ceases to be his own but that of the banker who is bound to return an equivalent amount by paying a similar sum to the customer or depositor when he asks for it. The banker makes whatever profit he can from the money. This profit he retains while paying back the principal although sometimes he pays back the principal with interest depending on the type of account the customer operates whether current or saving.

The debt due by a banker differs from an ordinary commercial debt because unless the debt is demanded it is not regarded as due. On the other hand, for a commercial debt a request by the creditor for payment is not necessary. Thus the bank is not liable to pay the customer the full amount of his balance until he/she demands for the payment. The banker is therefore a debtor to the customer and not an agent. Under certain circumstances however, bankers enter into fiduciary relations with their customers. For example, when a banker accepts valuables for safe keeping from a customer he acts as a Trustee because the property in them does not pass on to the banker and when he buys or sells securities for the customer he acts as an Agent. Some of the features of a banker/customer relationship include:-

Appropriation of payments

When a customer pays in money or when a third party pays in money into a customer's account, the customer has a right to say that it should be placed in a particular account or applied in payment of a particular debt or in meeting certain cheques or bills and the banker is bound to appropriate it accordingly. Where the customer does not make any specific appropriation, the banker can appropriate and apply the payment even to a statute barred debt. When this method of appropriation is communicated to the customer it becomes irrevocable.

Bankers obligation to honor customers cheques

A banker has a statutory obligation to honor the cheques of his customer drawn against the customer's current account provided the balance in the account is sufficient to allow the bank to do so and the cheques are presented within a reasonable time after their date of issue. This statutory obligation may be extended by an agreement express or implied to the amount of overdraft agreed upon, but it does not apply to bills of exchange accepted by the customer and made payable by the banker.

Before dishonoring a customer's cheque the banker must be sure that circumstances permit him to do so, otherwise he will be liable to pay damages to the customer for injuring his/her credit. For example in the absence of an agreement giving the customer a right to draw cheques against uncleared items, the banker is entitled to return such cheques with the note "effect not cleared". It should be noted that the liability of a banker for wrongful dishonor of a cheque is only to the drawer and not the payee of the cheque.

Bankers duty to keep the customer's account details secret

Due to the private nature of transactions between the banker and customer, the banker should not divulge the state of the account of the customer to third parties except on reasonable grounds which may include:-

1. Where disclosure is made with the consent of the customer.

2. Where disclosure is under compulsion of law.

3. Where there is a duty to the public to disclose the information.

4. Where it is in the interest of the bank to make the disclosure.

In addition, the banker should not make statements which may make him liable for defamation or fraudulent misrepresentation. Also the bank should decline to give any information in response to enquiries from an outsider who is not a banker, in the absence of an express authority from the customer.

Banker's Right of Lien

Lien is the right to possession of property until such a time that an outstanding liability has been repaid. A banker's lien gives a bank the right to retain or sell the property of a debtor in lieu of payment. Therefore the banker has the right of lien over such of his customer's securities as may come into his possession in the course of business.

A distinction may be made between a "General lien" and "Particular lien". A "Particular lien" confers a right to retain the goods in respect of a particular debt involved in connection with a particular transaction. A "General lien" on the other hand, confers a right to retain goods not only in respect of debts incurred in connection with a particular transaction but also in respect of any general balance arising out of the general dealing between the two parties. Banker's lien is a general lien. There are some cases where the banker cannot exercise his right of lien. These include:-

1. In the case of securities deposited with the banker for safe custody only, the banker is acting as a bailee and has no lien over such articles.

2. The banker cannot exercise his right of lien in respect of a separate account maintained by the customer which is known to the banker as a Trust Account.

3. No lien arises over properties on which a customer has no title.

4. In the case of funds and securities specifically appropriated, the banker cannot exercise his right of lien because there is an express contract inconsistent with the lien.

5. A bank has no right of lien in respect of money deposited by a customer or a credit balance earmarked by the customer for a specific purpose.

6. A banker cannot exercise his right of lien where documents or valuables are left in his hands inadvertently.

7. A general lien cannot hold in respect of a property of a customer pledged as security for a particular debt.

Banker's right to charge interest and commission

A banker is entitled to charge interest on loans, either by express agreement or by right of custom or usage of trade. He is also allowed to charge compound interest unless there is an agreement to the contrary. In the absence of an express agreement, or without due notice, a banker is not entitled to debit his charges at any other time than the customary dates. The banker is also entitled to charge commission for services rendered to his customer.

GARNISHEE ORDER

This is a remedy available to any judgment creditor and the order may be made by the court to holder of fund (third parties such as banks etc.) that no payment should be made until the court

authorizes them. The third party is known as the garnishee, while the court order is known as a garnishee order. The purpose of the order is to protect the interest of creditors. A garnishee order therefore is an order of the court, obtained by the judgment creditor attaching funds in the hands of a third party who owes judgment creditor money, warning the third party (the garnishee) not to release money attached until directed by the court to do so.

When a garnishee order is served on a banker, he should attach all funds due or accruing due. The term accruing due means debts that are already incurred but payable on a future date. It does not include debts that were not in existence at the time the order was served. Thus a current/saving bank account is attachable by a garnishee order. Also a deposit account repayable on demand is attachable by a garnishee order. A deposit repayable on a fixed notice is attachable by a garnishee order provided the notice has been given before the order is received. A deposit repayable on a fixed date is a good case of a debt accruing due, therefore when the banker is served with a garnishee order in this situation, he should stop operations on the accounts of the customer and the account must remain dormant until the order is discharged.

There are also situations where funds are not attached by a garnishee order. These include the case of funds coming into the banker's hands after the receipt of the garnishee order, they are not attached. A joint account is not attached by a garnishee order, provided the order is issued against only one of the account holders. For a partnership firm's account, it is not attached by a garnishee order provided the order is issued against only one of the partners. For an overdrawn account of a customer, the garnishee order will not attach funds even though the customer has not reached the agreed limit of the overdraft when the order is served. In the case of a garnishee order which does not correctly designate the judgment debtor and the account which he operates with the bank, funds are not attached.

OPENING OF ACCOUNTS

It is important that the banker takes certain precautions before opening accounts for customers. First and foremost the banker should obtain references from respectable parties as to the proposed customer's integrity and respectability. To achieve this some banks in Nigeria insist on the introduction by an existing customer of the branch before opening a new account. Modern banking therefore requires that a new customer should either be known to the banker or should be properly introduced.

After satisfying himself as to the respectability and integrity of the customer the banker must obtain the customer's full name, address, occupation and specimen signature. To be sure of the customer's address most banks in Nigeria will require a new customer to bring a utility bill, water board bill etc. If the customer intends another person to operate on his account then the banker should get a mandate from the customer specifying the power delegated to the mandatory. The banker has to exercise special care and may require the customer to fulfill some other obligation while opening certain accounts. Example:-

Partnership Account

Before opening an account in the name of a partnership company, the banker should obtain a mandate signed by all the partners containing information regarding the nature of the company's business, the names and addresses of all the partners and those who are authorized to operate the account together with their specimen signatures and the extent of their authority. It is also advisable for the banker to examine the deed of partnership to know whether there are any special regulations regarding the bank account, borrowing powers etc.

Agents Account

A banker may open an account in the name of a person who is acting as an agent of another person. The account should be considered as the personal account of the agent. The banker has no authority to question his power to deal with the funds in the

account unless it becomes obvious that the agent is being guilty of breach of trust.

Joint Accounts

To open an account in the joint names of two or more persons, the banker should obtain in writing, instructions signed by all the account holders regarding the names of the persons authorized to operate the account and the extent of their authority. In the absence of such instructions the banker should honor only those cheques which are signed by all the account holders.

Joint Stock Companies

To open an account for a joint stock company the banker should ascertain the powers of its directors and managers from the articles and Memorandum of Association. The banker should also examine its certificate to commence business. In Nigeria this is mostly represented by the Certificate of Incorporation obtained from the Corporate Affairs Commission (*CAC*). The banker should also obtain an authenticated copy of the resolution appointing him as the banker as well as a mandate containing such information as the names of the persons authorized to sign cheques, their specimen signatures and the extent of their authority etc.

Unincorporated bodies

To open an account for unincorporated bodies like clubs, associations, committees etc. the banker should obtain a copy of the resolution appointing him as a banker, a mandate containing the names of persons authorized to operate the account. It should be noted that an unincorporated body cannot be held liable in respect of any liabilities incurred by its officials since it has no· legal personality.

CHEQUE AS A BANKING TOOL

A cheque is a bill of exchange drawn on a specified banker and payable only on demand. A bill of exchange on the other hand is an instrument in writing containing an unconditional order, signed by

the maker directing a certain person to pay a certain sum of money only, to or to the order of, a certain person or to the bearer of the instrument. Thus a cheque is used to transfer funds from a bank to someone else and is the usual way of withdrawing money from a current account. For an instrument to be called a cheque it should have the following features:-

1. The instrument must be in writing which may be done by means of printed characters, computer, typewriter, or by pen or pencil. But bankers do not generally honor cheques drawn on pencil because it is easy to make unauthorized alterations when a cheque is drawn in pencil.

2. A cheque must contain an unconditional order. For instance, if the banker is ordered to pay a certain amount provided the payee fulfils certain conditions, it cannot be considered a cheque since the order is conditional. However if such instructions are addressed to the payee and not to the banker, to order to pay may be regarded as an unconditional one.

3. The drawer must sign the instrument for it to be a valid cheque. In the case of an illiterate person his/her thumb print will suffice. Signatures impressed on the cheque by means of rubber stamps are not generally permitted.

4. The order to pay must be addressed to a banker and that banker must be a specified one. This means that the instrument should not only be drawn on a banker but also a specified banker.

5. The order must be to pay a certain sum of money only. The term money here implies legal tender currency. Therefore if the order is for something other than legal tender currency, then the instrument will not be

considered as a cheque. Also the sum of money must be certain.

6. The instrument must be payable to a certain person or to the bearer. If a cheque is not payable to the bearer, the payee must be named or otherwise indicated or identified with reasonable certainty. For instance, the payee may be a legal entity or corporate body.

7. The amount indicated must be payable on demand.

Dating and Crossing of Cheques

A cheque is not invalid because it is not ante-dated or post-dated, or that it does not bear any date at all. Any holder of the cheque including the banker may insert a date but generally bankers require drawers to date their cheques or they may return them. The ante-dated cheque is one which bears a date earlier than the date of issue. A banker cannot refuse payment just because the cheque is ante-dated. A post-dated cheque on the other hand bears a date later than the issue date. It is a negotiable instrument.

Crossing of a cheque is a directive to the paying banker that the cheque should be paid only to a banker. This means that the holder of a crossed cheque is not allowed to cash it across the counter. A cheque is crossed when there are two parallel lines drawn across it. When a cheque in addition to the parallel lines bears an addition of the words "and co" or "not negotiable", or "account payee" then the cheque is deemed to bear a general crossing. When a cheque is crossed generally it means that the paying banker should not make payment except through a banker. When a cheque bears across the face an addition of the name of a banker with or without the words "not negotiable" that addition shall be deemed to be crossing and the cheque shall be deemed to bear special crossing to the banker. A special crossing warns the paying banker that the amount of the cheque should be handed over only to the bank the name of which is mentioned in the crossing.

A cheque may be crossed generally or specially by the drawer. When a cheque is uncrossed the holder may cross it. When a cheque is crossed specially, the banker to whom it is crossed may again cross it specially to another banker for collection. Where an uncrossed cheque or a cheque crossed generally is sent to the banker for collection he/she may cross it specially to himself/herself. The drawer alone has the right to open a crossed cheque by writing the words "please pay cash" and adding his signature to it.

Conditions for Honoring Customers Cheques

A banker is expected to honor his customer's cheques up to the amount of credit balance in his account or up to the limit of any agreed overdraft, but for this to happen certain conditions have to be fulfilled and such conditions include:-

1. The cheque must be in the proper form bearing all the features of a cheque as discussed earlier.

2. The drawer's signature must correspond with the specimen signature obtained by the banker at the time of opening of the account.

3. The cheque must not be stale or post-dated. A stale cheque is one which has been in circulation for an unreasonably long period, while a post-dated cheque is one which bears a date later than the one on which the cheque is actually drawn.

4. The amount should be expressed in words and figures which should agree.

5. The cheque must be properly endorsed. In the case of a bearer cheque, endorsement is not necessary but for an order cheque endorsement is necessary.

6. Material alterations must be confirmed by the drawer. An alteration is material which in any way alters substantially the operation of the instrument and the liabilities of the parties thereto, irrespective of whether or not the change is prejudicial to the payee.

7. The banker should be careful when dealing with mutilated cheques. A cheque is mutilated when it has been cut or torn or a part of it is missing. Mutilation may be accidental or intentional. When presented with a mutilated cheque the bankers best option is to return such a cheque marked "mutilated cheque" or "mutilation requires confirmation".

Conditions for Dishonoring Customers Cheques

A banker's obligation to honor a customer's cheque is terminated if any of the following events occur:-

1. Notice from the customer to stop payment (Countermanding payment). In this wise the banker should obtain instructions in writing concerning the drawer stopping the payment of the cheque.

2. Notice of the customer's death.

3. Notice of the customer's insanity.

4. Notice of the customer's bankruptcy.

5. Knowledge of any defect in the title of the person presenting the cheque.

6. Notice of an assignment by the customer of the available credit balance. On the receipt of such a notice, the customer's credit balance ceases to belong to him.

7. Notice of a garnishee order.

8. In the case of trust accounts, knowledge that the customer contemplates breach of trust.

PRINCIPLES OF BANK LENDING

Some of the general principles guiding the granting of loans/advances by a banker include:-

Liquidity

The term "liquidity" implies the ability to produce cash on demand. A bank's deposit is utilized mainly for the purpose of granting loans and advances. These deposits on the other hand are payable on demand, therefore the banker must be ready to meet these liabilities when they arise because failure to do so will cause a run on the bank which might ultimately precipitate nationwide bank failures.

Profitability

Banks are essentially commercial ventures therefore it is necessary for them to ensure that their lending operations are sufficiently profitable. Moreover the shareholders of a bank are entitled to reasonable dividends and depositors as well have to be compensated by giving them reasonable returns on their deposits. It is therefore necessary for banks to ensure that their lending operations are sufficiently profitable.

Safety and Security

In this regard the banker should ensure that the borrower has the ability and willingness to repay the advances when they mature. Therefore before granting a secured loan, the banker should consider the margin of safety by the security concerned and possibilities of fluctuations in its value. For an unsecured loan, its repayment depends on the creditworthiness of the borrower and the guarantor where applicable. Therefore for unsecured loans the banker should adhere to the cardinal principles of Character,

Capacity and Capital (popularly known as the three Cs) or the principles of Reliability, Responsibility and Resources (known as the three Rs) of the borrower and guarantor.

Purpose

The banker should carefully understudy the purpose for which the advance is applied for. Assuming the loan is intended for productive purposes, it is expected that cash flows therefrom will result in prompt repayment of the loan. Therefore proper provisions should be made by the banker for post credit supervision.

Social Responsibility

Given that banks are essentially commercial ventures they should not forget that they should provide advances not only to the well to do in the society but also to those who are not so rich so as to make them credit worthy through productive efforts on their part. Social responsibility is no doubt highly exerting on banks.

Industrial and Geographical Diversification

The banker should aim at spreading its loans and advances across different industries and localities. This would enable the banker to compensate for any losses which might arise from unanticipated factors adversely affecting particular industries or localities. Branch banking system helps to sort out this problem where it exists.

In summary it should be noted that any of the principles above should not be considered in isolation while considering a proposal for advance or loan, rather what is required is a judicious mix of all these principles when evaluating a loan proposal.

METHODS OF GRANTING LOANS/ADVANCES

The main methods of granting advances by banks include:-

Cash Credit

With this method the banker allows the customer to borrow up to a certain amount known as "cash credit limit" and this borrowing is

supported by security. It may not be necessary for the borrower to draw the full cash credit limit in one installment but he can do so according to his requirements subject to the condition that the total amount does not exceed the limit granted.

Overdrafts

To benefit from an overdraft, the customer has to open a current account, and this account is then allowed to be overdrawn up to a certain limit. The borrower pays interest only in the amount actually overdrawn and only for the period during which it is utilized. An overdraft is a short-term credit facility but can be rolled over thereby being a source of at least medium term credit facility to the customer.

Discounting Bills of Exchange

This is a shot-term facility intended to provide current working capital; to the customer. Under this method, the banker advances money on the security of bills of exchange after deducting a certain percentage known as discount from the face value of the bill. A genuine commercial bill of exchange is considered to be a self liquidating paper since it liquidates automatically out of the sale of the goods covered by such a bill. Also a banker can purchase a bill of exchange outright at the face value less bank charges. The purchase of bills of exchange is normally confined to bills payable on demand.

Letters of Credit

A letter of credit can be defined as any arrangement whereby a bank acting at the request and in accordance with the instructions of a customer is to make payment to a third party or is to pay, accept or negotiate bills of exchange drawn by the beneficiary or authorize such payments to be made accepted or negotiated by another bank against stipulated documents and compliance with stipulated terms and conditions. A commercial letter of credit substitutes the creditworthiness of the importer with the creditworthiness of the banker issuing it, since it is a promise by

the bank to pay or accept the bill, provided the exporter or beneficiary fulfills the terms and conditions set-out in the credit.

SUMMARY

A banker is a person carrying on the business of accepting deposits from customers subject to the obligation of honoring cheques drawn upon them. The relationship between a banker and his customer is that of a debtor and creditor although sometimes it may be an agent or trustee relationship, which has its basic features. One of the basic tools that a banker uses is a cheque which is a bill of exchange drawn on a specified banker and payable only on demand. For an instrument to qualify as a cheque it should have some basic features. Also there are certain conditions before a banker can honor or dishonor a customer cheque. There are also basic principles of banking lending like liquidity, profitability, and purpose etc. while the main methods of granting loans and advances include cash credit, overdrafts, discounting bills of exchange and letters of credit.

REVIEW QUESTIONS

1. Write a short note on the term "banker".
2. Examine the obligation of a banker to honor his customer's cheques.
3. Explain the precautions to be taken by a bank before opening an account for a customer.
4. Under what circumstances is a banker justified in refusing payment of a cheque drawn on him?
5. Discuss the general principles of bank lending.

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CHAPTER 8

CENTRAL BANKING

INTRODUCTION

A Central bank is the apex bank of every economic system. It is the government's representative in the banking sector and acts mainly as banker to the government and other banks. Although the name "Central Bank" may not hold for all countries, yet the functions they perform are basically the same. For example, in Britain the apex bank is called the Bank of England, while in the United States of America it is known as the Federal Reserve Bank.

ESTABLISHMENT AND GROWTH OF THE CENTRAL BANK OF NIGERIA (CBN)

Prior to the establishment of the ***CBN***, the West African Currency Board (***WACB***) which was established in 1912 was in existence. The board had quite some deficiencies and shortcomings which, coupled with the banking failures of the early 1950's gave rise to the establishment of a Central bank, but this did not come quite easily. First, there was a report from Mr. Fisher of the Bank of England, who was appointed in 1952 by the colonial authority to inquire into "the desirability and practicability of establishing a Central bank in Nigeria, as an instrument for promoting the economic development of the country".

In his report Fisher concluded that it would be inadvisable to contemplate the establishment of a Central bank at that time, noting that it would be difficult to establish a Central bank which could operate satisfactorily given the Nigerian financial system at

that time. Rather, he recommended the following:- (1) the formation of a development corporation by the government; (2) the issue of treasury bills; and (3) the establishment of an institution by government to lend to cooperative societies. He also recommended a three-step programme towards the development of a Central bank. First was the transfer of the operations of ***WACB*** to Africa so that its management would eventually be indigenized after the local people have acquired the necessary experience. Second was the establishment of a Nigerian currency board and a separate Nigerian currency to take over Nigeria's share of ***WACB*** assets. The third was the establishment of a bank of issue as the embryo of a future Central bank.

While this was going on, a World Bank mission which visited Nigeria in 1953 was also mandated to examine the desirability and practicability of establishing a Central bank in the country. This mission agreed generally with Fisher's analysis and contention that the country was not financially developed enough for the proper operation of a Central bank. Rather, it recommended an early creation of a "State Bank of Nigeria" with limited functions. Following the attainment of internal autonomy in 1957, the Federal Government again appointed Mr. J. B. Loynes of the Bank of England to study the possibility of the establishment of a Nigerian Central Bank. This time he was given specific terms of reference thus:-

Having regard to the political and economic development of Nigeria, to the existing organization of banking and currency and to the importance of maintaining monetary stability at home and the credit standing of Nigeria abroad, and in the light of the recommendation of the 1953 mission of the International Bank for Reconstruction and Development (***IBRD***) to advise on:-

1. The establishment of a Federal institution to perform appropriate Central banking functions.

2. The introduction of a Nigerian currency and the administration of such currency so as to preserve its external value and its acceptability within the country.

3. The relationship of the Federal institution to the Federal and Regional governments to government institutions, to commercial banks and to the public.

4. The role of such an institution in the development of a local money and capital market.

As it were, Mr. Loynes had no option but to proffer recommendations which culminated in the establishment of a Central Bank of Nigeria through a Central Bank of Nigeria ordinance promulgated on 17th March, 1958. The Central Bank of Nigeria effectively came into existence and commenced operations on 1st July, 1959, with the following objectives:-

1. To issue legal tender currency in Nigeria.

2. To maintain external reserves in order to safeguard the international value of the currency.

3. To promote monetary stability and sound financial structure in Nigeria.

4. To act as banker and financial adviser to the Federal government.

Vision & Mission

The vision of the ***CBN*** is "to be one of the most efficient and effective of the world's central banks in promoting and sustaining economic development. Its mission is "to be proactive in providing a stable framework for the economic development of Nigeria through the effective, efficient and transparent implementation of monetary and exchange rate policy and management of the financial sector.

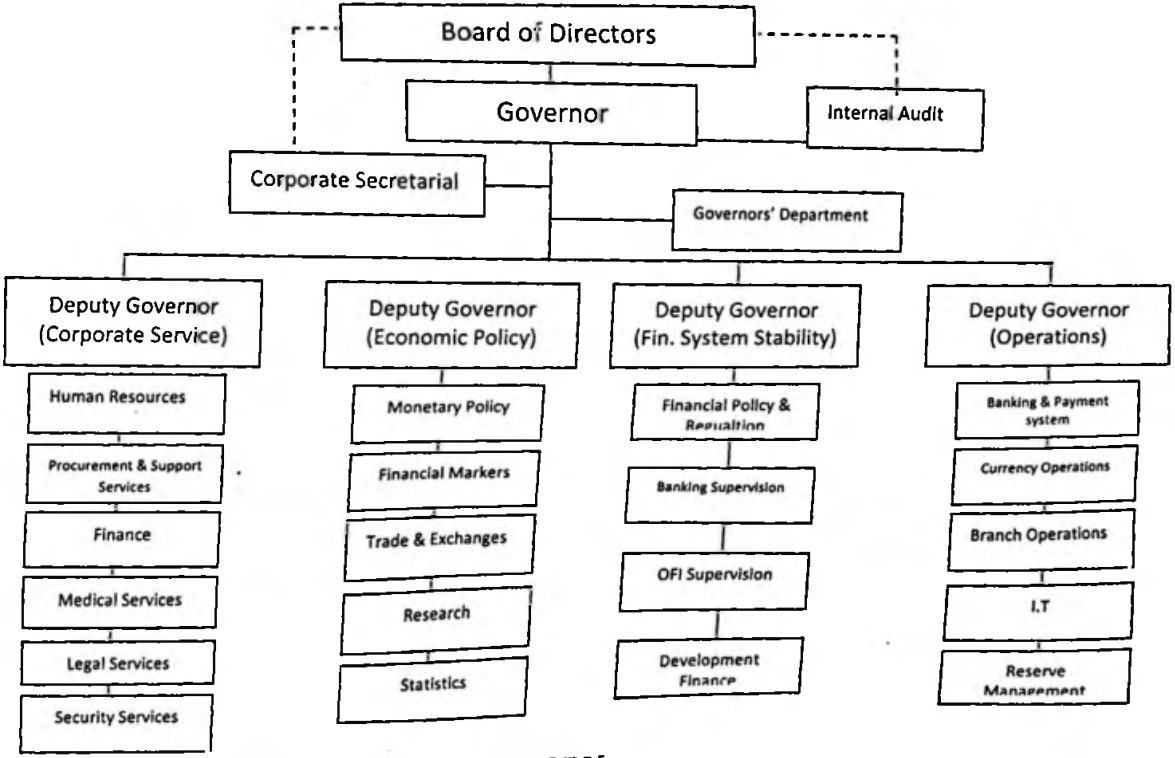


Figure 8.1 **Organizational Structure of the CBN**
Source: CBN Financial Stability Report 2012

The decree of 1991, now an Act of the National Assembly of the Federal Republic of Nigeria provides for the continuance of the CBN with a Board of Directors consisting of the Governor, four deputy governors and five non-executive directors.

Table 8.1: Governors of the Central Bank since independence:

Governor	Previous position	Term start	Term end
Roy Pentelow Fenton		24 July 1958	24 July 1963
Aliyu Mai-Bornu	Deputy Governor, CBN	25 July 1963	22 June 1967
Clement Nyong Isong	Advisor International Monetary Fund	15 August 1967	22 September 1975
Adamu Ciroma		24 September 1975	28 June 1977
Ola Vincent	Deputy Governor, CBN	28 June 1977	28 June 1982
Abdulkadir Ahmed	Deputy Governor, CBN	28 June 1982	30 September 1993
Paul Agbai Ogwuma	CEO, Union Bank of Nigeria	1 October 1993	29 May 1999
Joseph Oladele Sanusi	CEO First Bank of Nigeria	29 May 1999	29 May 2004
Charles Chukwuma Soludo	Chief Executive, National Planning Commission	29 May 2004	29 May 2009
Sanusi Lamido Aminu Sanusi	CEO, First Bank of Nigeria	3 June 2009	20 February 2014
Godwin Emefiele	Chief Executive Officer, Zenith Bank	3 June 2014	to date

Source: CBN

FUNCTIONS OF THE CENTRAL BANK OF NIGERIA

The functions of the Central bank can be grouped into two namely:- (1) the traditional functions; and (2) the development functions. The traditional functions could further be categorized

into two as:- (1) the banking functions; and (2) the monetary functions.

Banking Functions of the Central Bank

The banking functions of the Central Bank include:-

Currency Issue

The Central Bank is the bank of issue. It issues its notes which by law are legal tender and are accepted throughout the Federation. The first truly Nigerian currency was issued on 1st July, 1959, the day the Central Bank officially started operations. Before then, the notes in circulation were the West African currency notes issued by the West African currency board. In 1961 the *CBN* redeemed the Nigerian currency in circulation in the then Southern Cameroon. In 1963, when Nigeria became a republic the then existing Federation of Nigeria notes were replaced. In 1968 as a result of the Civil war the old notes were demonetized and new ones issued. In 1973, the decimal currency was introduced leading to the issue of new notes and coins, also the names of the Nigerian currency were changed from Pounds and Shillings to Naira and Kobo. In 1977, the twenty naira note was introduced into the Nigerian financial system.

By 1984, the colours of the currency were changed as part of strategy adopted to curtail the economic problems posed by massive smuggling of the nation's currency abroad. In 1993, another currency denomination was introduced, this time the fifty naira note which was followed by the introduction of one hundred naira note in December 1999, two hundred naira note in November 2000, five hundred naira note in April 2001 and one thousand naira note in October 2005.

Banker and Adviser to the Government

In this capacity, the Central Bank to a large extent does for the government what the Commercial bank does for its private customers. The Central bank maintains the accounts of the federal government as well as undertakes most of Federal Government banking businesses within and outside the country. The Bank also

provides banking services to the state and local governments and may act as banker to institutions, funds or corporation set up by the Federal, State and Local Governments.

Given that government revenue does not always come in a steady flow, the Central bank is required by law to make temporary short-term advances to the federal government for it to maintain a steady flow of expected expenditure especially on current services. The granting of this type of facility called "ways and means advances" is to assist the federal government meet temporary deficits. Also the government, like any other economic unit, needs loans and long-term funds for its investment programmes. Therefore, as banker to the government, it is also the responsibility of the ***CBN*** to arrange all the federal government's borrowings, short-term through the issue of treasury bills and treasury certificates and long-term through the issue of development stocks.

As financial adviser to the Federal Government, the Bank advises on the nature and size of government debt instruments to be issued, while it acts as the issuing house on behalf of government for the short, medium and long-term debt instruments. The Bank coordinates the financial needs of government in collaboration with the treasury to determine appropriately the term, timing of issue and volume of instruments to raise funds for government financing.

The ***CBN*** also manages the public debt of the federation by advising the government on the terms of issue of government debt instruments and the state of money and capital markets. In addition, the central bank contributes to the preparation of the federal government's budget, as well as in the managing of the country's external debts. In 2001, the responsibility of debt management was transferred to Debt Management Office (***DMO***).

Banker to, Supervisor of, Banks and other Financial Institutions

Just as the ***CBN*** is banker to the federal government, so also does it act as banker to commercial banks, merchant banks, development banks and other financial institutions. In this regard, all banks in

the country keep accounts with the ***CBN***, this helps in having a smooth interbank operations. The supervisory role entails examining and scrutinizing the books of financial institutions to ensure that they do not contravene existing banking rules and regulations. This role of the central bank as a bankers' bank is definitely an important one because through it the ***CBN*** can help these institutions remain liquid. The supervisory function of ***CBN*** is structured into three departments

a) Financial Policy and Regulation
b) Banking Supervision Department
c) Other Financial Institutions Supervision Department

i. Financial Policy and Regulation department develops and implements policies & regulations aimed at ensuring financial system stability. It also licenses & grants approvals for banks and other financial institutions.

ii. Banking Supervision Department carries out the supervision of Deposit money banks and Discount houses

iii. Other Financial Institutions Supervision Department supervises other financial institutions. The other financial institutions include Micro-finance Banks (***MFBs***), Finance Companies (***FCs***), Bureaux-de-change (***BDCs***), Primary Mortgage Institutions (***PMIs***) and Development Finance Institutions (***DFI's***). The supervisory process of both departments involves both on-site and off-site arrangements.

Lender of last resort

The central bank is the lender of last resort to other banks. It maintains current account for deposit money banks and also provides clearing house facilities through which instruments from the banks are processed and settled. The essential duty of a central

bank as the lender of last resort is to curtail the shortage of cash among competing banks. For example, when a given commercial bank has exhausted its resources and cannot supplement through any outside source, it falls back on the central bank, who acting as the lender of last resort tries to bail it out. The interest rate it charges for lending money to other banks is known as the Monetary Policy Rate (previously known as the Minimum Rediscount rate).

Management of Foreign Exchange

Foreign Exchange management involves the acquisition and deployment of foreign exchange resources in order to reduce the destabilizing effects of short-term capital flows in the economy. The ***CBN*** monitors the use of scarce foreign exchange resources to ensure that foreign exchange disbursements and utilization are in line with economic priorities and within the annual foreign exchange budget in order to ensure available balance of payments position as well as the stability of the Naira.

MONETARY FUNCTIONS OF THE CBN

The Central Bank of Nigeria has a primary responsibility of formulating monetary policy. Through this function the ***CBN*** exercises its main regulatory and supervisory role over the banking system.

Monetary policy is a deliberate action of the monetary authorities to influence the quantity, cost and availability of money and credit in order to achieve desired macroeconomic objectives of internal and external balances. The action is carried out through changing money supply and/or interest rates with the aim of managing the quantity of money in the economy. Money supply is the amount of money that is available to the economy at any point in time. Money supply could be defined both in narrow and broad terms, depending on the ease with which it could be converted into cash. A narrow definition of money supply comprises currency in circulation and demand deposit, while a broader definition would include balances in other deposit accounts. In Nigeria, narrow

money (*M1*) consists of the currency in circulation plus demand deposits while broad money (*M2*) is made up of narrow money plus savings, time and foreign currency deposits. The definition of what constitutes narrow or broad money depends to a large extent on the level of development of financial infrastructure and its deployment.

Monetary policy can either be expansionary or contractionary depending on the overall policy thrust of the monetary authorities. Monetary policy is expansionary when the policy adopted by the central bank increases the supply of money in the system and contractionary when the actions reduce the quantity of money supply available in the economy or constrains the growth or ability of the deposit money banks to grant further credit.

The objectives of monetary policy may vary according to the level of development of the economy involved, but invariably they include the attainment of price stability, maintenance of external payments equilibrium, as well as promotion of employment and output growth, and sustainable economic development. Irrespective of the type of economy, these objectives are critical for the attainment of internal and external balance and ultimately the promotion of long-run economic growth. Where the stability of the financial system is threatened, these short and long term objectives could be subordinated to the overriding objective of achieving financial stability.

In pursuit of the provisions of the *CBN* Act 2007, the primary objective of monetary policy has remained the maintenance of monetary and price stability. This gives the citizens confidence in the future value of their money, so that they can make sound economic and financial decisions. Low and stable inflation also helps to prevent inflationary boom and bust cycles that could result in a recession and higher unemployment.

The importance of money in economic life has made policy makers and other relevant stakeholders to accord special recognition to the conduct of monetary policy. The Central Bank of Nigeria is responsible for the conduct of monetary policy in

Nigeria. It is the core of the central bank's strength and authority, for it enables the bank to influence the movements in money supply and credit in the banking system. This constitutes the bank into an effective apex institution. It does this through the use of various powers and instruments of monetary policy such as:- (1) open market operations; (2) discount rate system; (3) direct regulation of interest rates; (4) Selective credit control; and (5) Moral suasion

Open Market Operations

This refers to the buying and selling of short-term and long-term government securities in the money market and capital market by the ***CBN***. If the credit expansion by the banking system is excessive, the ***CBN*** will sell securities thereby reducing the level of the capacity of the banks to create credit. It can also embark on the reverse course if there is too little liquidity and the banks needed to be encouraged to expand credit. The efficient application of this instrument presumes the existence of a-well developed money and capital markets. Thus, open market operations have come to be adopted as a principal instrument of monetary policy and also an independent method since it can influence the market trends by varying the total amount of money in circulation and the power of banks to create more credit.

Discount Rate System

Discount rate is the rate at which the central bank discounts bills for the commercial banks. By raising or lowering the discount rate, the central bank expects the other rates for lending to follow suit and adjust accordingly. The rate at which the central bank will discount these bills for commercial banks will depend on the prevailing economic and monetary policies being pursued by the bank because discount rate has direct impact on the cost of credit. Thus whenever the central bank wants to reduce the total amount of money in circulation it will increase the bank rate. This will result in increase in market rates which eventually discourages borrowing resulting in a reduction of the creation of bank credit.

Direct Regulation of Interest Rates

Interest rate structure is directly controlled and managed by the ***CBN***. Thus in its yearly monetary circulars the ***CBN*** fixes the ranges within which both the deposit and the lending rates are to be maintained. Even where interest rates have been allowed to float or be flexible it is still a deliberate policy of the ***CBN***. Therefore whether interest rates are flexible or fixed, the basic objectives of the ***CBN*** have been to promote orderly growth of the financial markets, combat inflation and as much as possible lessen the burden of internal debt servicing on the government.

Reserve Requirements

Reserve requirements of banks serve not only as a means of preserving their liquidity but as a medium through which contractionist or expansionist pressure can be exerted on the credit situation. All banks in the country are required to maintain two major reserve ratios. They are cash ratio and liquidity ratio.

Cash ratio is the ratio of cash to bank deposit, i.e. the ratio of stipulated cash reserve requirement to total current liabilities. It is expressed as a ratio of each bank's total demand deposit liabilities. In the Nigerian banking system the banks are grouped into classes and their ratio of cash to demand deposits vary accordingly.

Liquidity ratio is the ratio of total specified liquid assets to total current liabilities. All banks are required to keep a given percentage of their deposits in cash or approved securities. Banks must also retain in liquid or readily realizable form sufficient funds to meet abnormal or unforeseen demands by depositors. Generally speaking therefore, when the reserve requirement is raised, it puts pressure on the reserves of commercial banks and the reverse is true when the ratio is lowered.

Selective Credit Control

The traditional instruments of monetary policy, which are employed to restrict the total quantity of credit are sometimes not effective in controlling the quality of credit and channeling same to those sectors where they are needed most. Selective credit control therefore involves direct restraint on certain types of bank lending. It restricts credit from flowing into particular sectors which are considered less essential while directing them to the preferred sectors. Selective credit control affects mainly the demand side of the money market and exercises a restraining influence on the demands of potential borrowers.

Moral Suasion

This is simply a process by which the Central bank makes known to Commercial and Merchant banks, through informal discussions, the direction in which it wishes monetary policy to proceed and the contribution which is expected of them. The banks do cooperate realizing that the Central bank has wide statutory powers to regulate the banking system. Moral suasion does not contemplate coercive measure just like direct actions.

MONETARY POLICY STRATEGIES

There are different strategies used by central banks in the conduct of monetary policy. These strategies affect the operating, intermediate and ultimate targets through different channels. The common strategies include: monetary targeting, interest rate targeting, exchange rate targeting, nominal gross domestic product or output targeting and inflation targeting.

Since inception, the ***CBN*** has used two frameworks or strategies for the implementation of its monetary policy namely: exchange rate targeting and monetary targeting. Exchange rate targeting framework was used between 1959 and 1974, while monetary targeting has been in use from 1974 to date. The shift to monetary targeting was largely informed by the collapse of the Bretton Woods system of fixed exchange rates in 1972 and a change in strategy to demand management as a means of

containing inflationary pressures and balance of payments imbalances.

Monetary Targeting is one of the traditional strategies of monetary policy. It involves targeting one of the monetary aggregates such as money supply or any other measure of money stock in order to impact the ultimate objective- inflation. The use of monetary targeting as a framework of monetary policy means a central bank announces a certain target for the annual rate of growth of the monetary aggregate of choice. The central bank is therefore responsible for achieving the target. In Nigeria, the central bank tries to control base money which is the liability of the central bank comprising currency in circulation plus the reserves of Deposit Money Banks (*DMBs*) with the central bank.

The attraction of the use of monetary targeting lies in its advantages including allowing central banks to cope with domestic considerations, for example inflation rate and/or output growth, in solving the monetary policy question. Others include its ability to immediately signal monetary policy stance and help fix inflation expectations and accountability of central banks. It is easy to implement under direct and market-based systems of monetary policy regimes even in under-developed financial markets. Its quantitative nature makes it a ready benchmark in many countries' monetary programme, especially when involved in stabilization or other programmes with the International Monetary Fund (*IMF*). However, a major short-coming of monetary targeting is that its efficacy depends on a strong, predictable and reliable relationship between output/income and base money. If the relationship is weak, monetary targeting would be difficult to implement.

Interest Rate Targeting involves making the interbank rate the anchor rate for monetary policy. In this case, the central bank targets the interbank rate which it uses as the policy rate. Under this regime, the central bank stabilizes the rate with the use of repo and reverses repo operations. Thus, short term liquidity shortages

which often lead to swings in the interbank rate are evened out with repo operations which restore the liquidity condition of the banks.

Nominal Gross Domestic Product (nominal GDP) targeting is a monetary policy strategy based on the assumption that the monetary base can be influenced to keep nominal ***GDP*** close to a path consistent with price stability. This school of thought relies on the philosophy that price stability is better achieved with the adoption of monetary policy rules. Such rule, it is further argued, would maintain price stability without inhibiting long term economic growth. The proponents of this strategy conclude that as long as the monetary authorities play by the rules, price stability would be achieved. This process entails the central bank setting specific targets in terms of a variable or variables that the monetary authorities can monitor. Such variables as M1 (narrow money supply), M2 (broad money supply) or long term interest rates, are useful.

The procedure involves a combination of variables that influence the course of ***GDP*** growth. Proponents of ***GDP*** targeting also recognize the existence of an intermediate target, but maintain that as a goal, the monetary authorities only need the intermediate targets to get at the ***GDP*** objective. The implicit nominal anchor strategy does not rely on a money-inflation relationship. Rather, the central bank is saddled with dual mandates, for instance; to maintain the long run growth of the economy and growth in credit aggregates commensurate with the economy's long-run potential to increase production, so as to promote effectively the goals of high employment, stable prices and moderate long-run interest rates. The greatest drawback of an implicit nominal anchor strategy as a framework of monetary policy is its lack of transparency which more often than not keeps the market guessing on the thrust of monetary policy.

Exchange rate targeting is also known as exchange rate peg. It refers to the fixing of the value of the domestic currency in respect of another low inflation currency. The strategy had its origins in the

pre-World War I era, when the gold standard was in use. At that time, the currencies of most countries were convertible directly to gold at fixed exchange rates.

In recent times, exchange rate targeting involves the fixing of the value of a domestic currency to another called the anchor currency. The choice of the foreign currency to which the domestic currency is anchored usually depends on the relative stability and low rate of inflation of that country as well as the relative weight of its trade in the anchoring country's international trade with the anchored country's currency. Two variants of exchange rate targeting have been identified in the literature namely: currency board and dollarization.

Under the currency board system, a country's currency is 100 per cent backed by a foreign currency. This implies that the country's monetary authorities or government maintains a fixed exchange rate to the foreign currency and stands ready to exchange domestic currency for the foreign currency at the established exchange rate. Unlike the typical fixed exchange rate that still allows some level of discretion in the conduct of monetary policy, a currency board arrangement presupposes that monetary policy is completely taken out of the hand of the monetary authorities.

Dollarization occurs when another country's currency, such as the United States dollar is adopted as a country's legal tender currency. This is an indication of a strong commitment to fixed exchange rate mechanism than a currency board. The greatest advantage of dollarization is its total avoidance of possibility of a speculative attack on the domestic currency, which could still be possible under a currency board arrangement.

Exchange rate targeting is embraced as a framework of monetary policy in both industrialized and emerging market economies for a number of reasons. These include its simplicity and clarity that makes for easy understanding by stakeholders and the general public. An exchange rate target has the capacity to keep inflation under control by anchoring the inflation rate of traded goods to that in the anchor country. Also, the central bank no longer has the ability to print money and thereby cause inflation,

while at the same time speculative attack on a country's currency is discouraged.

Notwithstanding the positive side of an exchange rate targeting framework, it has many shortcomings. First, it weakens the accountability of the monetary authorities as it eliminates important signals that can assist in containing monetary policy from becoming too expansionary. With capital mobility, an exchange rate targeting country loses its discretionary/independent monetary policy to respond to domestic random shocks that are not associated with those of the anchor country. On the other hand, the shocks in the anchor country are directly and automatically transmitted to the targeting country, as changes in foreign interest rate lead to corresponding changes in the domestic interest rate

In addition, there is the loss of capacity of the central bank to perform the lender- of-last resort function in periods of financial crises. In this case, if there is speculative attack on a currency, the resultant exchange of domestic currency for foreign currency leads to a contraction in the money supply with a damaging effect on the domestic economy especially under a currency board system. Another disadvantage of exchange rate targeting is the exposure of a country's currency to speculative attack, thereby requiring substantial holding of foreign reserves by the anchoring country.

Inflation Targeting (IT) is a framework for monetary policy in which the central bank makes an explicit commitment to conduct monetary policy to meet a publicly announced numerical inflation target within a particular time frame. It can also be described as a framework in which the primary goal of monetary policy is to achieve price stability in form of an inflation target. The importance of inflation targeting is that it clearly specifies the inflation objective and a clear commitment to the achievement of this objective, given that monetary policy works in part by influencing inflation expectations.

Inflation targeting involves several elements. The type of inflation being targeted should be properly defined in terms of core or headline inflation. The measure could be a producer price index,

wholesale price index or retail price index. It is important to specify, whether it is point or range targeting. There must be institutional commitment to price stability as the primary goal of monetary policy by the fiscal and monetary authorities under an environment of effective fiscal and monetary policy co-ordination. Others include an information inclusive approach whereby many financial and economic variables are employed in making decisions on monetary policy. Inflation targeting requires increasing the transparency of the monetary policy process through communication with the market and the public about plans and objectives of monetary policy; and increasing the accountability of the central bank for achieving the inflation target.

Inflation targeting requires a number of pre-conditions for its successful implementation as a monetary policy strategy. The first requirement for the adoption of *IT* in any country is that the central bank should have a considerable degree of independence - instrument and/or goal independence - and must be free from fiscal dominance in which monetary policy is dictated or constrained by fiscal considerations. This implies that public sector borrowing from the central bank should be low or non-existent, while government should have a broad revenue base and should not rely on seigniorage (the difference between the value of currency and the cost of its production-profit made by a government from the printing of money).

The domestic financial market should have enough depth to absorb public and private debt placements, while the accumulation of public debt (foreign and domestic) should be sustainable. There should be the absence of multiple policy objectives, meaning that other objectives, such as high employment, exchange rate stability, etc, must be subordinated to the inflation objective. Equally important are technical considerations such as the availability of data/information and appropriate models for inflation forecasting that provide the monetary authorities with the right signals about the time-path of future inflation in order to successfully hit the target and guarantee sustained macroeconomic stability.

Inflation targeting has been embraced by many central banks because of the transparency arising from its simplicity and clarity of target. This makes market participants and the general public to understand the thrust of monetary policy. Consequently, it brings down inflation expectation as well as reduces the effect of inflationary shocks. Also, it does not rely on a stable relationship between monetary aggregates and inflation. Above all, it increases the accountability of the central bank.

IT has been criticized on the grounds that it is prone to delayed signalling owing to the long lags in the effect of monetary policy decision, making inflation outcomes to be revealed only after a substantial lag. Another concern of an ***IT*** monetary policy framework is low growth in output and employment associated with inflation reduction at the outset of an ***IT*** strategy. Also, the framework focuses too much on inflation which may lead to too tight a monetary policy when inflation is above target and thus promoting larger output fluctuations. For this reason, inflation targeting countries set their inflation targets above zero reflecting the concern of monetary policy makers that too low inflation or deflation can have negative effects on real economic activity.

Quantitative easing (Balance sheet approach) refers to an increase in the size of the balance sheet of the central bank through an increase in its monetary liability (base money), holding constant its asset composition. It is also a shift in the composition of the assets of the central bank towards less liquid and riskier assets, holding constant the size of the balance sheet. The less liquid and more risky assets can be private securities which may be toxic as well as sovereign or sovereign guaranteed instruments that include all forms of risks such as liquidity and credit risks.

Quantitative easing is another nominal anchor usually employed in periods of large scale deflation or financial crisis to put money into the economy through the deposit money banks (***DMBs***). The purpose is to encourage investment when the traditional operating instrument such as interest rate has failed. It is aimed at easing liquidity shortage in a manner that reduces pressure

on the banks. Under this framework, a central bank's principal operating instrument becomes the level of current account balances held by financial institutions at the central bank. In practice, the central bank provides ample liquidity and the policy/call rate is determined by the market.

Quantitative easing is essentially an unconditional monetary policy in which a central bank creates money and injects such money into the banking system, i.e. the deliberate expansion of money supply in an economy. A central bank does this by using new money to purchase treasury securities (bonds, treasury bills and certificates, etc.) in the open market, or by buying private sector assets from banks in exchange for money, or by lending new money to ***DMBs*** or a combination of these actions. The new money thus created is deposited in the accounts of the ***DMBs*** which in turn create new money through the fractional reserve banking system in a process known as deposit multiplication. This policy action results in reducing interest yields on government securities and reducing interbank interest rate and thus encourages banks to grant credit to the real sectors of the economy.

MONETARY POLICY IMPLEMENTATION IN NIGERIA

The implementation of monetary policy in Nigeria has been under two broad regimes in consonance with the Federal Government's macroeconomic policy objectives. The two regimes are direct and indirect controls.

The direct method of monetary policy lasted from 1959-1985. Between 1960 and 1962, the ***CBN*** operated a passive monetary policy regime in which the focus was on developing and maintaining a sound domestic currency. In 1962-63, the focus changed to development issues with the need to ensure adequate supply of credit to the economy with minimal inflationary pressures. In the latter part of 1964 and in 1965, the primary objective of monetary policy was on the achievement of balance of payments equilibrium and the policy tool was credit rationing

conveyed in guidelines that placed ceilings on the rate of expansion of commercial bank advances.

Credit restriction was lifted in November 1966 to enable the banking system provide the Nigerian government with sufficient resources to prosecute the civil war. The result was high post-war inflationary pressures, deteriorating balance of payments position, and a rapid increase in deficit financing. Subsequent policies were directed at reducing inflationary pressures, restoring normal economic conditions, relieving the pressures on the external payments position, increasing government revenue and reducing government's reliance on the banking system. This policy stance continued throughout the period 1966 to March 1972.

In the period April 1972 and March 1976, the thrust of monetary policy was to expand domestic aggregate output and curtail inflationary pressures. During the same period, government finances and foreign exchange reserves improved owing to increased oil earnings. This resulted in increased aggregate demand and money supply. The task of monetary management became complicated with excess liquidity. Consequently, the selective credit control policy was retained, supported by interest rate and exchange rate policies in the latter part of the period. Stabilization securities were also introduced in an attempt to reduce the high liquidity conditions in the banking system.

The ***CBN*** continued with its monetary restraint policy between April 1976 and December 1981 due to the persistence of excess liquidity in the system. Direct credit ceiling, cash reserve requirements, stabilization securities, the exclusion of deposits against letters of credit from eligible liquid assets and interest rate changes were combined to address the challenge of excess liquidity. Between 1981 and 1985, the monetary policy instruments were broadly the same as in the decade preceding it (1970-1980). However, the instruments were fine-tuned in line with the challenges faced. Some major highlights during this period included:

1. Prescription of permissible aggregate credit expansion ceilings;

2. Guidelines on the sectoral allocation of banks' loans and advances which continued to favour the preferred sectors of the economy (agriculture and manufacturing);
3. Selective credit controls to encourage indigenous
4. Businesses, small-scale enterprises and the rural areas;
5. Unchanged Cash Reserve Requirement (CRR) during the period
6. Marginal upward adjustments of interest rates.

The policy of stringent monetary restraint targeted the conservation of foreign exchange reserves and the maintenance of price stability. Measures taken to reduce foreign exchange disbursements included the re-introduction of pre-shipment inspection and the imposition of pre-import deposits ranging from 10.0 per cent to 250.0 per cent. In addition, interest rates were raised to encourage savings and reduce demand for foreign exchange.

Indirect Controls -As conditions in the economy worsened in 1986, concerted efforts were made to eliminate unnecessary economic controls and to free the economy. This prompted the introduction of the Structural Adjustment Programme (***SAP***) in July 1986. The purpose was to ultimately institute a more efficient market system for the allocation of resources, with the implication that excessive controls of the previous two decades would be gradually eliminated or reduced to levels that would not inhibit economic development.

The three major planks for achieving this overall goal included exchange control liberalization, adoption of relevant pricing policies in all sectors of the economy and a further rationalization and restructuring of public expenditure and customs tariffs. Thus, monetary policy was expected to play an important role in the new economic management process. Indeed, the ultimate objectives of monetary policy remained as in pre-1986

period. However, in the specific environment of financial and economic liberalization, monetary policy was also to stabilize the economy in the short-run and to induce the emergence of a market-oriented financial sector.

At the start of ***SAP***, traditional instruments were fine-tuned to deal with the excess liquidity in the economy. In August 1986, the ***CBN***, for instance, required banks to deposit in a non-interest bearing deposit account at the Bank, the naira equivalent of all outstanding external payment arrears. Also, the 10 per cent ceiling imposed on the rate of credit expansion by banks fixed in January 1986 was reduced to 8 per cent in July and maintained until August 1987 when it was further reduced to 7.4 per cent.

Several measures were also added to stem the growth of excess liquidity. There was the abolition of the use of foreign guarantees/currency deposits as collateral for naira loans which implied that deposit money banks were no longer to grant domestic loans denominated in naira on the security of foreign guarantees or deposits held abroad and in domiciliary accounts with the banks. In May 1989, the Federal Government directed that all public sector accounts be withdrawn from the banks. Its immediate impact was the reduction in banking system liquidity. A reverse policy took place in 1999 when the retail functions of the ***CBN*** were transferred to the ***DMBs***. Other policy measures included:

1. Rationalization of sectoral credit controls so as to give a larger measure of discretion to banks in respect of credit operations in 1986 and 1987.

2. Abolition of all mandatory credit allocation mechanisms by the ***CBN*** from October 1996.

3. Adjustment of ***CRR*** to embrace the total deposit liabilities (demand, savings and time deposits) of banks instead of the earlier method of computing the ***CRR*** based on demand deposits alone.
4. Deregulation of interest rates.

5. Reintroduction of the use of stabilization securities in 1990.

6. Enhancement of commercial bank's minimum paid-up capital from N20 million to N50 million in 1992, N500 million in 1999 and N1.0 billion from January 2001; and shift to the use of ***OMO*** in 1993 with intention to migrate from direct controls of monetary management to an indirect or market-based approach.

In line with the liberalization policy thrust of ***SAP***, there was a paradigm shift from the hitherto direct monetary control method to an indirect approach anchored on the use of market instruments in monetary management. This was borne out of the desire to eliminate the distortions and inefficiencies in the financial system caused by the prolonged use of administrative controls and the need to engender competition amongst banks and other operators in the financial system.

Two major policy regimes of short- and medium-term horizon can be identified:

The Short–Term Monetary Policy Horizon (1986-2001)

Following the liberalization of the economy in 1986, monetary policy was refocused to a one year perspective. Consistent with the broad objective of monetary policy for the year, a number of monetary targets and instruments were adopted during the one-year horizon. ***OMO***, conducted wholly using the Nigerian Treasury Bills (***NTBs***), continued to be the primary technique of monetary policy. This was complemented by the cash reserve requirement (***CRR***) and the liquidity ratio (***LR***).

Other policy instruments employed included the discount window operations, mandatory sale of special ***NTBs*** to banks and a requirement of 200 per cent treasury instruments to cover for banks' foreign exchange demand at the Autonomous Foreign Exchange Market (***AFEM***). Interest rate policy was deregulated

through the proactive adjustment of the minimum rediscount rate (*MRR*) to signal policy direction consistent with liquidity conditions. Surveillance activities of the *CBN* focused mainly on ensuring sound management and maintenance of a healthy balance sheet position on the part of the banks. On the external side, the official and interbank exchange rates were unified in 1999.

The Medium-Term Monetary Policy Horizon (2002-Date)

In 2002, the *CBN* commenced a two-year medium-term monetary programme aimed at freeing monetary policy from the problem of time inconsistency and minimizing over-reaction due to temporary shocks. The new monetary policy horizon, which is still in operation, is based on the evidence that monetary policy actions affect the ultimate objectives with a substantial lag. Under the medium-term, monetary policy guidelines are open to half-yearly review in line with developments in monetary and financial market conditions in order to achieve medium to long-term goals.

The main objectives of monetary policy have remained largely the same, namely to subdue inflation to a single digit level and maintain a stable exchange rate of the naira, as well as the objectives of output and employment generation. Attention has also been focused on the need for a more competitive financial sector geared towards improving the payments system. The *OMO* has continued to be the primary tool of monetary policy, and is complemented by reserve requirements, discount window operations, foreign exchange market intervention and movement of public sector deposits in and out of the *DMBs*. The *CBN* has continued to ensure banking soundness and financial sector stability to enhance the efficiency of the payments system.

The Monetary Policy Implementation Framework (2006-Date)

Following recent developments in the economy, particularly in the financial sector, it became necessary to review the conduct of

monetary policy and strengthen the machinery of monetary policy to achieve set targets and objectives. In particular, the relationship between the Minimum Rediscount Rate (***MRR***) and other rates in the market became weak and the significance of using the ***MRR*** as the anchor for other short-term interest rates was eroded. Also, the persistent failure to meet stipulated monetary policy targets continued unabated.

Consequently, in December 2006, the Bank introduced the current framework for monetary policy implementation with the objective of addressing the persistent interest rate volatility and making the money market more responsive to monetary policy interest rate changes, especially the overnight interbank interest rate. The containment of interest rate volatility was to be addressed through the application of some policy measures including averaging of reserve requirements over a maintenance period of two weeks and the use of Standing Lending and Deposit Facilities to define an interest rate corridor around the monetary policy rate (***MPR***) which would drive interest rates in the money market.

The ***CBN*** Standing Facilities comprise the Standing Lending and Standing Deposit Facilities. The standing facilities were introduced in December, 2006 as an improvement to the monetary policy implementation machinery. Its aim was to effectively reduce interest rate volatility in the interbank market and ensure a fairly stable financial market environment that aids investment decisions and engenders increased public confidence in the financial system. The Standing Lending Facility provides access to liquidity for participants in the Real Time Gross Settlement System (***RTGS***), on an overnight basis, to assist them square-up their short positions in the interbank market and ensure the smooth operation of the market.

The Standing Deposit Facility on the other hand, provides an investment outlet for the surplus reserves of operators in the ***RTGS***, thereby increasing the incentive for resource mobilization. The ***CBN*** Standing Facilities (Lending and Deposit Facilities) which constitute the hub of the current monetary policy implementation framework were designed to achieve interbank rate

stability by influencing the short-term money market rates. They, therefore, provide the financial valves for absorbing surplus funds and injecting overnight funds on a lender of last-resort basis.

INSTITUTIONAL FRAMEWORK FOR MONETARY POLICY IN NIGERIA

The central bank of Nigeria Act 2007 vests the responsibility for formulating and implementing monetary policy in Nigeria on the ***CBN***. Hitherto, the function was carried out by the ***CBN*** under the supervision of the Ministry of Finance in consultation with the President of the Federal Republic of Nigeria. Under the 2007 ***CBN*** Act, the Bank performs its monetary policy functions through the Monetary Policy Committee (***MPC***). The ***MPC*** was established by the ***CBN*** in 1999 to anchor the task of monetary policy formulation. However, legal recognition was accorded the Committee with the passage of the ***CBN*** Act of 2007. Consequently, Section 12 of the ***CBN*** Act of 2007 noted that, there shall be within the ***CBN*** the Monetary Policy Committee (***MPC***), which will have the main responsibility of formulating monetary and credit policy. Specifically, the Act provides that the ***MPC*** will help to: (1) facilitate the attainment of price stability; and (b) support the economic policy of the Federal Government. .

The memberships of the ***MPC*** is drawn from both within and outside the Bank so as to enhance the quality of monetary policy, introduce transparency and credibility, as well as facilitate monetary policy transmission. The Act provides that the ***MPC*** shall consist of twelve members, namely:

1. The Governor of the Bank who shall be the Chairman.
2. The four Deputy Governors of the Bank.
3. Two members of the Board of Directors of the Bank.
4. Three members appointed by the President.

5. Two members appointed by the Governor.

The Monetary Policy Department (***MPD***) acts as Secretariat to the ***MPC*** and coordinates all the meetings of the Committee. The ***MPC*** is statutorily required to meet at least six times in a year and publishes its calendar of meetings on the ***CBN*** website. The Governor or in his absence, the Deputy Governor in charge of Monetary Policy may summon a meeting of the ***MPC*** giving not less than 7 days' notice. For the ***MPC*** to meet, six members, two of whom shall be the Governor and a Deputy Governor or two Deputy Governors shall constitute a quorum. Decisions are taken by the vote of all those present at the meeting and in the event of a tie, the Chairman shall have a second or casting vote. The ***MPC*** submits periodic reports of its meetings and activities to the Board of Directors of the Bank. The decisions of the ***MPC*** are communicated to the public through the issuance of a Monetary Policy Communiqué at the end of each meeting.

Apart from the ***MPC***, other administrative Committees exist within the Bank to facilitate the task of monetary policy. These include the Monetary Policy Technical Committee (***MPTC***), Monetary Policy Implementation Committee (***MPIC***), the Liquidity Assessment Group (***LAG***) and the Fiscal Liquidity Assessment Committee (***FLAC***).

The Monetary Policy Technical Committee (MPTC)

The Monetary Policy Technical Committee (***MPTC***) is the technical arm of the ***MPC***. The ***MPTC*** was established in 2005 and is headed by the Deputy Governor (Economic Policy). The committee prepares economic analysis for the Monetary Policy Committee. It receives inputs from the member departments - Research, Statistics, Banking and Payments System, Banking Supervision, Financial Policy and Regulation, Reserve Management, Financial Markets, Trade and Exchange as well as Monetary Policy. The economic report reviews monetary, financial, output, and price developments in the economy as well as

developments in the international economy that have impact on the Nigerian economy. The Committee reviews the economic report for the technical soundness of the monetary policy recommendations for the ***MPC***. The ***MPTC*** meets as often as it is necessary to get a harmonized and consistent report for the ***MPC*** members.

The Monetary Policy Implementation Committee (MPIC)

The Monetary Policy Implementation Committee (***MPIC***) meets weekly to take decisions on how much liquidity to mop-up or inject into the system and with what instruments. The ***MPIC*** is chaired by the Deputy Governor, Economic Policy, with the Directors of Monetary Policy, Research, Statistics, Trade and Exchange, Banking and Payments System, Reserve Management, Currency Operations, Finance, Financial Policy and Regulation, Financial Markets, Banking Supervision, and Branch Operations as members.

The Liquidity Assessment Group (LAG)

The Liquidity Assessment Group meets daily to assess the actual liquidity that would determine the policy action to undertake. Such actual liquidity is seen from the perspective of the Banking and Payments System and The Trade and Exchange Departments for purposes of mop-up either by the sale of Treasury Bills or foreign exchange. It also serves to validate as well as improve the accuracy of the forecasts of liquidity which was formerly conducted by the Monetary Policy Department, but was transferred to the Financial Markets Department in 2010. The theoretical basis of the liquidity assessment is supplied by the Research and Monetary Policy Departments. The membership of the ***LAG*** is drawn from Banking and Payments System, Reserve Management, Financial Markets, Trade and Exchange, Research and Monetary Policy Departments.

The Fiscal Liquidity Assessment Committee (FLAC)

The Fiscal Liquidity Assessment Committee (***FLAC***) is an inter-agency committee established in 2005 to pool fiscal and monetary data for monetary management. The broad objectives of the Committee are to enhance the effective interaction of monetary with fiscal policies to facilitate obtaining credible and high frequency data on fiscal operations of the Federal Government that impact on liquidity and price stability. The ***FLAC*** has succeeded in eliciting the cooperation of the various fiscal agencies since its inception. The Committee meets on weekly basis to collect data on the fiscal operations of the Federal Government and other relevant information for liquidity management. The output of the ***FLAC*** also serves as input to the Monetary Policy Implementation Committee (***MPIC***) and monetary policy technical committee (***MPTC***).

DEVELOPMENT FUNCTIONS OF THE CBN

With this function, the Central Bank of Nigeria aids the development and growth of the financial market comprising the capital and the money markets. Towards this goal, the ***CBN*** introduced treasury bills into the system in 1960, while in 1986 treasury certificates were introduced and subsequently other certificates like certificates of deposit, bankers' unit fund and call money fund.

In addition, in order to effectively channel financial resources to the real sectors of the economy, provide the required policy support and improve access to financial services by the otherwise excluded segment of the economy, the ***CBN*** has over the years performed some major developmental functions, focused on all the key sectors of the Nigerian economy (financial, agricultural, industrial and education sectors) through the following initiatives, schemes and programmes:

The Agricultural Credit Guarantee Scheme Fund (ACGSF)

The *ACGSF* was established by the Federal Government and the *CBN* to induce banks to channel credit to the agricultural sector, with the *CBN* exercising oversight responsibility.

The Agricultural Credit Support Scheme (ACSS)

In furtherance of its developmental role and to reduce the cost of agricultural production, increase output, generate exportable surplus, and provide inputs for the manufacturing sector, the *ACSS*, was introduced in 2006 by the federal government with the backing of the *CBN*. Under the Scheme, loans are granted to benefiting farmers at 14 per cent, but the farmers pay a concessionary rate of 8 per cent while the *CBN* bears the remaining 6 per cent.

The Commercial Agricultural Credit Scheme (CACS)

The N200 billion *CACS* was introduced in 2009 by the *CBN*, in collaboration with the Federal Government, to mitigate the effects of the global food and financial crisis. As a response mechanism, *CACS* was established to finance the development of large scale commercial agriculture value chain and shore up the level of aggregate food supply. Other objectives of the Scheme are to increase foreign exchange earnings, generate employment, diversify the country's revenue base, and provide the raw materials required by the manufacturing sector of the economy on a sustainable basis.

The N300Billion Power Infrastructure Fund

This was introduced in April 2010 by the *CBN* to provide long-term support to finance power-chain projects and *SME* clusters. The Fund is a 15-year debenture investment in the Bank of Industry (*BOI*) for on-lending to all eligible *DMBs* and Development Finance Institutions (*DFIs*) at 1 per cent. The *DMBs*

and ***DFIs*** would, in turn, lend to promoters of appropriate projects at a maximum rate of 7.0 per cent.

The N200Billion Refinancing/Restructuring of SME/Manufacturing Fund

The ***CBN*** introduced the N200 Billion Refinancing/Restructuring of SME/Manufacturing Fund in 2010 to enable banks refinance and restructure their existing loan portfolio to ***SMEs*** and manufacturing. The 15-year facility has a 3-year moratorium, with loan amounts ranging from N5 million (minimum) to N1 billion (maximum) to a single obligor at an interest rate of 7.0 per cent annually, repayable quarterly.

The SME Credit Guarantee Scheme (SMECGS)

The ***SME*** Credit Guarantee Scheme (***SMECGS***) was established by the ***CBN*** to provide a credit enhancement window to manufacturing ***SMEs***, agriculture value chain, and educational facilities. The intervention was targeted at creating more jobs. The Scheme allows a maximum tenor of 7 years and provides an 80 per cent guarantee. All ***DMBs*** and development banks are eligible to participate in the Scheme.

In conclusion, as part of its corporate social responsibility, the ***CBN*** has also assisted educational institutions in the country especially in the area of infrastructural development. In pursuing these development functions therefore, it is expected that the Central bank should take appropriate measures to infuse efficiency and effectiveness in financial intermediation and stability in the system, for such efficiency, effectiveness and stability assure the availability of credit for all productive purposes.

SUMMARY

A Central bank is the apex bank of any economic system. The Bank effectively came into existence and commenced operations in Nigeria on 1st July, 1959, following a Central Bank of Nigeria ordinance promulgated on 17th March, 1958. The main functions of

a typical central bank include, among others, the issue of currency, being banker and adviser to the government, banker to other banks and lender of last resort. The formulation of monetary policies and regulation of the financial system also fall within the ambit of the central bank. Some instruments of monetary policy which a central bank can employ include Open market operations, discount rate system, direct regulation of interest, reserve requirement, selective credit control and moral suasion. In performing these functions, the Central Bank of Nigeria directly or indirectly contributes towards the development of the country's financial market comprising the Money and Capital Markets.

REVIEW QUESTIONS

1. Appraise the performance of the Central Bank of Nigeria with regards to currency issue.

2. Describe the role of a central bank as a banker's bank and lender of last resort.

3. Write a brief note on open market operations.

4. Explain how selective credit control is applied as an instrument of monetary policy.

5. Explain the roles of the following Committees in monetary policy implementation in Nigeria:
   a. Monetary Policy Technical Committee (MPTC)
   b. Monetary Policy Implementation Committee (MPIC),
   c. Fiscal Liquidity Assessment Committee (FLAC).

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CHAPTER 9

THE NIGERIA DEPOSIT INSURANCE CORPORATION

INTRODUCTION

A bank deposit insurance scheme could be seen as a financial guarantee to depositors especially the small ones in the event of a bank failure. In Nigeria, just like in other countries, the bank deposit insurance scheme developed as a result of the need by government to protect depositors particularly the less informed from the risk of loss and the banking industry from instability occasioned by runs and loss of confidence. The Nigeria Deposit Insurance Corporation (*NDIC*) therefore is an independent agency of the federal government set up to protect depositors and guarantee the settlement of insured funds when a deposit-taking financial institution can no longer repay their deposits thereby helping to maintain stability in the financial system.

The regulatory activities of *NDIC* are different from that of the Central Bank of Nigeria. While *NDIC* is primarily concerned with the regulation of insured banks to protect depositors' interest, the *CBN* regulates the entire finance industry comprising banks and non-bank financial institutions for the stability of the system and for the effectiveness of monetary policies in the country. Therefore, the *NDIC* through its functions strengthens and complements the regulatory activities of the *CBN* over the insured banks.

RATIONALE FOR THE ESTABLISHMENT OF THE NDIC

The ***NDIC*** was established by decree No. 22 of 1988 as a federal government agency designated to insure the deposit liabilities of licensed banks and other deposit-taking financial institutions operating in Nigeria. The corporation commenced operations in 1989, while the ***NDIC*** act No. 16 which replaced the ***NDIC*** decree No. 22 of 1988 established the corporation as a corporate entity with perpetual succession and common seal.

The vision of ***NDIC*** is "to become one of the leading deposit insurers in the World" while its mission is "to protect depositors and contribute to the stability of the financial system through effective supervision of insured institutions, provision of financial/technical assistance to eligible insured institutions, prompt payment of guaranteed sums and orderly resolution of failed insured financial institutions". The establishment of ***NDIC*** was informed by some economic and environmental factors among which are:-

Economic Reforms and Change in Government Policy

In 1986, the Federal Government of Nigeria introduced and implemented the Structural Adjustment Programme (***SAP***) which was an economic programme aimed at deregulating the economy in the direction of market-determined pricing. This programme which was mostly carried out through the financial system imposed challenges and enormous responsibilities on commercial banks which warranted the federal government to establish a bank deposit insurance scheme for the country. Prior to this, government had deliberately on his own propped up a number of inefficient banks but with the new economic policy, it has shifted from direct support of banks to prevent failure, to protecting customers' deposits.

Stiff Competition in the Banking Industry

The deregulation of the Nigerian financial system led to a liberalization in the approval and issuance of banking licences, a phenomenon that boosted the growth in the financial institutions in the country. This growth in turn led to an increase in the level of competition in the industry thereby breeding sharp practices by bankers, and such practices increased the risk to which bank deposits were exposed to. There was therefore the need for government to protect bank depositors.

Bank Failures

The Nigerian economy witnessed quite a number of bank failures in the first half of the century and learning from that experience therefore, there was the need to protect bank depositors from the aftermath of such failures if and when they do occur.

Lessons from other Countries

In establishing the *NDIC*, the Federal Government towed the line of other countries that have benefited from the services of such schemes in their economies. For example, Czechoslovakia was the first country to establish a nation-wide deposit insurance scheme in 1924, mainly as a measure to revitalize the banking system after the First World War. The scheme was further meant to stimulate savings by increasing the safety of deposits and ensuring the best possible development of banking practices in that country. Also the United States' Federal Deposit Insurance Corporation (*FDIC*) was established in 1933 in response to the banking collapse and panic of that year. In fact, the Nigeria Deposit Insurance Scheme was modeled after that of the United States.

FUNCTIONS OF NDIC

These include among others:-

Insuring the Deposit Liabilities of Licensed Banks

The *NDIC* decree mandates the Corporation to insure the deposit liabilities of licensed banks and such other financial institutions operating in Nigeria. This basic function therefore confers

regulatory responsibilities on *NDIC* over the insured financial institutions so as to avert possible failure of such institutions.

Rendering Liquidity Support to Banks

In the interest of depositors and to help engender confidence in the banking industry, the *NDIC* has as part of its function the task of assisting insured banks that have liquidity problems. In addition to this, the Corporation has been actively involved in the restructuring exercises in many of the financially distressed banks.

Guaranteeing Payments to Depositors

Like most insurance schemes the *NDIC* maintains a formal cut-off point for insurance coverage. Thus the Corporation guarantees payment to depositors up to a maximum amount per depositor or in case of imminent or actual suspension of payment by insured banks. At the commencement of the scheme in 1989, the maximum insurance limit was set at fifty thousand naira per depositor but was later revised upwards to two hundred thousand naira only in 2004. The deposit insurance scheme being implemented by the *NDIC* is seen as a risk minimizer.

Assisting Monetary Authorities in the Formulation and Implementing of Banking Policies

The *NDIC* is expected to assist monetary authorities in the formulation and implementation of banking policies so as to ensure safe and sound banking practices. Both the *CBN* and *NDIC* were instrumental in getting the Central Bank decree No. 24 of 1991 and the Banks and Other Financial Institutions Decree (*BOFID*) No. 25 of 1991 promulgated. These two decrees have strengthened the regulatory authorities in ensuring safe and sound banking practices. Banking supervision is an essential element of the *NDIC* scheme as it seeks to reduce the practical risk of failure and ensure that unsafe and unsound practices are checked.

Promoting Competitive Equality and Efficiency among Banks

NDIC is expected to ensure fair competition among banks. To achieve this, the corporation ensures that all licensed banks are

treated equally in the payment of insurance premiums. A flat premium rate on deposit liabilities of insured banks ensures that the weak banks are not exposed because such an exposure if it occurs would put the banks at a competitive disadvantage or even precipitate runs on them.

Information Dissemination

The ***NDIC*** since its inception has contributed a lot to the dissemination of banking information to the Nigerian public. Efforts made by the corporation at publicizing its activities have culminated in much information being put out to the public about the banking industry and the attendant problems arising from bank distress and failures.

Bank Failure Resolution/Liquidation

One of the primary roles of the ***NDIC*** is to ensure that failing and failed institutions are resolved in a timely and efficient manner. The bank liquidation option on the other hand is adopted by the corporation for banks that fail to respond to failure resolution measures. Liquidation process involves the orderly and efficient closure of the failed institutions with minimum disruption to the banking system, cost-effective realization of assets and settlement of claims to depositors, creditors and where possible shareholders.

Banking Supervision

The ***NDIC***, like the ***CBN***, also performs the function of Banking Supervision. Bank Supervision in the ***NDIC*** is the responsibility of three departments, namely, Bank Examination Department (***BED***), Insurance & Surveillance Department (***ISD***) and Special Insured Institutions Department (***SIID***). As the names imply, on-site examination is carried out by ***BED*** and ***SIID*** while the ***ISD*** is charged with the responsibility of maintaining off-site surveillance over all insured banks.

Off-site supervision involves the receipt and analysis of returns from insured banks on a periodic basis to ascertain the banks' compliance with prudential regulations. Both the On-site and Off-site supervision ensure that the insured institutions remain

healthy at all times and/or where there are problems, they would be detected and addressed promptly. In addition, supervision protects the bank depositors, encourages competition among banks and assists in efficient and orderly payment system. To complement the off-site surveillance, on-site examinations are usually undertaken to determine the reliability of the banks' returns sent to the regulators, determine banks' adherence to laws and regulations as well as verify the quality of their assets.

The examination of a bank generally entails an appraisal of the soundness of the institution's assets; an evaluation of the adequacy of internal operations, policies and management; and analysis of key financial factors such as capital, earnings, liquidity, and interest rate sensitivity. Also, bank examination involves a review to ascertain the correctness or otherwise of banks' returns on their operating books of account in order to ensure compliance with all banking laws and regulation as well as monetary policy circulars; an overall determination of the bank's solvency; and ensuring that the banking operations, especially external transactions, are being carried out in accordance with standard accounting practices.

The ***CAMEL*** (Capital, Assets Quality, Management, Earnings and Liquidity) rating is used as an internal assessment guide to determine how sound a bank is. This is done with a view to highlighting the position of a particular bank in comparison with the rest of its peer group, as well as determining the level of health of the particular bank in respect of capital-to-risk-weighted-assets ratio parameters. Other financial institutions such as Micro Finance Banks and Primary Mortgage Institutions (***PMIs***) are supervised by Special Insured Institutions Department of the Corporation. It covers both the on and offsite aspect of their supervision.

Other Functions

The ***NDIC*** is permitted by law to pursue other measures necessary to achieve the functions of the corporation provided such measures and actions are not repugnant to the main objective of the corporation.

SUMMARY

In recognition of the importance of an efficient, safe and sound financial system in the Nigerian economic system, the Federal government established the Nigeria Deposit Insurance Corporation via decree no. 22 of 1988, following the banking deregulation of the Structural Adjustment Programme era. The scheme was to herald a change from past government policies which protected bank shareholders to a new policy framework that protects bank depositors, especially the small ones in a competitive banking environment. The corporation was, therefore designated to insure the deposit liabilities of licensed banks and other deposit-taking financial institutions operating in Nigeria. Also the scheme is expected to guarantee payments to depositors, assist monetary authorities in the formulation and implementation of banking policies, render liquidity support to banks and promote competitive equality and efficiency among banks.

REVIEW QUESTIONS

1. What do you understand by a deposit insurance scheme?

2. What was the rationale behind the establishment of Nigeria Deposit Insurance Corporation?

3. What are the functions of NDIC?

4. What role does NDIC play in the liquidation of a bank?

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CHAPTER 10

ASSET MANAGEMENT CORPORATION OF NIGERIA

INTRODUCTION

An Asset Management Company (*AMC*) is a special vehicle usually created to acquire, manage and dispose impaired banks' risk assets. Countries that experience banking distress due to non performing loans usually resort to the establishment of asset management companies (*AMCs*) for the resolution of the problem. For example, the four-crisis affected countries of Thailand, Korea, Malaysia, and Indonesia established *AMCs* soon after the onset of the financial crisis in 1998 to clean out non-performing loans or toxic assets from their financial system (Uwaleke & Udenwa, 2012).

ESTABLISHMENT AND OBJECTIVES

Asset Management Corporation of Nigeria was set up by *AMCON* act No. 4 of 2010, on 19th July, 2010 as a statutory corporation with the main objective of absorbing or buying up non-performing loans of banks in order to improve their liquidity and operations. This came about following the observation by the Central Bank of Nigeria that quite a number of banks in operation in the system have a huge level of non-performing loans that have eroded their capital bases.

AMCON's business philosophy therefore is basically to acquire eligible bank assets from eligible financial institutions at a fair value and put these assets to economic use in a profitable manner.

AMCON was therefore set up mainly to inherit all non-performing loans of commercial banks especially those whose management boards were dissolved and taken over by the Central Bank of Nigeria in 2010, (Union Bank Plc., Bank PHB Plc., Intercontinental Bank Plc. and AfriBank Plc.). In 2011 ***AMCON*** acquired and restructured three of these banks namely AfriBank Nigeria Plc is now Mainstreet Bank, Bank PHB is now Keystone Bank while Spring Bank Plc was restructured as Enterprise Bank.

AMCON therefore was created to be a key stabilizing and revitalizing tool for the purposes of reviving the financial system by efficiently resolving the issues of non-performing loan assets of the banks in the Nigerian economy. In this regard ***AMCON*** should be seen as a rescue financial institution that is geared towards addressing liquidity problems in the banking industry by buying up the industry's non-performing loans with the overall objective of restoring confidence in the sector. The management and regulatory control of ***AMCON*** is vested in the ***CBN***. The mission of ***AMCON*** could then be stated as follows:- (1) complimenting the recapitalization of affected Nigerian banks; (2) providing an opportunity for banks to sell off non-performing loans; (3) freeing up valuable resources and enabling banks focus on their core activities; (4) to get banks lending again.

The primary objectives of ***AMCON*** as spelt out in the enabling act establishing it are:- (1) assist eligible financial institutions to effectively dispose eligible bank assets in accordance with the provisions of the act; (2) efficiently manage and dispose of eligible assets acquired by the corporation in accordance with the provisions of the act; and (3) obtain the best achievable financial returns on eligible bank assets or other assets acquired by it in pursuance of the provisions of the act.

FUNCTIONS OF AMCON

The functions of ***AMCON*** include:-

1. Acquiring eligible bank assets from eligible financial institutions.

2. Holding, managing, realizing and disposing of eligible bank assets (including the collection of interest, principal and capital due and taking over of collateral securities of loans).

3. Paying coupons on, and redeeming at maturity, bonds and debt securities issued by the corporation as consideration for the acquisition of eligible bank assets.

4. Performing such other functions directly related to the management or the realization of eligible bank assets that the corporation has acquired, including managing and disposing of assets acquired with the proceeds derived by the corporation from managing or disposing of eligible bank assets acquired by it.

5. Taking all steps necessary or expedient to protect, enhance or realize the value of the eligible bank assets that the corporation has acquired.

6. Performing such other activities and carrying out such other functions which in the opinion of the board are necessary, incidental or conducive to the attainment of the objectives of the corporation.

POWERS OF AMCON

Some of the powers of ***AMCON*** include but are not limited to:-

1. Issue bonds or other debt instruments as consideration for the acquisition of eligible bank assets.

2. Maintain a portfolio of diverse assets including equities, fixed income bonds and real estate.

3. Provide equity capital on such terms and conditions as the corporation may deem fit.

4. Borrow or raise money, with or without the guarantee of the ***CBN*** or secure the payment of money in any manner including issuing debentures, bonds etc.

5. Initiate or participate in any enforcement, restructuring and reorganization.

6. Draw, accept and negotiate negotiable instruments.

7. Accept any security, guarantee, indemnity or surety.

8. Form or acquire a wholly owned subsidiary or form or acquire an interest in a holding company for the purpose of performing any of its functions.

9. Establish a trust or participate in a trust as trustee or beneficiary.

10. Do all such other things as the board considers incidental to or conducive to the attainment of any of the corporation's functions under the act.

SUMMARY

Asset Management Corporation of Nigeria was set up by ***AMCON*** act No. 4 of 2010 basically to acquire eligible bank assets from eligible financial institutions at a fair value and put these assets to economic use profitably. Its basic objective is to assist eligible financial institutions to effectively dispose eligible bank assets in accordance with the provisions of the act. Both the functions and powers of ***AMCON*** are geared towards achieving this onerous goal of acquiring eligible bank assets from eligible financial institutions, holding, managing, realizing and disposing of such eligible bank assets.

REVIEW QUESTIONS

1. When and how was ***AMCON*** set up?
2. What is the business philosophy behind the setting up of ***AMCON***?
3. What are the functions of ***AMCON***?
4. Explain some of the powers of ***AMCON.***

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CHAPTER 11

NON-BANK FINANCIAL INSTITUTIONS

INTRODUCTION

There is always the tendency to minimize the role of non-bank financial institutions while emphasizing that of commercial banks in any discussion involving the financial system. But this should not be so because non-bank financial institutions are an important part of the financial system as they play a vital role in the flow of money and credit within the financial system.

It should be noted that many non-bank financial institutions are becoming increasingly like commercial banks in their activities and are competing for many of the same customers. On their side, commercial banks themselves are offering many of the services traditionally offered by non-bank financial institutions such as brokering services and selling insurance. Therefore both bank and non-bank financial institutions are moving toward each other in the services they provide and markets they service – a phenomenon known as "Convergence". This is why financial analysts stress the importance of studying the whole financial institutions' sector to better understand how the financial system works. The non-bank financial institutions to be studied in this chapter include Thrift Institutions, Pension Scheme and the Nigerian Insurance Industry.

THRIFT INSTITUTIONS

These institutions play a vital role in the flow of money and credit within the financial system and are particularly important in

selected markets such as the market for personal savings. Savings and loans associations are among the largest of all thrift institutions accepting deposits and extending loans and other services primarily to households.

In the Nigerian economy the local thrift institutions have been of great help to the un-banked rural populace by helping mobilize their savings and granting them loans where necessary. The different tribes and localities in Nigeria have different names for such institutions for example the Igbos call it"Isusu", the Yorubas call it "Esusu" while the Hausas call it "Adashi". Not minding the name, they perform basically the same function. It is a fund to which a group of individuals make fixed contributions of money at given intervals and the total amount contributed by the entire group is assigned to each of the members in rotation. In a way it has some elements of a credit union or an insurance scheme but differs from them. The incentive here is that the "Isusu" or "Adashi" compels one to save thereby encouraging one to save money today so as to benefit from a lump sum payment in the future.

In more developed economies savings and loan associations emphasize longer-term loans to individuals and families in contrast to the shorter-term lending focus of many other deposit-type financial institutions. In the Nigerian economy, quite a number of these institutions have been in existence in the recent past but the number has thinned down considerably due to failures.

CREDIT UNIONS

These are co-operative, self-help associations of individuals rather than profit motivated financial institutions and they are regarded as thrift institutions. Savings deposits and loans are offered only to the members of each association as such it is not open to the general public. The members of a credit union are technically the owners, benefitting from the dividends and sharing in any losses that occur. Credit unions are organized around common affiliation or common bond among their members. Most members work for same employers or for one of a group of related employers. Moreover, if

one family member belongs to a credit union, other family members usually are eligible as well. In Nigeria, non-profit associations such as labour unions, church, social organizations, state/city associations, age grades etc. have been used to get credit unions started.

Credit unions began in the 19th century in Germany in order to save low-income individuals and families primarily in industrial jobs and farms by providing them with inexpensive credit and a ready outlet for their savings. The credit union movement began as a response to "loan sharking" where poorer households were charged extremely high interest rates for small cash loans. Interestingly enough, credit unions often report one of the lowest default and delinquency rates on their loans due to the fact that they give fewer business loans than other competing financial institutions, and the common bond between credit union members seems to encourage most borrowing members to repay their loans on time.

PENSION FUNDS

Pension funds protect individuals and families against loss of income in their retirement years by allowing workers to set aside and invest a portion of their current income. A pension plan places current savings in a portfolio of stocks, bonds and other assets in the expectation of building an even larger pool of funds in the future. In this way the pension plan member can balance planned consumption after retirement with the amount of savings set aside today. There are two main types of pension plans namely:

Defined benefit plan

This promises a specific monthly or annual payment to workers when they retire based upon a specific benefits formula that typically takes into account the size of their salary during the working years and the length of employment. It has the advantage of guaranteed income if the employee remains with a particular employer for a relatively long period, but an employee who leaves early or is dismissed before retirement may get little or nothing.

Defined benefit plans are declining as a percentage of all pension programs.

Defined Contribution Plan

This plan specifies how much must be contributed each year in the name of each worker but the amount to be received during retirement will vary depending upon the amount saved and returns earned on accumulated savings. Under this plan, the funds saved belong to the employee and are portable provided the employee stays on the job long enough (usually one to two years) for the savings to be "vested" in his/her name. Defined contribution plans are rising and now account for the majority of private pension programs.

In fact this is the pension scheme that is in existence in contemporary Nigeria. According to the Pension reform act, 2014 which repealed the Pension reform act No. 2, 2004, "There is established for any employment in the federal Republic of Nigeria, a contributory pension scheme for payment of retirement benefits of employees to whom the scheme applies under this act" the act goes further to specify that the contribution shall be a minimum of ten percent relating to the employees monthly emolument by the employer and a minimum of eight percent by the employee. It states further that notwithstanding the provisions of the act, an employer may agree on the payment of additional benefits to the employee upon retirement or elect to bear the full responsibility of the scheme provided that in such a case, the employer's contribution shall not be less than 20 percent of the monthly emoluments of the employee.

Investment strategies of Pension Funds

Pension Funds are long-term investors with limited need for liquidity. This is because their incoming cash receipts are known with considerable accuracy given that a fixed percentage of each employee's salary is usually contributed to the fund. Also, cash out-flows are not difficult to forecast, because the formula for computing benefit payments is spelt out in the contract between the

fund and its members. This situation therefore encourages pensions to buy common stock, long-term bonds and real estate and to hold these assets on a permanent basis. Ideally pension funds should be big investors in the stock market.

Also it should be noted that interest income and capital gains from pension-plan investments are exempt from Federal income taxes, and pension plan members are not taxed on their contributions unless benefits are actually paid out. Despite all these the pension fund industry is closely regulated in many of its investment activities and indeed its entire operation so as to curb the incidences of fraud. The pension fund sector in Nigeria still faces problems that will require creative solutions in the future, including a redefining of the role of public and private institutions in assuring an equitable timely and adequate distribution of retirement benefits to those who have earned them.

THE INSURANCE INDUSTRY

Insurance in its simplest form is the provision of security to lives and property. The primary purpose of any insurance policy is to indemnify the policy-holder or insured in respect of any loss or damage caused as a result of an accident arising from an insured peril. The overriding intention is to put the insured in the same financial position as he was immediately before the incident. An insurance policy does not prevent an accident or misfortune rather it attempts to ensure that funds are available for prompt repair or replacement of the damaged or lost asset. In the case of life policy, it ensures that appropriate compensation is paid.

Insurance can, therefore, be rightly defined as a contract whereby the insurer or assurer agrees in consideration of a premium paid to him by the insured or assured to indemnify the latter against loss resulting on the occurrence of certain events. From the legal point of view, insurance could be defined as an arrangement whereby the insurer promises to pay the insured a given sum of money if something happens and causes the insured to suffer financial loss. Briefly put, insurance simply means providing against the occurrence of risk.

In fact, it could be rightly argued that in the traditional African society the concept of insurance has been in practice in its primitive form. Owing to the extended family practice, some cultural groups such as the age grades, social clubs and committee of friends acted as insurers and provided the basic insurance needs of their kinsmen especially in meeting up with burial expenses of dead relatives, marriage expenses, festivities and to some extent fire incidents. But as the traditional society gave way to a modern industrialized society and the extended family system became weakened by urbanization, modern insurance business stepped in to serve the insurance needs of the people.

The insurance business is founded upon the law of large number. This mathematical principle states that a risk not predictable for one person can be forecast with reasonable accuracy for a sufficiently large group of people with similar characteristics. For example no insurance company can accurately forecast when any one person will die, but its actuarial estimates of the total number of policy holder who will die in any given year are usually quite accurate. The basic objective of insurance companies therefore is to ensure that their funds will at all times be able to meet their liabilities to policy-holders. This objective is enshrined in the insurance Act of 1976 which was replaced by the insurance Decree No. 58 of December 1991 and currently the insurance industry is operating with the insurance act of 2003.

Non-Life Insurance

Non-Life Insurers otherwise known as Property–Casualty (***PC***) insurers offer protection against fire, theft, accident, workmen's compensation, negligence, bad weather and other acts that result in injury to persons or property. So broad is the range of risk for which these companies provide protection that property-casualty insurers are referred to as insurance supermarkets. In addition to their traditional insurance lines – automobile, fire, marine, personal liability and property coverage – many of these firms have branched into the health and medical insurance areas thereby colliding with life insurers offering the same services. For example

in Nigeria many of them participate in the National Health Insurance Scheme (*NHIS*).

Non-Life insurance business has grown over the years due to the effects of inflation, rising crime rates, and increasing number of lawsuits arising from product liability and professional negligence claims. Nevertheless it should be noted that Non-life insurance is a riskier business than life insurance because the risk of policy-holder claims arising from crime, fire, airplane crashes, automobile accidents, and similar causes is less predictable than the risk of death. Moreover, inflation has had a potent impact on the cost of property and services for which this form of insurance pays.

Life Insurance Business

Life insurance companies offer their customers a hedge against the risk of financial loss that often follows death, disability, ill health or retirement. Policy holders receive risk protection in return for the payment of policy premiums that are high enough to cover estimated benefit claims against the company. Life insurance business has not been growing like the non-life insurance because people are not sufficiently aware of the benefits and role of life assurance in their lives and even many of those who are aware are very skeptical about the business. To boost their business therefore life insurers have branched out to include not only traditional life insurance policies in their menus, but also health insurance and annuity plans. Health insurance programs cover a portion of their policy holders' medical bills, while annuity plans aid clients in building their long-term savings.

The primary funding source for life insurers is from premium receipts from sales of various kinds of annuities and insurance policies and income from investment comprising interest, dividend and rents. Life insurers invest the bulk of their funds in long-term securities such as bonds and stocks, thus helping to fund real capital investment by businesses and governments. They are inclined to commit their funds to long-term investments due to the high predictability of their cash inflows and outflows.

Insurance Intermediaries

The main intermediaries and distributors of insurance in Nigeria are Agents and Brokers.

Agents

An agent may be employed on full-time basis by an insurance company and is remunerated either by way of salary or commission or both. Part-time agents like lawyers, accountants, bank managers, etc. may be appointed on the grounds that by the nature of their professions they are in positions to attract prospective policy-holders to insurance companies, and they are usually remunerated by way of commission. Sometimes some companies allow proposers of insurance to act as their own agents in introducing their own insurances.

Brokers

Whereas an agent is a person who has been employed to perform an act or acts on behalf of his principal within specified guidelines, the broker on the other hand, is an independent operator not in anyone's direct employment. He merely sets himself the task of bringing parties to an insurance transaction together. The broker conducts his business with all and sundry and does not represent or endeavour to obtain business for one office or group of offices to the exclusion of others. He is open to arrange any contract which is entrusted to him with any company in his market and which from his knowledge and experience seems to him to be best fitted for the purpose. The other intermediaries operating in the Nigerian insurance industry include Surveyors, claim adjusters and risk management personnel.

SUMMARY

Non-Bank financial institutions are an integral and important part of the financial system as they play vital roles in the flow of money and credit within the financial system. These institutions include thrift schemes like the local *isusu*, credit unions which are co-operative self-help associations, Pension funds that protect

individuals against loss of income due to retirement, Insurance institutions that make provisions for security to lives and property among others

REVIEW QUESTIONS

1. Explain how Credit Unions function.
2. Differentiate between defined pension benefit plan and defined pension contribution plan.
3. Explain the term "Insurance"
4. What are the different types of insurance business in existence in the country?

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CHAPTER 12

ELECTRONIC BANKING TRANSACTIONS AND THE CASHLESS POLICY

INTRODUCTION

Banking practices are today undergoing a technological revolution. Computer terminals and high-speed information processing are transforming the industry with emphasis on convenience and speed in handling such routine transactions as making deposits, withdrawing money and paying for purchases of goods and services. This phenomenon has come to be known as "virtual" banking or e-banking. This broadly speaking denotes the provision of banking and related services through extensive use of information technology without direct recourse to the bank by the customer. Most of the new technology is designed to reduce labour and paper costs, thereby making the banking industry more capital intensive than labour intensive.

E-BANKING PRODUCTS

Among the most important pieces of technology available in the industry are:-

Automated Teller Machine (*ATM*)

This machine accepts deposits and dispenses cash with the use of an *ATM* card. An *ATM* card is a variation of a debit card which one can use in a cash machine by punching in one's Personal Identification Number (*PIN*) for making cash withdrawals from one's bank account. *ATM* cards have the advantage over debit

cards in that a person other than the card holder will not be able to use it for cash withdrawal unless he/she knows the *PIN*. Also most banks limit the amount of cash that can be withdrawn on any single day. For many banking transactions *ATMs* perform as well as human tellers and they have the added advantage of providing 24-hour services.

Credit Cards

A credit card is basically a payment mechanism which allows the holder of the card to make purchases without any immediate cash payment. Credit limit is fixed by the issuing bank and this limit is mostly determined by the financial history of the customer as well as the type of card. The issuing bank makes the payment to the merchant establishment selling the relevant goods and services, while the card holder reimburses the bank at the end of the month. There are different types of cards and the benefits attached to them vary according to the type of card.

Debit Card

As one is using a debit card one is running down his/her money in the bank account. Thus while making a payment to a merchant establishment using a debit card. It assumes the form of a transaction between the establishment and one's bank account. Debit cards are more readily accepted by merchant establishments since they get instant payment whereas in the case of a credit card, the card holder makes the cash payment at the end of the month. Debit cards free the card holders from carrying cash for their transactions. Debit card holders have to be extremely careful with their cards because losing such a card might result in the balance in their bank accounts being wiped out with a single purchase by an unscrupulous person.

Point-of-Sale (PoS)

Point-of-Sale terminals accept plastic credit card and debit cards thereby allowing the customer to pay instantly for a purchase without necessarily cashing a cheque or withdrawing money

through the *ATM. POS* terminals are located in retail stores and other commercial establishments and they are connected online to the bank's computer.

Electronic Funds Transfer (EFT) Service

This is a service whereby funds are transferred electronically over the telephone, either nationally, or internationally. International funds transfers from applicant to beneficiary are made in as little as a few seconds. The international network known as "*SWIFT*" (Society for Worldwide Interbank Financial Telecommunications) an organization promoted by banks and financial institutions around the world is utilized to facilitate the speedy transfer of funds across international destinations without any paper work and expeditious efficiency. This is a path breaking technology that will ultimately pave the way for paperless banking.

Automated Clearing House (ACH)

This is another piece of electronic machinery which transfers information from one financial institution to another and from account to account via computer-tape. It is used principally for handling business payrolls and processing government transactions and many financial service institutions offering such services use it.

Internet Banking

Banking over the internet through home and office computers continues to expand rapidly, allowing customers to quickly enter their requests for financial information and conduct remote financial transactions. A growing number of bank websites offer 24-hour transactional services such as transferring funds, paying of bills and security trading.

IMPLICATIONS OF E-BANKING TRANSACTIONS

These recent technological changes have profound implications for bank costs, employment and profitability. The financial benefits are manifold and they include the advantage of having a lower cost of

handling transactions, increased speed of response to customer requirements, cost of efficiency, and the possibility of improved quality and an enlarged range of services being available to the customer more rapidly and accurately at his/her convenience.

In the future, there will be little or no need for customers to enter a bank building since their needs will be met mainly by electronically transferring information rather than by requiring people to move from one location to another. The banker's principal function then will be one of providing the necessary channels and allowing customers conduct their own transactions. This development therefore implies fewer but more highly skilled employers and more capital equipment. Heavy investment in computers and money machines will result in substantial fixed costs, requiring a large volume of transactions and favoring the largest banking organizations. It is expected therefore that these new technologies will intensify pressures for further consolidation such that in the long run technology should lower overall operating costs and save the industry billions of Naira.

THE CENTRAL BANK OF NIGERIA'S CASHLESS POLICY

The Central Bank of Nigeria (*CBN*) recently introduced a new policy on Cash-Based transactions which stipulates that over the counter cash transactions above ₦500,000 for an individual and ₦3,000,000 for corporate entities will attract charges. Also the policy has it that the limit of cheque amount a third party can cash is ₦150,000. The pilot scheme of this policy started in Lagos State by January 1, 2012 and phased to cover Port Harcourt, Kano, Aba and Federal Capital Territory (*FCT*) and by June 1, 2014 the whole 36 States of the Federation have come under the ambits of the policy.

Some of the salient consideration that went into the formulation of the policy include:-

1. The Central Bank of Nigeria through this policy is encouraging banks to shift the cost burden of heavy cash

management to customers conducting high volumes of cash transactions.

2. The Central Bank of Nigeria through this policy is paving way for Nigerians to enjoy the benefit of technological revolution in the banking sector since the policy aims at reducing the amount of physical cash circulating in the economy because an efficient and modern payment system is positively correlated to electronic development.

Advantages of a Cashless Economy

The benefits of a cashless economy cut across the main stakeholders in the industry i.e. the government, the banks and merchants and the customers. The banks and merchants benefit with increase in customer coverage, reduction in operational costs, and availability of international products. Also there is increase in customer satisfaction and personalized relationship with customers and easier documentation and transaction tracking.

To the customers, the electronic transactions that go with cashless economy improve convenience as most of them are available 24-hours a day and seven days a week. Also these technologies help reduce transfer costs, processing and transaction times, and facilitates immediate notification of all transactions on customer's account. For the government electronic money transaction aids adequate budgeting and taxation and improves regulatory services. It also improves administrative processes and reduces cost of currency administration and management. Moreover, electronic money transaction leads to reduction in money laundering since it leaves an audit trail all the time.

Disadvantages of a Cashless Economy

One basic disadvantage of electronic money transactions of a cashless economy is that it robs people of their privacy as they constantly key in their personal data into the computers. This increases the risk of identity theft which fraudsters perpetrate once they can hack into a bank's security system. Also there is the added

cost of transactions which can result in an increase in the cost of goods and services.

SUMMARY

The practice of banking has undergone transformation as a result of the introduction of electronic transactions in the industry. Among the most important pieces of technology introduced are the Automated Teller Machine, Credit Card, Debit Card, Point-of Sale terminals, Electronic Funds Transfer service, Automated Clearing House, and Internet banking. These technologies have profound implications for bank costs, employment and profitability. For Nigerians to benefit from these changes, the Central Bank of Nigeria recently introduced a new policy on cash-based transactions. This cashless policy has since taken effect in the 36 States of the Federation.

REVIEW QUESTIONS

1. Distinguish between a credit card and a debit card.

2. What is an ATM?

3. What are the implications of electronic banking transactions on a given economy?

4. Based on the *CBN's* new policy on cash-based transactions, what are the advantages of a cashless economy?

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SECTION THREE:

THE CAPITAL MARKET

CHAPTER 13

STRUCTURE OF THE NIGERIAN CAPITAL MARKET

INTRODUCTION

The capital market is a major component of the Financial System hence it plays an important role in the economic development of any country. The Nigerian Capital Market is one of the emerging capital markets in the world. Emerging markets are those markets that have since left the rudimentary stages of development but are yet to attain levels of efficiency currently enjoyed by the capital markets in advanced economies of the world like the United States, United Kingdom, France, etc. The league of emerging markets includes India, South Africa, and Malaysia to mention a few. This chapter examines the structure of the Nigerian capital market which is fashioned in the model of the United States market.

HISTORY OF THE NIGERIAN CAPITAL MARKET

The first window opened for capital market activities in Nigeria is believed to be the floatation of £300 development stock issued by the Nigerian Colonial government in 1946. The success of that issue awakened the interest of many stakeholders then in creating an environment for capital formation transactions in Nigeria. Subsequently, in May 1958, the Barback Committee recommended the establishment of a formal capital market for Nigeria, resulting in the formation of the Lagos Stock Exchange in 1960. This Exchange was formalized by the statutory recognition accorded it

via the enactment of the Lagos Stock Exchange Act, 1961. The Exchange was and remains a private organization with initial financial support from the Federal Government of Nigeria through the Nigerian Industrial Development Bank (***NIDB***) as it then was. Further to this development, the Capital Issues Committee was created in the Central Bank of Nigeria to monitor, supervise and regulate capital market activities in Nigeria. This was followed by the establishment of the Capital Issues Commission via the Capital Issues Commission Decree No. 4, 1973.

The Capital Issues Commission metamorphosed into the Securities and Exchange Commission in 1979 by the promulgation of the Securities and Exchange Commission Decree No. 71, 1979. Apart from creating the ***SEC***, this Act gave the Minister of Finance judicial powers to settle capital market disputes. ***SEC*** had very limited regulatory powers under this Act. In 1988, the Securities and Exchange Commission Decree No. 29, 1988 enlarged the powers of ***SEC*** and subjected the Nigerian Stock Exchange (formerly the Lagos Stock Exchange) to regulation by the ***SEC***. The Decree also conferred jurisdiction over capital market disputes on the Federal High Court.

Consequent upon the growth of the capital market in Nigeria from the early 1990s, the General Sani Abacha administration, in 1996, set up a panel headed by Chief Dennis Odife to review the market and make appropriate recommendations to upgrade the local market to world standards based on international best practice. The panel submitted its report and the recommendations contained therein formed the basis for the Promulgation of the Investments and Securities Decree No. 45, 1999. This Act was recently repealed and a new Investments and Securities Act No. 29, 2007 enacted with effect from the 25th day of June, 2007.

The new Act fine tuned the provisions of the repealed Act and gave ***SEC*** wider powers over regulated entities in the market including the power to intervene in the management and control of the affairs of market operators in the event of failure or distress and to freeze assets of violators of the Act as appropriate. With the new

Act, the regulatory regime in Nigeria has become world class in accordance with International Organization of Securities Commission's (***IOSCO***) standards. The Securities and Exchange Commission as an Appendix 'A' signatory to the ***IOSCO*** Multilateral Memorandum of Understanding has joined the elite club of capital market regulators in the world. Only 35 countries in the world belong to this class.

In Africa, while the South African financial regulatory system is based on the English model with a single regulator known as the Financial Services Board (a consolidated regulatory regime); the Nigerian system is modeled after the system operating in the United States of America (a multi regulatory regime) probably based on the similarities between the two nations in terms of population, cultural and ethnic diversities. Under the ***IOSCO*** principles of regulation, each country adopts a regulatory regime that best serves its purpose and which suits its environment.

LEGAL FRAMEWORK OF THE NIGERIAN CAPITAL MARKET

The Investment and Securities Act No. 29 of 2007 recognizes two main levels of regulation of the capital market i.e. apex regulation represented by ***SEC*** and self regulation represented by The Nigerian Stock Exchange (***NSE***), ***ASCE***, etc. Under the new Act, ***SEC's*** apex regulatory authority is expressed without equivocation. However, some provisions of the following Acts also impact on the operations of the Nigerian Capital Market:

1. Company and Allied Matters Act, 1990;
2. Chartered Institute of Stockbrokers Act, 1992;
3. Banks and Other Financial Institutions Act, 2004;
4. Central Bank of Nigeria Act, 2007;
5. Foreign Exchange (Miscellaneous) Provisions Act, 1995
6. Nigerian Investment Promotion Commission Act, 1995
7. Money Laundering (Prohibition) Act, 2004;
8. Economic and Financial Crimes Commission Act, 2004;
9. Pensions Reform Act, 2004 (particularly Part IX);
10. Insurance Act 2003.

The above statutes recognize the peculiar position of the capital market as one strong leg of the tripod upon which the Nigerian economy rests.

STRUCTURE OF THE CAPITAL MARKET

The capital market is the segment of the financial markets in which medium and long term financial instruments with maturity in excess of one year are transacted. It is a network of participants, instruments and facilities which function in a synergy to facilitate efficiently, the flow of savings into long term investments for socio-economic development. The capital market is a market of intangible goods (e.g. stocks and bonds). Its concepts, operations, operators and boundaries are regulated by carefully crafted instruments and body of Rules including.

1. Investment and Securities Act, 2007

2. Rules and Regulations of Securities and Exchange Commission, Nigerian Stock Exchange, Central Securities Clearing System, etc.

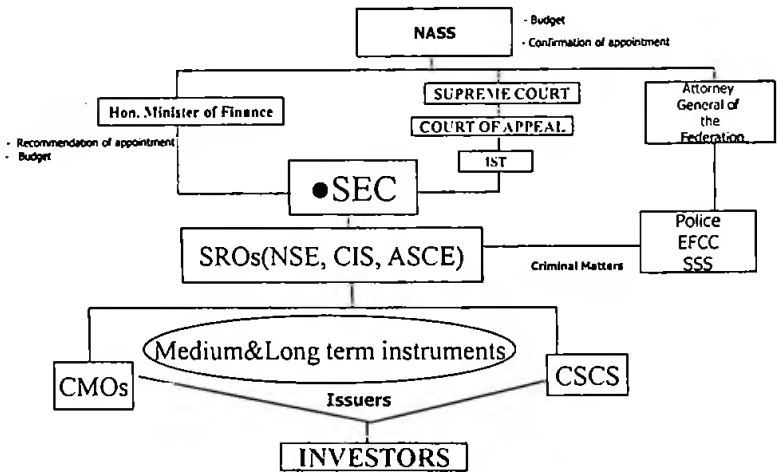
3. Title documents e.g. Share Certificates, Bonds Certificates, Investments Notes, etc.

This market is sustained by the confidence of its participants in the system supported by adequate framework for the protection of individual and corporate rights. The Securities and Exchange Commission is the apex Regulator in this market supported by Self Regulatory Organizations registered by it e.g. The Nigerian Stock Exchange (***NSE***), the Abuja Securities and Commodities Exchange (***ASCE***) and other Capital Market Trade Associations e.g. Institute of Capital Market Registrars (***ICMR***), Chartered Institute of Stockbrokers (***CIS***), Capital Market Solicitors Association (***CMSA***), etc. The Capital Market is principally regulated by the Investments and Securities Act, 2007 and Rules made by the

Securities & Exchange Commission. The general structure of the Nigerian capital market is depicted in the figure below:

Fig 13.1

General structure of the Nigerian capital market



Source: Adapted from Udora, C. (2003) The review of the Nigerian financial system in *Securities Market Journal*, a publication of the Securities and Exchange Commission, Abuja.

The capital market in Nigeria remains the stabilizing force in the economy. During the recapitalization of banks in Nigeria, 2005, the capital market rescued some of the existing twenty five (25) banks from liquidation by providing them the platform to raise needed funds at the cheapest possible cost and without any collateral. The same capital market supported the Insurance Industry recapitalization and continues to support all public companies with cheap funds to sustain their businesses.

SEGMENTS OF THE CAPITAL MARKET

There are two major segments of the market namely:

1. The primary market: this is the market for new issues including offer for subscription, offer for sale and private placement.

2. The Secondary market: this is the market for resale of securities earlier issued and paid up. Here transactions on securities held by investors are consummated resulting to the previous holder dropping off and a new holder taking his place and the name of the new holder entered into the register of the company whose securities are transacted upon.

An example of a typical secondary market is The Nigerian Stock Exchange (*NSE*) with trading floors in many states of Nigeria. The NSE is a private sector owned platform for share exchange although plans are in progress to convert it into a publicly owned company. Another example of a secondary market is an Over-the-Counter Market (*OTC*). This is a secondary market facility without trading floors; rather trades are conducted via telephones and connected computers in a structured platform for dealing in securities of public companies not quoted on the Stock Exchange. *OTC* transactions are basically remote trading.

Major instruments traded in the Nigerian capital market are ordinary shares or equities, debentures and bonds. Federal, State and Local Governments raise funds in the capital market through the issuance of bonds with maturities of up to twenty five (25) years. Funds raised are used for capital projects such as water supply, roads, housing estates, hospitals, markets, financing budget deficits etc. Market Participants include the regulatory bodies such as the Securities and Exchange Commission, the Exchanges, the Operators and investors.

SUMMARY

Institutions of the capital market fall under two broad categories - the regulators and the intermediaries (facilitators). The regulators include the Securities & Exchange Commission (*SEC*), and other self-regulatory bodies. The other category of capital market institutions are intermediaries often called market operators.

REVIEW QUESTIONS

1. Besides the Investment and Securities Act No. 29 of 2007, other Acts also impact on the operations of the Nigerian capital market. Mention FIVE of these laws.

2. Distinguish between the primary market and the Secondary market

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CHAPTER 14

CAPITAL MARKET OPERATORS

INTRODUCTION

Capital market operators facilitate the flow of savings into long term investments for economic development. In this chapter, we examine the key operators in the Nigerian capital market namely issuing houses, stockbrokers, registrars, trustees, receiving bankers, solicitors, reporting accountants and other capital market consultants.

ISSUING HOUSE

Companies seeking to raise money from the capital market are expected to appoint an Issuing House which is usually the first party to be appointed to manage floatation. An issuing house performs financial and investment advisory functions to its client company in respect of the client's need/desire to raise capital or to restructure its finances An Issuing House can be a Bank or any other financial organization registered as an Issuing House by the Securities and Exchange Commission. The minimum capital requirement for Issuing House in Nigerian has been increased from N150 million to N200 million.

Functions of an Issuing House

Issuing House functions can only be performed by any institution duly registered to perform such functions among which are the following:

1. Co-ordinates activities of other professionals in a public offer.

2. Plays a key role in putting together the prospectus for the issue as well as other documents required for the registration of securities intended to be offered to the public

3. May also assist in the selection of the other parties.

4. Registers the issue with, and obtaining the approval of the *SEC*.

5. Prepares the allotment proposal approved by the issuer for submission to *SEC* for clearance

6. Jointly responsible with the Registrar, for collating all applications in respect of any public offer

7. Plays a key role in the valuation and pricing the securities on offer

8. Underwrites the public offer

Thus, the issuing House plays the lead advisory role and is expected to drive the entire process which can be broadly divided into four: (1) securing mandates; (2) packaging; (3) marketing; and (4) post offer activities. These functions presupposes that the issuing House must be familiar with the Issuer's business as well as all the relevant rules and regulations that will affect the assignment such as the securities laws, *SEC* rules and regulations, Exchange listing requirements etc. As the chief marketing institution, the issuing House must work towards the successful sale of the offer, manage the Company's perception, keep the company informed of all developments that might impact the Offer, collect and disburse Offer proceeds according to agreed time-table and recognize that

Post offer activities for any issue are as important as the dressing-up of a company before approaching the market.

STOCKBROKER

A broker is a person or firm that facilitates trades between customers. A broker acts as a go-between and, in doing so, does not assume any risk for the trade. A dealer is a person or firm that buys and sells for his or her own inventory of securities and for others. A dealer therefore assumes risk for the transactions. In Nigeria, stockbrokers act as broker-dealers. A broker-dealer is allowed to operate in either role, but never as both at the same time. To be involved in the buying, selling or trading of securities, a person or firm must be registered with the Securities and Exchange Commission, the Nigerian Stock Exchange (*NSE*) and the Chartered Institute of Stockbrokers (*CIS*). Recently in Nigeria, the capital requirement for Broker/Dealer was increased from N70 million to N300million. For broker only, the capital requirement was increased from N40 million to N200 million; while for dealer, it was increased from N30 million to N100 million.

The Role of the Stockbroker

In a public issue, once a mandate has been won and the Issuing House and the Issuer have determined the timing of the offer, the broker must be appointed. He acts as the principal intermediary between the company, its advisers, and the Stock Exchange. He facilitates the listing of securities after the application and registration requirement of the *SEC* have been complied with.

The issuing house and the stockbroker meet with the issuer to ensure compliance with the requirement of the Companies and Allied Matters Act 1990 as amended. At the mandate giving stage, the stockbroker files an application to the Stock Exchange intimating her of the offer. He consequently vets all documents for presentation to regulatory authorities and authenticates all claims made therein. At the approval stage, the stockbroker sponsors the application to the Stock Exchange along with the accompanying documents and information. He is responsible for leading the

parties to, and introducing them at the Quotation Committee meeting and answers any queries and or question that may be asked by the Quotation department of the Nigerian Stock Exchange.

Furthermore, the stockbroker delivers to the Exchange proof print of the prospectus, the application form, posters and newspaper adverts after approval has been given by the Quotations Committee as well as collect the Certificate of Exemption issued in accordance with section 553 of Companies and Allied Matters Act and this authorizes the Issuer to produce the abridged prospectus prior to the Completion Board Meeting. Also, the stock broker with the other parties to the issue signs the verification questionnaire and offer documents at the Completion Board Meeting and files a complete set of the signed documents with the Stock Exchange immediately after the meeting and he acts as a receiving agent for the application and ensures wide distribution of the shares.

Apart from the primary market activities of the stockbroker, he also plays a major role in secondary market transactions. Indeed he takes to the floor of the Exchange the shares of an investor who wants to sell or buys on the floor the shares of investors offered for sale by other stockbrokers. He is expected to act in the interest of the investors and be fair efficient and transparent. In addition, the Stockbroker is expected to exercise due diligence at the floor of the Stock Exchange by not engaging in sharp practices. Other Roles of a Stockbroker include:

1. Intermediates in the Treasury Bills Market (Money Market).

2. Renders advisory and investment management services to clients.

3. Investment adviser in the government's privatization programme.

4. Performs custodial roles for clients.

5. Collects and revalidates dividends for clients.

6. Provides liquidity and promotes transfer of ownership from his trading activities

The Stockbroker charges a Commission for his services known as brokerage. In the primary market, this commission is 0.125% of market value while in the secondary market, it is graduated from 0.75 – 1.35% of Consideration.

REGISTRARS

The Registrar is primarily the facilitator of offer and purchase of shares and stocks in the capital market. The official or organization takes responsibility for documentations relating to stock transactions. He prepares and keeps the register of shareholders and by so doing, plays vital roles in the primary and secondary market for shares, as well as promoting investor confidence in the market. The usefulness of the Registrar to the investor and the entire market can be enumerated as follows:

1. Maintenance of the registrar of shareholders of client companies, a function that takes it through change of address, bank mandate or letters of administration.

2. Payment of dividend warrants to stakeholders.

3. Organizing and officiating at Annual General Meetings.

4. Issuing of share certificates.

5. Production and filing of statutory reports with the corporate Affairs commission.

6. Rendering statutory reports to Nigeria stock Exchange and the Securities and Exchange Commission.
7. Registration of share transfers.

8. Liaising with *CSCS* to update the register of shareholders.

In general, the Registrar ensures that structures erected by the regulatory authorities for the promotion of investor confidence and virile market are not subverted. Often, the Registrar acts as ombudsman to ensure processes are followed to the ultimate good of various parties in securities trading. The investor stands to benefit substantially from good understanding of the intermediary roles of the registrar in the primary market, the secondary market and in gingering investor and market confidence.

Responsibilities in the primary market

With the opening of the offer, the Registrar sends documents to receiving and existing shareholders. At the end of the offer period, the receiving agents make returns to the Registrar (two weeks grace is always given where there is no extension). The Registrar crosschecks returned forms to ensure that amount on the attached bank cheques or drafts tally with the shares applied for. Any return that is not in line with the terms of the issue is rejected. The registrar can reject forms on the grounds of irregularities in printed signature, tipexing, application below minimum number of shares, multiple application, application not in correct multiples and differences between the amount (cheque) attached and that on the form.

After the cross checking exercise, the Registrar sends cheques to the issuing houses and keeps two registers on the offer- one concerned with forms received with cheques from the issuing houses and another for forms received without cheques from the receiving agents. When the allotment proposal is approved, he sends share certificates to the company for signing and sealing. On the return of the share certificates to the Registrar by the company's secretary, the Registrar sends the signed and sealed certificates to the shareholder directly or through the receiving agent. The Registrar also ensures that all returned money in respect of unused share is dispatched to the prospective investor as soon as possible.

Responsibilities in the secondary market

The Registrar's role in the primary market finishes with the delivery of share certificates to the investor or a ***CSCS*** statement given to the buyer of shares. Beyond that, the Registrar deals with the investor at the secondary market. The market operates after the issue has been completed and the securities listed on the floor of the Nigerian Stock Exchange (***NSE***). The secondary market provides a window for sale and purchase of shares. It makes shares liquid and attractive as the investor can easily exchange shares for cash to meet financial needs. The Registrar's responsibilities include the following:

1. The Registrar updates data in the register of shareholders as investor write for change of address, change of name, bank mandate, and administration of estate, mergers of account and amalgamation of share certificates.

2. The office processes dividend warrants ensuring there are no forgeries and conversion. It ensures that dividend warrants received from collecting banker or the clearinghouse are properly checked to ensure instrument is duly issued and signed by the authorized official.

3. It is the duty of the Registrar to ensure warrant are properly crossed by the commercial bank; there is no difference between the amount in words and in figure; it is currently dated, not beyond six months and that it is not defaced.

4. The Registrar performs vital role in the process of authenticating transfer shares. It is done by ensuring that shareholders intending to sell shares contact the stockbroker and sign transfer forms with share certificates submitted by authorized stockbrokers. The official checks the specimen signature in the course of verification.

Serious internal control is put into share registration to ensure that all laid down procedures regarding operations, accounting and

administration are observed. The purpose is to eliminate fraud in vulnerable areas in stock trading like dividend payment; share transfer and verification; shareholder data and ***ICT*** related fraud. Registrars detect fraud in a number of ways such as:

1. When share capital is not balanced; it opens up room for enquiry.

2. When a shareholder complains of non-receipt of share certificate that is already sold or dividend already paid.

3. When suspicious lodgments are made in respect of share verification/transfers.

4. When foreign entries are discovered in the computer system.

In Nigeria, the activities of Registrars are regulated by the ***SEC*** as well as by the Institute of Capital Market Registrars (***ICMR***)- a self regulatory body. For a Registrar in the Nigerian capital market, the minimum capital requirement is now N150 million, from N50 million;

TRUSTEES

Whenever a bond is to be issued there is a need to set out the contractual obligations of borrowers and lenders. This is constituted in a document called the "Trust Deed" which usually contains among other information:

1. Restriction imposed on the borrower, usually referred to as the covenant.

2. Assets to be pledged as security.

3. Creditors protection with regards to future additional borrowing by borrower

4. Principal repayment terms

5. Interest payment terms – coupon rate and when payable

6. Rights of creditors in case of default

A Trustee is appointed to protect and enforce the rights of the Bondholders as contained in the Trust Deed. Trustees keep custody of assets (funds and documents) relating to Trusts for which they are appointed, monitor the register of unit/note holders or contributors in a collective Investment scheme, ascertain profitability of investments and the rationale behind investment decisions of Fund/investment managers as well as their compliance with relevant statutory provisions and Trust Deeds. They are also expected to ensure that monthly and other mandatory periodic returns/reports are filed with ***SEC***.

The advantages of appointing a trustee are:

1. It would be difficult for the company to make arrangements with each individual loan stockholder regarding the creation of security.

2. A trustee is better placed to act in the interests of the loan stockholders. The trustee has professional expertise.

3. When decisive action is called for, the various loan stockholders probably would not be able to agree among themselves.

RECEIVING BANKERS

Receiving Bankers receive and keep custody of proceeds of the public offers until disbursed to the Issuer by the Issuing house in accordance with the rules.

FUND/PORTFOLIO MANAGERS

Fund/Portfolio Managers perform advisory and investment services to their clients i.e. manage funds and portfolios on behalf of

investors. In the process, they determine securities to transact in on behalf of their clients and also publish financial market periodicals to guide investors.

INVESTMENT ADVISERS

An Investment Adviser performs advisory services to assist an investor to make an informed investment decision. He makes recommendations to the investor on which securities to transact in and publishes periodicals on market trends based on verifiable facts and analysis of information available in the market. He does not engage in maintenance or management of funds or portfolio.

CAPITAL MARKET CONSULTANTS

Solicitor to the company

This ensures that necessary resolutions are passed by the Board of the Issuer; ensures that other necessary legal documents are prepared as appropriate and when needed. He ensures that the company is always of sound legal health.

Solicitor to the offer

This protects the interest of investors in any offer. He drafts relevant agreements e.g. Trust Deed, Underwriting and Vending Agreements, etc. in consultation with the Issuing House and other stakeholders. He verifies all legal documents supplied by other parties to an offer. He generally ensures that the offer fully complies with all regulatory requirements.

Reporting Accountants

They review Issuers audited accounts or statement of affairs. It involves reviewing company's forecasts, circularize banks and major customers of an Issuer to ascertain the true financial health of the Issuer in comparison with disclosures in the financial statements of the company and prepare reports addressed to the Directors of company and for the attention of the Issuing House(s). In that report he is expected to express his professional opinion on the adequacy of the audited financial statements and the forecasts

reviewed by him. The table below provides a summary of market operators in Nigeria and the respective roles.

Table 14.1: Capital Market Operators

Participant	Roles
Issuing Houses	Primary Market role: • Manage overall transactions manager for primary market issues • Prepare offer timetable and ensures adherence to it • Liaise with the issuer, SEC & other parties to obtain necessary information & documents. • Prepare & files offer documents at the SEC. • Market & distribute offer documents. • Act as receiving agents. • Prepare & file allotment proposal. • Ensures compliance with rules & regulations
Receiving Banks	Primary Market role: • Receive application monies and pay interest on such monies for the period between when returns are made on public issues and allotment approval by the SEC
Registrars	Primary Market role: • Receive all application forms and reconcile the data on the forms with the application monies. • Prepare the allotment schedule and forward it to the Issuing House. • Print and dispatch share certificates & warrants for returned money Secondary market role: • Maintain the register of shareholders • Manage the logistics of AGMs • Dispatch bonus share certificates and dividend Warrants
Stockbrokers	Primary Market role • Liaise with the issuing house to ensure adherence to NSE requirements. • Prepare & file listing application at the NSE. • Obtain a Quotations Committee Meeting ("QCM") date and a listing date.

	• Aid in pricing, marketing & distributing the offer. • Act as receiving agents Secondary Market • Executing trades on behalf of clients
Solicitors	Primary Market role: • Prepare the vending, underwriting, joint issuing house Agreements and, in a debt issue, a trust Deed. • Review the issuer's legal & statutory documentation; exercise due diligence. • Review the issuer's litigation files • File offer documents at the CAC after the CBN
Reporting Accountants	Primary Market role: • Review issuer's audited accounts and report on projections
Receiving Agents	Primary Market role: • Receive application forms and subscription monies during public offers
Trustees	Primary Market role: • Engaged for debt issues and investment Trusts. • Ensure adherence to the Trust deeds Secondary Market role: • Holding assets in trust
Primary Dealers & Market Makers (PDMM)	Primary Market role: • CBN-appointed underwriters of government bonds to trade government bonds and treasury bills in the primary and secondary market • Submit bids for primary auctions, distribute securities to investors Secondary Market role: • Make continuous markets for bonds and treasury bills by quoting two-way prices

Source: The Report of the SEC Committee on the Nigerian Capital Market

SUMMARY

An Issuing House is the lead financial adviser and coordinates the activities of the advisory team. A broker is a person or firm that facilitates buying and selling of securities between customers while Registrars keep the register of members of a company and effect appropriate changes in the register. A Trustee is appointed to protect and enforce the rights of the Bondholders as contained in the Trust Deed while Receiving Bankers receive and keep custody of proceeds of the public offers until disbursed to the Issuer by the Issuing house. An Investment Adviser performs advisory services to assist an investor to make an informed investment decision.

REVIEW QUESTIONS

1. State five functions of an Issuing House.

2. Explain the role of the Stockbroker in the Nigerian capital market.

3. What are the responsibilities of the Registrar in the secondary market?

4. A Trustee is appointed to protect and enforce the rights of the Bondholders as contained in the Trust Deed. State five contents of a Trust Deed

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CHAPTER 15

CAPITAL MARKET OPERATIONS

INTRODUCTION

This chapter examines the operations in the Nigerian capital market. It explains the stages in accessing the capital market, the methods of accessing the market, the listing requirements of the Nigerian Stock Exchange, electronic transactions, concept of underwriting and the stock market index. Other related issues highlighted include fraudulent practices and the dispute resolution mechanisms in the market. The chapter ends by examining the challenges facing the Nigerian capital market.

STAGES IN ACCESSING THE CAPITAL MARKET

The process of taking a private company to the Daily Official List of The Nigerian Stock Exchange can be broken down into the following stages: (1) consultation/discussion; (2) decision making/mandate; (3) documentation/packaging; (4) regulatory – *NSE* quotation approval/*SEC* registration; (5) completion board meeting; (6) distribution/marketing; (7) range of analysis/allotment; (8) general undertaking/declaration of compliance; and (9) listing.

Consultation/Discussion Stage

A company that desires to raise funds and is considering the stock market option may approach its local banker or an issuing house.

Alternatively, an issuing house may approach a company with a proposal for re-capitalization through the stock market. If the initiative is from an issuing house, the benefits of public quotation will be explained to the company.

Decision Making/Mandate Stage

After discussions with the proposed issuing house, the management or Board or owners will meet and resolve to go public. This meeting could be held alone or with the financial advisers in attendance. The memorandum and articles of association will be suitably amended through passing the necessary resolutions to facilitate this. A successful public quotation process is a product of team effort and the composition of that team will be a crucial factor in the outcome of the exercise. Professional advisers, which a company had used in the past, may not necessarily be suitable or experienced to take the company to the market because of the specialist input required.

Parties to an Issue

In any public quotation or public offer process, the following parties are involved: (1) the issuing house; (2) the stockbroker to the issue; (3) the reporting accountant; (4) the solicitor to the issue; (5) underwriter; (6) registrar to the issue; (7) receiving banker; (8) trustee; and (9) solicitor to the trustee

Documentation/Packaging Process

After all the parties to the issue have been appointed, the first all parties meeting is called. At this meeting, functions are allocated to every party and a timetable of the issue is also drawn up. Costs and fees are agreed and all the parties proceed to work and package the issue. If need be, a second all parties meeting is held to finalize and get the application ready. For a fast tract approval by the Council of The Nigerian Stock Exchange, the application to The Exchange must be accompanied with the following documents:

1. Detailed Application (2 copies).

2. Listing fee.

3. Abridged Application for Quotation and Listing on The Nigerian Stock Exchange (20 copies) specimen copies of the abridged form are attached.

4. Certificate of Incorporation and evidence of attaining a Public Limited Company (PLC) status (2 copies).

5. Memorandum and Articles of Association (2 copies).

6. Certified copy of the Board Resolution authorizing the issue of all securities for which listing is sought; approving or authorizing the issue of the prospectus and increasing the share capital of the company in order to absorb the proposed issue.

7. Audited accounts (1 copy) for each of the 5 (or 3) completed financial years of the applicant company immediately preceding the date of the application.

8. A copy of the draft Trust Deed (or document securing or constituting the stock), which must comply with the Listing Requirements (this is applicable in case of loan stock or debenture).

9. A copy of the draft Underwriting Agreement (where applicable) and commitment letters from the consortium of underwriters. A signed copy must be submitted after execution of the underwriting agreement.

10. A true copy of the Reporting Accountants statement on the 5 years financial results, incorporating statement of adjustments and the profit forecast and the cash flow projections for the next 2 to 3 years.

11. A copy of the pricing proposal submitted to the Securities and Exchange Commission (*SEC*).

12. A copy of the Draft Prospectus.

13. Estimated cost of the issues (final cost must be submitted later).

14. Offer Time Table.

15. A certified copy of every report, valuation, resolution or other document any of which is extracted or referred to in the prospectus.

16. Consent letters from all the parties to the issue.

17. Updated list of Receiving Agents.

NSE Quotations Approval/SEC Registration Stage

The Stockbroker submits the application to The *NSE* with a covering letter and the *NSE* application fees for registration and queuing for the next Quotations Committee meeting. The quotation committee meeting of the *NSE* is primarily to consider and approve an application of the issuer or the company wishing to list its security on the daily official list. When the application is approved by the Exchange, an approval letter or certificate of exemption is issued by the exchange. The issuing company would be informed of the rules and regulations of the Exchange and is made to sign undertaken to abide by the rules and regulations of the Exchange.

Issues likely to be discussed at the quotation committee meeting are: (1) purpose for which the company wants to raise fund; (2) the contents of the prospectus; (3) gearing level of the company; (4) board composition; (5) nature of the business and market share of the product; (6) rendition of quarterly account to the Exchange; (7) listing fees payable annually; (8) price of

securities and volume of shares; and (9) penalty for reneging on the undertaken signed.

The following officers/parties are expected to appear and defend the application before the Quotations Committee of Council: (1) The ***CEO*** of the Issuer Company; (2) The Company Secretary; (3) The Head of Finance or Chief Accountant; (4) The ***CEO*** of the Issuing House; (5) Solicitor to the Company/Issue; (6) Trustees and their solicitors (in case of debentures); and (7) The Registrars, the Chairman and other Board members and management staff.

The Stockbroker to the issue leads the delegation to the Quotation Committee meeting to defend the application. The Stockbroker introduces the Issuer's team to the Quotations Committee. If the application is successful, the Stockbroker will be informed and he should liaise with The Exchange for the collection of the approval letter. If the application is rejected, the Stockbroker/Issuing House is informed of the reason for the rejection. The Quotations Department may suggest ways for repackaging the application to meet the expectations of The Exchange. In the same vein, the Issuing House files an application with SEC, ensures that approval is granted and the collects SEC's approval letter.

Completion Board Meeting Stage

Upon final approval by the Committee, The Exchange issues a letter of approval to indicate that the issue may proceed. However, before the exchange issues the Certificate of Exemption, the following offer documents must be submitted with a request for the Certificate, seven (7) working days to the proposed date for the Completion Board Meeting:

1. A letter indemnifying The Exchange from any loss associated with any litigation arising from the issue.

2. The proof-print of the Prospectus.

3. The proof-print of the Abridged Particulars of the Prospectus.

4. The proof-print of the Advertisement and Posters.

5. The updated Offer timetable and cost of Issue

If the request for a Certificate of Exemption is not submitted early enough, it might not be available before the Completion Board meeting because the ***DG/CEO*** of The Exchange has to personally sign the certificate. The documents considered at the completion Board meeting include: (1) draft prospectus; (2) specimen certificate; (3) specimen banners-advert materials; (4) application form; (5) underwriting agreement, if any. 4 copies of the document must be signed –***SEC***; and (6) debenture trust deed.

All parties to the issue, including the directors of the issuing company, will meet (at the Completion Board Meeting) to issue and sign the offer documents holding themselves individually and severally liable for all information contained in the prospectus and other offer documents. The Certificate of Exemption confers on the issuer the right to issue and circulate an abridged version of the detailed prospectus. If the issue is underwritten, the underwriting proceeds are paid at this stage. After the Completion Board meeting and before the offer opens to the public, copies of the documents executed at the Completion Board meeting will have to be lodged with the Nigerian Stock Exchange.

Distribution/Marketing Stage

The Issuing House distributes application forms to all receiving agents. The required number (50 copies of abridged and 25 copies of hardcover) is submitted to the Exchange for distribution to Branches and Council Members. The application list opens on the selected date and closes after 4 to 6 weeks. If extension in the application closure date is required, the Stockbroker must get the written approval of the Exchange. Any variation in the offer documents (both prospectus and other documents) must also be

supported with the written approval of The Exchange. A similar approval must also be sought and obtained from *SEC* by the Issuing House.

The launch of a new public company on the stock market is a delicate operation, which requires favorable conditions for a successful outcome. Two of the most important elements are timing and pricing. A listing which, is otherwise sound, can fail if the timing is poorly judged. If all other circumstances are positive, the market is not likely to accept an issue, which is over-priced.

Range of Analysis/Allotment Stage

If the issue is oversubscribed, the Registrar prepares a range of analysis on how the securities should be allotted. After the range is agreed upon, allotment is done and the pattern used is sent to *SEC* for information. A copy of the allotment pattern is also sent to The *NSE* for information. Monies in respect of unsuccessful/rejected applications are returned. Applications may be rejected because of incidences of multiple applications or the applications were not under seal (in the case of companies). If the issue is under-subscribed, every subscriber is allotted in full and the balance of the security is warehoused if there is no standby underwriting. If the issue subscription is under 25% the issue is aborted and the proceeds returned to subscribers. At the conclusion of allotment, allottees are sent share certificates or Account in Depository credited in case of e-*IPO.* The payments of proceeds are made to the issuer along with commission to receiving agents (stockbrokers and banks).

General Undertaking/Declaration of Compliance Stage

Application for listing supported by: (1) Copy of approved allotment proposal; (2) Newspaper cutting of announcement of the allotment; (3) Evidence of dispatch of return monies and share certificates; and (4) Executed "General Undertaking" Declaration of Compliance. General Undertaking and Declaration of Compliance to be signed by a Director & Company Secretary

under seal. At this point the company also requests for a listing date.

Listing on the Exchange

On the date the company is to be listed, it is mandatory for the Stockbroker, ***CEO***, Company Secretary, Finance Director and Registrar of the company to come to The Exchange for briefing. They will be informed of the importance of complying with the post listing requirements, submitting timely reports to The Exchange and getting approval before publishing any reports, notices or circulars. The Chairman of the Board of Directors and other members of the management team may also attend the briefing and/or listing sessions, but it is not mandatory for them. The Quotations Department will arrange for the team to have copies of the Daily Official List for that day and to attend and observe the day's trading at the Floor. Thereafter, the company will be listed on the Daily Official List.

Post Issue Documentation Requirements

At this stage, the company prepares and delivers to The Exchange the following documents: (1) Copy of the Approved Allotment Proposal; (2) Newspaper cutting of the Announcement of Allotment in the newspapers; (3) Form of General Undertaking proposal on the letterheaded paper of the applicant company; and (4) Declaration of Compliance in the form outlined in the Listing Requirement.

The Company Secretary and a Director must sign the General Undertaking and the Declaration of Compliance, which must be under the company's seal. On submitting these documents, the company can request for a listing date. The process of successfully taking a company to the market for public quotation does not end with the listing of the company. The company has to be nurtured by the Stockbroker (perhaps on a retainer basis) to ensure that the company meets its obligations as a quoted company with regards to: (1) prompt submission of results to The Exchange; (2) prompt notification to the exchange when there are

developments in the company of a price sensitive nature; (3) changes in the directorate of the company; and (4) prior approval of The Exchange before certain publications (notices of General Meetings, Results, Closure of Register, Distributions, etc).

UNDERWRITING

To provide guarantees for the success of a public offer, the issuing company may arrange partial or full underwriting of the shares to be issued. The issuing house is, in fact, obliged to underwrite at least 80% of the issue. Underwriting is a financial intermediation process involving risk bearing by the Underwriter who gives the Issuing Company a firm price when marketing a primary issue. An underwriting contract is, therefore, a guarantee that in the event of under-subscription, the underwriter will pay an agreed amount to the issuing company and take possession of the un-subscribed shares (to be warehoused) for sale later on the floor of the Exchange. Underwriting commitments not disposed off within six months must be reported to ***SEC***. Three forms of underwriting are set out in the ISA 2007:

Best Effort basis

An Underwriting term in which the Underwriter agrees to do his best to sell as many shares as possible to the public. He does not buy the securities outright The Underwriter has no liability for unsold shares.

Firm Underwriting

An Underwriting term in which the Underwriter agrees to take all the remaining unsubscribed portion after issue.

Standby basis

Here, the underwriter makes a firm commitment to take any balance of the issue unsubscribed to by investors. Proceeds of the issue including the underwriting commitment made available to the issuer within six weeks from the close of subscription lists.

Underwriting commission is Negotiable. A minimum paid up capital of N100 million is set for Underwriting Companies.

NSE LISTING REQUIREMENTS

In order to be listed on the NSE a company must through its stock brokers apply in a prescribed format to the *NSE* council quotation committee. The company must meet the following requirements:

First-Tier Securities Market (Main Board)

1. Company must be registered as a Public Limited Liability Co. under the provisions of the companies & Allied Matters Act.

2. Must submit to The Exchange financial statements/business record of past 5 years.

3. Date of last audited accounts must not be more than 9 months.

4. Amount of money that can be raised is unlimited depending on the borrowing powers of the company.

5. Annual quotation fees based on market capitalization.

6. At least 25% of share capital must be offered to the public.

7. Number of shareholders must not be less than 300

8. After listing, company must submit quarterly, half-yearly and annual accounts.

9. Securities must be fully paid up at time of allotment.

10. Un-allotted securities must be sold on NSE Trading floors.

11. There should be provision for issue of mergers, acquisitions, unit trust and mutual funds.

Second-Tier Securities (Emerging) Market

1. Company must be registered as a Public Limited Liability Co. under the provisions of the companies & Allied Matters Act.
2. Must submit to The Exchange financial statements/business record of past 3 years.
3. Date of last audited accounts must not be more than 9 months.
4. Amount of money that can be raised may not exceed N250 million.
5. Annual quotation fees is a flat rate of N30, 000.00.
6. At least 10% of share capital must be offered to the public.
7. Number of shareholders must not be less than 100.
8. After listing, company must submit half-yearly and annual accounts.
9. Securities must be fully paid up at time of allotment.
10. Un-allotted securities must be sold on *NSE* Trading floors

Third-Tier Securities Market

1. Company must be wholly indigenously promoted & registered as a Public Limited Liability Co. under the provisions of the companies & Allied Matters Act.
2. Must submit to The Exchange financial statements/business record of past 2 years.
3. Date of last audited accounts must not be more than 9 months.
4. Amount of money that can be raised may not exceed N100 million.
5. Annual quotation fees is Nil.
6. At least 10% of share capital must be offered to the public.

7. Number of shareholders must not be less than 50.
8. After listing, company must submit half-yearly and annual accounts.
9. Securities must be fully paid up at time of allotment.
10. Un-allotted securities must be sold on NSE Trading floors.
11. Full listing to Emerging market must be within 6 -18 months of listing

MERITS AND DEMERITS OF LISTING

The following represent the advantages of listing on the stock exchange:

Profile

A stock exchange listing leads to enhanced publicity, which assists companies in expanding market share or breaking into new markets. An enhanced profile also helps in the recruitment of high quality staff.

Raising Capital

Listed companies find it easier to find investors prepared to acquire new shares, thus raising additional capital to finance expansion.

Acquisition Opportunities

Listed companies are in a better position to expand through acquisition using own stock. For example the merger of Total with Elf and the takeover of Agip by Unipetrol were both done using stocks.

The **Demerits of Listing** include-

a. The risk of take over
b. High cost of listing
c. Loss of privacy as financial records must now be made public
d. Loss of control/dilution of control/ownership

PROCESS OF DE-LISTING A COMPANY FROM THE DAILY OFFICIAL LIST

In the case of **voluntary de-listing**, the following process is followed:

1. The Directors meet and pass a resolution to de-list the company.

2. A resolution for de-listing is proposed for approval of shareholders at Annual General Meeting/ Extraordinary General Meeting.
3. A Draft notice containing proposed resolution must be submitted to the Nigerian Stock Exchange for vetting and approval.

4. Draft notice should be published in at least 2 National Dailies at least 21 days before the *AGM/EGM*.

5. The Nigerian Stock Exchange is represented at the *AGM/EGM* to observe proceedings.
6. Simple majority of members present in person or by proxy is required to approve de-listing.

7. The majority shareholder/core investor must set aside sufficient funds to payoff any shareholder who does not want to remain a member of the Company in its unlisted status.

8. Funds must be kept with a Custodian acceptable to The Exchange such as the *CSCS* Ltd.

9. Price at which unwilling shareholders are bought shall not be less than the highest price at which the Company traded in the 6 months preceding the date of the *AGM/EGM* where the resolution to de-list was passed.

In the case of **Regulatory De-listing**:

1. De-listing is used as the ultimate sanction on a Company for persistent non-compliance with post-listing rules.

2. The Listing regulation Department submits recommendation to management of the Exchange for de-listing of errant companies with reasons for the action.

3. The company is notified directly or through a press statement that de-listing is being contemplated.

4. Proposal for de-listing is cleared with the Council of the Exchange/Quotations Committee.

5. The market is informed and the company is subsequently de-listed.

TECHNICAL SUSPENSION **VS TRADING SUSPENSION**

Technical suspension is the freezing of the price of a security. It can occur in any of the following circumstances: (1) public offer; (2) sanction from exchange; (3) intending merger/acquisition/consolidation; (4) boardroom crisis; (5) ownership tussle; (6) changes in executive management without information to the exchange; (7) changes in ownership without informing the exchange; and (8) receivership/bankruptcy. Trading suspension, on the other hand, arises when the stockbroker or the Exchange decides to investigate or confirm allegation against a particular company. In such instance the share/stock of that company would be placed on suspension. It is usually at the instance of the stockbrokers or the Exchange.

METHODS OF ACCESSING THE CAPITAL MARKET

The methods of raising finance from the capital market include the following:

Offer for Subscription

This is the direct sale of new securities (shares or debentures) to the public before the shares are admitted by The Exchange for trading. Guidelines specified by *SEC* and the *NSE* are to be complied with before a company can undertake a public offering of its shares. It involves the preparation of selling documents – referred to as prospectus and abridged prospectus, underwriting agreement (optional), return sheet, printing of share certificates etc. The approval of *SEC* is required on pricing, timing and amount to be offered. The *NSE* approval is required for listing, certificates of exemption.

Section 553 of *CAMA* empowers the *NSE* to issue Certificate of Exemption from the requirements of the Act relating to the form and content of a Prospectus. The Certificate of Exemption is required to exempt the issuing-company from printing the detailed prospectus or rights Circular to be distributed to the investors. They would have only the abridged version. The detailed document will be available with the stockbrokers and receiving banks for scrutiny.

Offer for Sale

This is an offer to the public by or on behalf of a shareholder. The proceeds thereof will go to the shareholder who is divesting. It is similar to offer for subscription except that the fund so raised would not increase the capital base of the company and the process will not lead to a change in the issued shares of the company.

Offer for Sale by Tender

This method is similar to offer for sale except that the sales price is not pre-determined. Rather, the subscribers are required to state in their application form the price they want to bid for the security. Essentially, it is an offer of specific quantity of shares and stock to the public by or on behalf of a company or other authority or a third party for bidding. It is important to note that the Issuing house, in conjunction with the issuer would have a reserve price

below which they are not willing to go. The objective of this method is to maximize investment.

Private Placement

In a Private Placement, securities of a company are sold to clients of the issuing house/stockbrokers handling the issue. Instead of being offered to the general public or to existing shareholders. Private placement involves the invitation to selected high net worth individuals or corporate organizations to invest in a company's issue. Companies usually embark upon the process when the promoters do not want complete dilution of control. As the securities are not yet listed on the stock exchange, promoters do not need to meet the exchange requirement for public issue. By *SEC* directive, Companies undertaking Private Placement are to inform investors on whether there are plans to list on The Exchange

Listing by Introduction

This is a method of bringing in the security of a company, which qualifies in all respect for quotation but not yet quoted, to the exchange for listing. It is applicable where a company seeking listing has met the minimum requirements with regard to the spread and percentage of the issued shares held by the public. The process does not lead to raising funds but allows the company to participate in the market through secondary market operations. The company would thereby enjoy the benefits of a quoted company while its securities would be traded on the floor of the Exchange. It may be at the instance of the Stock Exchange. It requires the publication of a prospectus which may only be filed with the Exchange. The full complement of parties to an issue is not required.

Rights Issue

A rights issue is a privilege offer made to existing shareholders to acquire proportionately additional shares in the company usually at a concessionary price. The price of the right is usually below the ruling market price. The method is used when the majority of the existing shareholders do not want a dilution of the shareholding

structure and they are willing to provide the additional capital required by the company. Rights are offered in proportion to existing shareholding. May be in varying proportions i.e. 2:1 read as 2 for 1– for every one share being held, the holder is entitled to purchase an additional two.

Rights can also be offered as derivatives to new shareholders. Rights Trading commenced on the *NSE* on July 13, 1998. Investors not willing to take up their Rights can sell it on the floor at a price, which may allow new shareholders to invest in the company and permit existing shareholders to increase their holdings. A rights issue has the following advantages to the Shareholder:

1. Where the shareholders has an existing substantial stake in the company with influential voting power, renouncing right waters down the influence of the affected shareholder.

2. Where favourable forecast relating to the future dividend profile of a company would result in market price exceeding the right's price.

3. Where the shareholder has surplus fund for investment and cannot obtain a high return elsewhere with low risk

4. Where funds can be borrowed at a lower rate than the returns offered by the right

Opening and Closing of Offer Period

An offer for subscription or sale of security shall remain open for a period of 21 working days from the day/date of opening stated on the prospectus. In the case of a right issue, the offers shall remain open for a period of 28 working days. An application for extension of time of the offer period shall be made to ***SEC***/Commission at least 5 working days before the date of closure of the issue as stated in the offer document. No offer shall continue beyond the closing date without the written consent of ***SEC***.

What could make an Application to be Void?
And application shall be rejected for any of the followings:

1. Incorrect multiples of units
2. Omission of signature
3. Omission of company seal/RC No.
4. Thumb print impression not witnessed
5. Wrong amount
6. Failure to write names in the correct order
7. Printed signature
8. Improper completion of application form
9. Omission of surname
10. Incomplete address
11. Multiple applications
12. Applications by person below the age of 18 years
13. Any others reasons which the Commission can prescribe from time to time

PROSPECTUS
It is a document prepared by the Issuing house to give required information to the prospective subscribers or investors in the securities which it offers.

Information Contained in Prospectus

1. Full name of the issuing authority
2. The amount
3. The title
4. Price of the issue

5. A statement, in a form approved by the Exchange, that application has been made to the Council of the Exchange for listing of the relevant security
6. Opening and closing date for application
7. Object of the issue
8. Revenue against which security is charged
9. The places at which applications would be accepted
10. Particulars of directors and other parties to the offer
11. Claims and litigation in respect of the issuer
12. Financial summary
13. The status of the new shares being sold
14. Underwriting commitment
15. Forecast financial static
16. History and business of the issuer
17. Statutory and general information
18. The application form
19. Cost and expenses of the offer

For Debt Securities

1. Date of interest payment
2. Full particulars of the security
3. Trustee status.- appointment and roles
4. Maintenance of registers
5. Right of stockbroker
6. Revenue against which security is charged

Every Prospectus shall be dated on the front cover. The date shall not be earlier than the date of the completion board meeting. On the front page of the prospectus, there shall be set forth among other information the following statement printed in 'red ink', "this prospectus and the securities which it offers have been registered by the Securities and Exchange Commission (*SEC*). The Investments and Securities Act 1999 as amended provides for civic and criminal liabilities for the issue of a prospectus which contains false or misleading information. The registration of this prospectus and the securities which it offers does not relieve the parties of any liability arising under the act for false or misleading information"

BONUS/SCRIP DIVIDEND

This is also known as free issue. It is a method through which companies increase their capitalization without selling additional shares. The effect is to increase the paid up share capital. A company with accumulated capital reserves/share premium out of line with its issued capital may decide to give additional shares to existing shareholders in bonus. It may be offered as a substitute or complement to cash dividend.Scrip issues are offered in proportion to existing shareholding at no cost. Unlike right issue, no fresh funds are injected into the company as a result of the issue although the number of shares of the issue will be increased accordingly.

The shareholders after receiving the notice can sell all or part of it on the Trading Floor. For a company to issue scrip, it requires the recommendation of the Board of Directors to the shareholders at the *AGM* for approval. If the authorized capital of the company will be affected, that is, if the paid up capital and bonus issue will overshoot the authorized capital, then the company should seek to increase the authorized share capital with the Corporate Affairs Commission before undertaking the scrip issue.

STOCK SPLIT

A stock split is necessitated when the Company's stock price has risen to a level that management feels is out of the popular trading range. The occurrence of this anomaly will cause a decline in the

trading volume of the shares. The outcome of a stock split is for the Company to end up with more outstanding shares that would sell at a lower price and have a lower par value than before the split. Split can occur at any ratio of new-to-old shares.

The All-Share Index

The Exchange maintains a broad Index known as the All-Share Index. It is a measure of level of activities in the equity section of the Daily Official List of the Nigerian Stock Exchange. It is an indication of the volume of activity as measured by the changes in equity price and, by inference changes in market capitalization. All-Share Index (*ASI*) is the measure of the magnitude and direction of the general price movement on the Stock exchange. It is measured in ordinary number and not in currency terms. All-Share Index was formulated in January 1984 (Base year is January 3, 1984 = 100). The index is value-relative and is computed daily. All-Share Index is said to be the barometer of the economy because it indicates the performances of companies listed on the Exchange, whose performances are positively correlated to government's economic policies. All things being equal, a growing economy would witness a better operating performance by the businesses, which would in turn facilitate their profitability, dividend payment and other rewards to shareholders.

Statistically, market capitalization or market cap is calculated as the sum of the product of market prices and quantity of all listed equities.

$$\sum P_i Q_i$$

Where:

P_i = Equity Prices

Q_i = Quantities of All-Shares listed on the Daily Official List

Formula for calculating ASI

$$ASI = \frac{\sum P_i Q_i}{P_o\ Q_o} \times 100$$

Where:

P_o = Price at base year
Q_o = Quantity at base year
P_i = Current price
Q_i = Current Quantity

The Index is said to be chain-linked because adjustments to the base are usually carried out so that the index is un-altered when re-calculated against capital changes. If a company is to be added to the Daily Official List, the market capitalization (calculated as the product of the outstanding shares and the market price per share) would be added to the entire current market capitalization whilst the base year market capitalization would be adjusted. Conversely, if a company is being de-listed from the Daily Official List, the market capitalization of such a company would be subtracted from the current market capitalization while the base market capitalization would be adjusted.

Only common stocks (ordinary shares) are included in the computation of the index. The index is value-weighted and is computed daily. The highest value of 66,371.20 was recorded on March 3, 2008. It also has five sectoral Indices that are used to gauge the sectoral performance and efficiency of the stock market. They are: ***NSE*** 30 index (which measures the performance of Blue Chips stocks listed on the Nigerian bourse), ***NSE*** Banking, ***NSE*** Consumer Goods (*Formerly Foods & Beverages)*, ***NSE*** Insurance and ***NSE*** Oil & Gas. ***NSE*** Index Committee members do meet on a quarterly basis to review and rebalance the ***NSE*** Indices. At the end of their deliberations, members will agree to review the ***NSE*** Index

Circuit breakers

The ***NSE*** has a 5% up/down single stock trading limit as a circuit breaker. This was temporarily changed to a 5% up/ 1% down limit for a period of 2 months in 2008 in a bid to curb the market downturn. The ***NSE*** reverted to the 5% up/down limit by October, 2008. Several stock exchanges throughout the world use circuit breakers for management of systemic risk.

STOCK EXCHANGE DAILY OFFICIAL LIST (*SEDOL*)

The Stock table, or Daily Official List as is often called, is published daily from Monday to Friday by the Nigerian Stock Exchange. The ability to understand and interpret the daily official list of the Nigerian Stock Exchange enables the individual to understand the stock market and to invest wisely. The ***SEDOL*** is categorized into the following segments:

Government Stock

This segment contains the list of all quoted federal government bonds also know as sovereign bonds. The table shows the coupon rate, name, maturity period and nominal value of each bond, the last time business was done and when interest on each bond will be due. The number of bonds may either increase or decrease depending on whether there is a new listing or a bond reaches maturity.

State Government Bonds

Bonds issued by state governments in Nigeria are listed in this segment. The name, coupon rate, nominal value, maturity period, and other information concerning each bond are reflected.

Industrial Loans

Industrial loans are bonds issued by companies with the same characteristic of other bonds. Like the Sovereign and state government bonds, information disclosed in the daily official list include name, coupon rate, maturity period, nominal value, etc. They are delisted at maturity.

Preference Stock

The stocks listed in this segment have the characteristics of both equities and debts. They are also fixed-income instruments and may not have maturity period in which case they are said to be irredeemable and therefore likened to equities that are owned in perpetuity. Information disclosed on preference Stock in the Daily

Official List are similar to the federal government bonds, industrial loans, and state government bonds earlier explained.

Equities

This segment comprises securities quoted on the Nigerian Stock Exchange. The segment is further subdivided into two broad categories: first and second tier securities markets. The companies in the first tier segment have stringent listing requirements and are classified into thirty four (34) sub-sectors ranging from banking, aviation, insurance, conglomerates, healthcare etc. The second tier segment, also called the emerging market segment, has fewer companies and involves less stringent listing requirements. The Information displayed in the equity segment includes:

Column 1 - Ordinary Shares

This column shows the companies listed on the stock exchange and whose shares are currently traded on the exchange.

Column 2- Public Quotation Price, the Nominal Value

Companies usually divide shares into bits that can be transferred and it is usually for accounting purpose only, which has nothing to do with the market value of the shares. It is commonly N1.00, or 50kobo. It is an assigned amount used to compute the naira accounting value of the common shares on a company balance sheet.

Column 3 - Current Market Price

The price at which the last deal was done at the exchange

Column 4 - Ex - Div and Ex Sc

These signs indicate whether the shares have been marked down either for dividend payment (Ex-Dividend) or for Scrip payment (Ex-Scrip) to those qualified to earn dividend or scrip. Only those whose names are in the register of the company before the closure dates are entitled to dividend or bonus. The plus and minus signs on each of the prices are quite important. They are meant to show

the extent of demand and availability of the particular share. A plus sign means that as at the date of the official list, stockbrokers were willing to buy the shares at the listed price, but the shares were not available. It is an indication that the shares of the company in question were in high demand.

On the other hand, a minus sign attached to a price implies that brokers were willing to sell the shares of the company in question at that price, but investors were unwilling to buy. Where there is neither plus nor minus sign, it is usually an indication that the share of the company is on technical suspension which could be due to a number of reasons. When the current market price is less than the public quotation price, it is said that the share is trading below par (at a discount) and when it is higher, the share is trading above par-at a premium.

Column 5- Business Done
There are three sub-columns under this namely:

1. Price (N) shows the first price at which business was done on the share.

2. Date indicates the last time business was done on the share when compared with the date of the official list- a wide gap is suggestive that the share may not have been active for some time.

3. Quantity indicates the volume of the share of the company traded on that particular day.

Column 6- This year's high and low
This column indicates the highest and the lowest price for the shares in the past 52 weeks. It tells how volatile the shares are and that the investor can gain or lose in the shortest possible time. It assists the individual to make an investment decision as to the type of stock he would want to invest in.

Column 7- Last Ex - Div Date
This indicates the last date the company's share was marked down for dividend payment.

Column 8- Last Ex- SC Date
It shows the date the company's share was last marked for scrip payment.

Column 9 dividends - Date Pd, Interim and Final Date Pd
This indicates the date dividend was last paid. Companies can pay twice within a financial year. The first tranche can be paid in the first six months (interim) while the second and final tranche can be paid at the end of the financial year. Most of the companies quoted on the Nigerian Stock Exchange official list pay dividend once in a financial year.

Column 10 E.P.S (earning per share)
This column is often watched closely as it indicates the cash generating power of the company which has issued the share. This is calculated by dividing the profit after tax of the company by the number of ordinary shares issued. It indicates how much a shareholder is entitled to during the year although part of it may be paid out in dividend and the balance retained and ploughed back into the business. ***EPS*** of the company can be compared over the past few years to see whether it is growing or declining and can also be compared with peers.

Column 11 - P/E Ratio
Price/earnings ratio shows the relationship between a share's price and the company's earnings for the past 12 months. It is simply dividing the current price per share in column 3 by the earnings per share in column 10. The ratio when calculated gives a number which indicates the number of years it would take an investor to recoup his investment if the company continues to perform at the current rate. Thus, a low ***P/E*** ratio may be considered more desirable than a high ***P/E*** ratio by a risk-averse investor since it

means that an instrument may recoup investment within shorter period.

ELECTRONIC OPERATIONS IN THE NIGERIAN CAPITAL MARKET

These include the following:

Electronic Bonus (e-Bonus)

The e-bonus refers to electronic form of bonus shares. It was put in place to ensure bonuses issued to an investor by companies are instantly credited to the investors' accounts at the ***CSCS***. It means that when a Quoted Company declares script or bonus issues, rather than issue physical bonus share certificates to investors, they are converted to electronic form and credited to the investors stock account in the Central Securities Clearing System (***CSCS***) depository under the investors stockbroking firm account with ***CSCS*** and a credit advice sent to the investor.

Benefits of Electronic Bonus

E-bonus enables shareholder's stock accounts to be automatically and electronically credited with their bonus shares in ***CSCS*** System for immediate transaction. Electronic bonus shares would eliminate postal delays and loss of certificates in –transit as well as hasten stock transactions which is time saving. Shareholders can easily take advantage of price movements immediately after approval of bonus shares, which would enhance liquidity in the market. Also, share certificate forgeries and theft are eliminated.

E-bonus will save cost of printing bonus certificates, postages, replacements etc. The cumbersome processes associated with bonus share certificates including verification are eliminated. Furthermore, shareholders can easily update and know their shareholding at a glance, which makes stock account reconciliation easier. It engenders improved confidence and transparency in the capital market as well as simplifies Share Transmission and Nominal Transfers. The need for special storage facilities (safes or fire proof cabinets) for certificates and space are eliminated. E-

bonus is the safest and quickest method of handling such security documents. Besides, the issue of unclaimed bonus and all associated costs is done away with. Finally, it internationalizes bonus issue and places the Nigerian capital market on the same pedestal with international capital market where share certificate-less system has been operational.

E-Dividend

In order to minimize cases of unclaimed dividends as well as enhance the ability of shareholders to immediately access and utilize their dividend proceeds, the *SEC* introduced the e-dividend payment system on the 28th February 2008. It is a convenient, secure, on-line means of paying dividends directly to shareholders account instead of printing and mailing dividend warrants. The e-dividend requires that dividends are automatically credited directly into shareholders account within 24 hours of payment of dividend by companies following which Registrars would send confirmation letters of the dividend payment to the respective shareholders.

In introducing the e-dividend payment system, the *SEC* collaborated with stakeholders such as *the NSE, CSCS, CBN, CAC*, Nigerian Interbank Settlement System (*NIBSS*), Stockbrokers, Registrars, Tax authorities, Banks, Issuers and Shareholders Associations. These stakeholders have different roles to play towards the successful implementation of the e-dividend payment system. The *NIBSS* for instance is operating the automated electronic funds transfer that is crucial to the success of the e-dividend payment system.

The e-dividend payment system is beneficial to investors in particular and the market in general. Some of the benefits are reflected in the ease and speed with which dividend payment transactions are now executed. Other benefits include reduction in incidence of unclaimed dividend; increased transparency in the administration of dividend payment and elimination of costs associated with the printing and posting of dividend warrants.

E-Allotment

This refers to the electronic (automatic) capture of allotted shares into investors' accounts in the ***CSCS*** and it was formally introduced in the Nigerian Capital Market on 1st July 2008 to replace the long practice of issuance of share certificates manually. It involves the electronic transfer of allotment schedule in respect of an ***IPO*** as prepared by the Registrars of a quoted company to the ***CSCS***, who make these shares available to allotees by crediting their stock account in the ***CSCS*** within 48 hours of receipt from the registrars. Some of the reasons for introducing the e-allotment system are similar to those of the e-dividend payment system. They include submission of wrong name and/or address on the subscription form, postal services delay in forwarding certificates.

In ensuring the smooth implementation of the e-Allotment system, both stockbrokers and investors have enormous obligations to perform. For instance, investors must create and know their ***CSCS*** Clearing House Number (***CHN***) which can be obtained through any authorized stock broking firm. Also, they must disclose their ***CSCS CHN*** to new stock broking firms they engaged to avoid multiple ***CHN***. While, the stockbrokers have to ensure that clients make available to them their ***CSCS CHN***, the ***CSCS*** must also ensure that clients' names are forwarded to it in the order of Surname, First name and other names.

The benefits derivable from introducing the e-Allotment system are quite important in the quest of the Nigerian Stock Market to compete favorably with its peers across the globe. It is expected that the e-Allotment system will lead to the attainment of greater transparency and efficiency in conducting securities market business in Nigeria, thereby shoring up investor's confidence and attracting more local and foreign investors to the market amongst many other benefits.

E-IPO

This system ensures that the Initial Public Offer of listed companies is electronically captured on the accounts of the ***CSCS***. After the closure of the offer and allotment by the company, lists of

the successful investors would be forwarded to the ***CSCS*** for retention in the depository. This system will eliminate the long waiting period which the registrar hitherto took to print and distribute certificates.

TRADE ALERT

This is an electronic device that the exchange has put in place to alert investors concerning their holdings or shares. It is received by ***SMS***. It alerts an investor when a transaction is about to take place on his account. Payment for this service is transaction based

DEMATERIALIZATION

This is the elimination of physical certificates or documents of title which represent ownership of securities so that securities exist only as accounting records. Dematerialisation ("Demat" in short form) signifies conversion of a share certificate from its physical form to electronic form for the same number of holding which is credited to the investors account opened with a Stock broking firm/Depository Participant (***DP***) or in custody of a Central Securities Depository. Shareholders need to open a demat account with ***CSCS*** through their Stockbroking firm (Depository Participant). The investor would be given a unique Clearing House Number (***CHN***), which must be quoted in all correspondence with any Depository Participant.

Benefits of dematerialization

Trading in the secondary market now requires investors to have a demat account with the ***CSCS*** through their Depository Participants. With demat, all risks associated with physical certificates such as delays, loss in transit, theft, mutilation, bad deliveries, etc. are eliminated. Dematerialized securities are most preferred by banks and other financiers for providing credit facility against securities. Generally, demat securities attract lower margin and lower rates of interest compared to physical securities. Courier / postal charges for sending share certificates / transfer deeds are avoided. Also, it provides a facility for freezing / locking of

investor accounts, which enables an investor's account to be made non-operational, for instance if the investor is abroad.

DISPUTES IN THE NIGERIAN CAPITAL MARKET

In any capital market, there exist disputes, questions and controversies which should be adjudicated upon and resolved in a timely manner that would increase the confidence of the public in the fairness and openness of the market. Differences, questions, disputes or controversies may arise in connection to the following: (1) The interpretation of any Law or Regulation; (2) Disputes between Regulators; (3) Disputes between Operators or an Operator and a Regulator; (4) Disputes between Operators and their Clients; and (5) Disputes between Quoted Companies and the Regulators or Exchanges.

Generally, disputes and grievances come to the knowledge of the ***SEC*** through the following ways: (1) complaints from market operators; (2) complaints from investors; (3) complaints from Self – Regulatory Organizations (***SROs***); (4) media reports; (5) rumours; and (6) inspections and investigations by the ***SEC***; etc

Common disputes in the primary market include: (1) failure/delay by an Issuing House or receiving agent to remit the proceeds of a public offer to an Issuer; (2) Failure of receiving agents to submit application forms of an investor during a public offering to the issuer; (3) Cases of an Issuing House appropriating part or all of the proceeds of the offer to offset bridging loans offered by it to the Issuer; (4) Irregularities in allotment of securities; (5) Failure of an Issuer and an Issuing House to submit allotment proposal to the regulatory body on time and the party to bear the penalty for the breach; (6) Refusal of the Issuer to pay fees agreed with the Issuing House; (7) Misrepresentation in the prospectus; (8) Non – receipt of share certificates and dividends in respect of securities paid for; and (9) Failure of an underwriter in a public offer to honour the terms of an underwriting agreement and failure by an Issuer to pay underwriting commission to the Issuing House.

Common disputes in the secondary market include: (1) failure or delay by a brokerage firm to perfect a client's mandate; (2) unauthorized sale by a brokerage firm of the securities of a client; (3) conversion of clients' funds or securities deposited with brokerage firms; (4) non – reflection of the true position of a client's account in the register of the (public) company; (5) misappropriation of client's money; (6) non-receipt of dividends/other benefits or entitlements and share certificates; etc

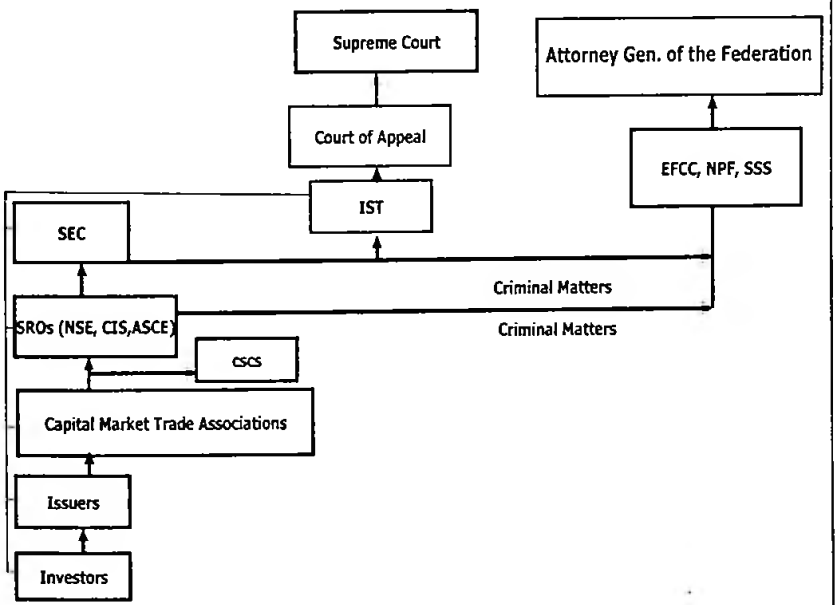
Dispute Resolution Mechanisms of the *SEC*

Section 14 of the ***ISA*** 2007 provides that the Commission may establish specialized department for the purpose of regulating and developing the Nigerian capital market. Pursuant to this, one of the departments established by the ***SEC*** is the Investigations and Enforcement Department. The department is charged primarily with investigating complaints/grievances/disputes, monitoring activities in the market, presenting cases of violations before the Commission's Administrative Proceedings Committee (***APC***) and ensuring that all the laws, Rules, Regulations and Codes regulating the market are complied with.

The Act also empowers the Commission to set up Committees to carry out such functions as it may determine. One of such Committees set up by the Commission is the Administrative Proceedings Committee (***APC***), mentioned in the above paragraph. The Committee is purely an administrative panel with simple Rules of procedure for ensuring transparency in hearing and resolving disputes. Every decision of the ***APC*** is subject to confirmation by the Commission's Board. Appeals from the decision of the ***APC*** lie with the Investments and Securities Tribunal (***IST***) subject to 14 days prior notice to the Commission by the appellant as provided by section 289 of the ISA 2007. With respect to Criminal Matters neither the ***APC*** of the ***SEC*** nor the ***IST*** has jurisdiction to entertain any criminal matter. Such matters shall be referred to criminal prosecuting authorities namely: (1) Attorney General of The Federation and Attorney General of the state as appropriate; and (2) Economic and Financial Crimes Commission.

Figure 15.1 JUDICIAL/QUASI-JUDICIAL FRAMEWORK

Dispute Resolution Framework in the Nigerian Capital Market (step by step Approach)



Source: Udora, C. (2003) The Review of the Nigerian Financial System in *Securities Market Journal*, a publication of the Securities and Exchange Commission, Abuja.

Figure 15.1: Illustrates the dispute resolution framework in Nigerian Capital Market: Step by Step Approach

INVESTMENT AND SECURITIES TRIBUNAL (*IST*)

The Investment and Securities Tribunal (***IST***) is established by section 274 of the ISA 2007. The Tribunal is of the same hierarchy

with the Federal High Court and comprises of 10 members (four of whom shall be legal practitioners inclusive of the chairman who must possess at least 15 years post call cognate experience in capital market matters.

The *ISA* confers exclusive jurisdiction on the *IST* to adjudicate on all capital market disputes in Nigeria. The mandate of *IST* is to determine any case brought before it within 90 days. Appeals against its decision lie to the Court of Appeal. Any further appeal shall lie to the Supreme Court of Nigeria. Three ways in which Proceedings Are Initiated Before The tribunal are:

1. By Originating Application: It can directly originate a fresh application. The Tribunal would decide whether to sit on the case or refer it to the Administrative Panel of *SEC*.

2. By Appeal: A case which has been heard before by another body or a regular court of law can be referred to *IST*

3. By Reference: This can result from a situation when a Court of law refers a case that is technical in nature to the Tribunal.

The Tribunal has the power to adjudicate on disputes, and controversies arising under the Act (*ISA*, 2007). It adjudicates on matters relating to: (1) The interpretation of any law, enactment or regulations to which the Act applies; (2) Disputes between the Commission and a Securities Exchange or Capital Trade Point; (3) Disputes between Capital Market Operators and the Securities Exchanges or Capital Trade Point; (4) Disputes between Capital Market Operators; (5) Disputes between Capital Market Operators and their clients; (6) Disputes between quoted companies and the regulators or the Securities Exchanges; and (7) Disputes between the National Pensions Commission (PenCom) and all parties involved in any pension dispute.

Examples of capital market cases that may be brought before the *IST* include: (1) Misappropriation of clients' funds by a

stockbroker; (2) Non-remittance of issue proceeds by an Issuing House to the issuer/company; (3) Non-remittance of dividends by a Registrar/Public company/Stockbroker; (4) Late transfer and/or registration of shares/ stocks by any stockbroker; (5) Disputes over mergers and acquisition between the shareholders and the public quoted company, self regulatory organization, the ***SEC*** etc; (6) Disputes between operators and any ***SRO*** in the market (e.g. stockbrokerage firm and a stock exchange and dispute between a registrar and exchange); (7) Disputes arising from the rules and such other guideline made by the ***SEC*** and any securities exchange; (8) Dispute arising from any decision, notice and/or decision issued by the ***SEC;*** (9) Appeals against delisting of any security or company by an Exchange; and (10) Disputes/claims arising from misrepresentations or false statements in offer documents or in a securities transaction.

The Investments & Securities tribunal is also empowered to adjudicate on pension disputes in Nigeria, on reference from the Pension Commission (PenCom.) Under section 93 Pensions Reform Act 2004, a party or body corporate aggrieved or dissatisfied with any action or decision of the National Pension Commission may refer the matter to the ***IST***. These disputes can be between Pension Funds Administrators (***PFA***) and their clients, the beneficiaries of the pension funds, Pension Funds Custodians (***PFC***) and their clients or any of these parties against the National Pension Commission (PenCom). Examples of pension disputes that could be brought before the Tribunal include:

1. Misappropriation of client's money by Pension Funds Administrator (***PFA***) and/or Pension Funds Custodian (***PFC***).

2. Non-payment of pension as at when due by a ***PFA***.

3. Non-crediting or wrong crediting of a beneficiary's contribution(s) or benefits arising from investments of his/her fund by a ***PFA/PFC***.

4. Disputes over pension between the beneficiaries/pension and the ***PFA/PFC***, and PenCom.

5. Disputes between ***PFA*** and ***PFC***.

6. Disputes arising from the rules, regulations and such other guidelines made by PenCom.

7. Disputes arising from any decision, notice and/or decision issued by PenCom.

8. Appeals against disciplinary measures by PenCom such as suspension and/or barring of any participant from the market.

9. Appeals against de-licensing of any ***PFA/PFC*** by the PenCom.

10. Disputes/claims arising from misrepresentation or false statements in ***PFA*** reports/documents or in pensions investments.

The Tribunal apart from being empowered to make its rules and procedures is also vested with powers to:

1. Summon and enforce the attendance of any person and examine him on oath.

2. Require the discovery and production of documents.

3. Receive evidence on affidavits.

4. Call for examination of witness or documents.

5. Review its decisions.

6. Dismiss an application for default or deciding matters ex-parte.

7. Set aside any order or dismissal of any application for default or any order passed by it ex-parte.

8. Do anything which in the opinion of the Tribunal is incidental or ancillary to its functions under the Act.

The judgments of the Tribunal are written and by way of orders impose sanctions such as fine, suspension or withdrawal of licenses, specific performance or restitution. An award of judgment of the Tribunal is construed as judgment of the Federal High Court, for the purpose of enforcement. Also, decisions by the Tribunal, lawfully made according to its power under the Act, are immune to challenges by court injunction or restraining order from any other authority. Appeal lies to the Court of Appeal on points of law only, from a decision of the Tribunal while appeal lies to the Supreme Court from decisions of the Court of Appeal at the instance of either party. The Tribunal is therefore put in place to simplify the process of investment dispute resolution and to insulate such disputes from the slow pace and tedious procedure associated with regular courts. It is a simple, cheap and effective means of resolving commercial disputes and to de-emphasize the use of regular courts for such purpose.

CHALLENGES FACING THE NIGERIAN CAPITAL MARKET

In spite of progress witnessed in the capital markets since the global financial crises of 2008/2009, specific challenges remain, which, if properly addressed, can reposition the country's capital markets in the long run, including:

Market depth/breadth

The market offers limited securities and products. Compared with other developing economies, equity investments dominate other

asset classes such as sovereign and municipal bonds, corporate bonds, and other convertible investments. The ***NSE***, the only active exchange in Nigeria, has 3 tiers with active trading only in the first tier. A few companies make up a significant proportion of the total market capitalization. Many eligible companies including multinational companies particularly in the telecom and oil and gas sectors remained unlisted.

Comparative capital market information for Nigeria and South Africa is presented in the table below. Despite having a bigger economy (as measured by ***GDP*** size), the market capitalization of equities- a function of outstanding shares-, the value of bonds, as well as the number of listed companies in the case of Nigeria are far behind those of South Africa.

Table 15.1: Comparative Capital market information as at June 2014

	Nigeria (USD)	**South Africa** (USD)
GDP	510 Billion	350 Billion
Market Capitalization – equities	86.07 Billion	942.8 Billion
Value of bonds	30 Billion	100.9 Billion
No of listed companies	192	375
Turnover (for 2nd quarter 2014)	1.88 Billion	194 Billion

Source: *SEC publication on Africa and Middle East Regional Committee 2014*

Transaction costs

Transaction costs are high and not competitive vis-à-vis other emerging markets (see table below). This is a disincentive to the number of companies willing to raise equity/debt capital through the market.

Table 15.2: Primary Market Regulatory Costs for Selected Exchanges

	Regulatory Costs	
	Bond Issue	Equity Issue
Chile	0.44%	0.12%
Mexico	0.08%	0.2%
Brazil	0.24%	0.25%
Nigeria	1.20%	1.21%

Source: SEC Annual Report and Accounts 2010

Investors in the Nigerian capital market currently bear the following costs when purchasing or selling stocks:

Purchases

- Stockbroking firm's commission: 1.35% of consideration
- SEC commission: 0.3%
- Stamp Duty: 0.06%
- VAT: 0.5% of brokerage

Sales

- Brokerage: 1.35% of consideration
- NSE: 0.3%
- CSCS: 0.3%
- Stamp Duty 0.06%
- VAT: 5% of brokerage

As part of measures aimed at reducing transaction costs, the federal government recently abolished the payment of VAT on all capital market transactions.

Market processes

Market processes are cumbersome and lengthy. The primary issue execution process is considered extremely long with an estimated timeframe of 27 weeks for issuing equity.

Market liquidity
Relative to comparable developing economies such as South Africa as revealed in table 15.1, market liquidity and levels of market activity (with respect to turnover) are low.

Transparency
Existing market infrastructure does not appear to support the provision of live trading prices to international investors. There is limited research on listed securities, industries and market, as well as frequent delays in the release of financial information.

Poor Savings Culture
A weak retail and institutional savings environment, as well as low income per capita level, inhibit effective savings mobilization in Nigeria

Macroeconomic factors
The relative maturity of the Nigerian capital market appears to make it extremely sensitive to macroeconomic changes, and undermines financial sector stability. Nigeria's economy is highly dependent on oil, further exposing it to global economic shocks.

Low Investor Confidence
The level of investors' confidence in the Nigerian Capital Market has remained low especially following the global financial crisis which negatively affected the stock market in Nigeria. This is particularly pronounced in the retail investor base which is shallow (less than five thousand). The loss of confidence has limited the participation of a sizeable proportion of the general public in the market as it continues to be dominated by foreign and institutional investors.

Inactivity of the Abuja Securities and Commodity Exchange
In spite of efforts made by the ***SEC*** to activate trading on the Abuja Securities and Commodity Exchange (***ASCE***), activities remain dormant with little or no trading activities.

Availability of information
Annual accounts and other company information are not readily and easily available. This makes analysis difficult for investment advisers whose opinions are relied on by prospective investors.

Low capital market literacy level
Capital market literacy is the level of education and awareness about capital market activities. It plays a major role in determining the number of retail investors that participate in the capital market. A majority of the potential investors in the country are ignorant of the operations of the capital market and the derivable benefits. There is no gain saying the fact that the growth and development of the market is dependent on increasing public knowledge and awareness of market operations.

UNETHICAL PRACTICES IN THE CAPITAL MARKET

One of the challenges of the Nigerian capital market in recent times has been the unethical practices associated with the operators and players in the market. Unprofessional and Unethical practices in the market include but not limited to the following:

Falsification of Accounts/ Financial Statements by Issuers
Section 71 of the Investment and Securities Act 2007 provides that an initial public offer or new issues of shares must be made via a prospectus which must comply with the provision of the Act. The Act also provides that a prospectus must contain the financial statements of the Issuer and Auditors and Accountants Reports. Furthermore Section 86 of the ISA makes it a crime for any director or officer who authorizes the issue of a prospectus containing any untrue statement or misstatement. On conviction, such officer is to pay a fine of not less than NI million or imprisonment for a term not exceeding five years or both fine and imprisonment. Despite the above provisions of the law, some officers of public companies still knowingly and recklessly falsify

accounts and financial statements of their companies to make the financial status of their companies look good and attractive to prospective investors. This is known as 'cooking the books'. The investors unknowingly invest in these companies and are defrauded at the end of the day when the companies fold up.

Concealment or Non-disclosure of Material Information

Material information could be described as information necessary for investors to make informed investment decisions or make a judgment about a particular investment that they are about to or contemplating to undertake. For example, the popular and notorious cases of Enron and WorldCom in the United States of America are cases worth referring to, where vital information about huge compensation payments to the companies' executives which were made when the companies' financial position were precarious were not disclosed. Investors would have been saved all the troubles of investing in these companies and the huge losses incurred if the information were disclosed.

There is also in Nigeria a case of concealment of N22 billion indebtedness of Apple in its 2001 Offer and the Cadbury Nig. Plc case where the management of the company was paid offshore remunerations without approval of the Remuneration committee and the payments were not recorded in the companies' financial report and accounts.

Mis-statement or Misrepresentation in the Prospectus and Other Offer Documents

A misstatement or misrepresentation is an understatement, an overstatement or a misrepresentation of facts. A statement that is exaggerated, embellished or tainted to make people believe. Misstatements are punishable as crimes in the capital market by virtue of section 86 and 87 of the *ISA* 2007 because they constitute acts capable of eroding confidence in the market and capable of defrauding unsuspecting investors who rely on these statements.

With-holding Dividends due to Shareholders

The *SEC* Rule 44 (2013), part B on payment of dividends imposes an obligation on issuers to ensure payment of dividends to shareholders not later than seven working days after the *AGM* at which the dividend was declared. Some quoted companies in Nigeria have been in breach of this rule prompting the Nigerian Stock Exchange to issue a warning in August 2014 that in line with S. 14 of the General undertaking by listed companies, the failure of a listed company to pay dividend on the due date shall attract a fine of 5 percent of the total dividend amount declared. Other fraudulent practices known to have been perpetrated in the capital market include the following:

1. Non remittance of proceeds of a public offer to the Issuer; or failure to remit same within the stipulated time by the law.

2. Varying the use of issue proceeds by the Issuer without clearance with the regulator and shareholders.

3. Public offering of unregistered securities.

4. Reneging on underwriting agreement i.e. failure of underwriters to pay underwriting commitment to the Issuer.

5. Market manipulation - transactions which create or maintain an artificial price for a tradeable security.
   a. Unauthorized trading - executing trades unauthorized on account without the investor's authorization. Manipulation of stock prices to obtain an advantage

6. Mixing broker/dealer funds with clients funds in the same account

7. An investment adviser engaging in the management of an

investor's funds/accounts without authority.

8. Insider trading abuse- a situation in which an investor has information that is not publicly available to others and trades such information for profit.

9. Short payment to client or short changing clients

10. Forging of shares certificates including forging of shareholders signatures and verification of their shares without their knowledge.

SUMMARY

The process of taking a private company to the Daily Official List of The Nigerian Stock Exchange comprises the following stages: Consultation/Discussion Stage, Decision Making/Mandate Stage, Documentation/Packaging Stage, Regulatory – *NSE* Quotation Approval/*SEC* Registration Stage, Completion Board Meeting Stage, Distribution/Marketing Stage, Range of Analysis/Allotment Stage, General Undertaking/Declaration of Compliance Stage and Listing Stage. Market behaviour and trends can be monitored through the major market averages and indices. These indices included market Capitalization and the All Share Index. The primary objective is to highlight the underlying trends and use them as a bench mark against which performance of portfolio can be measured.

The *ISA* 2007 confers exclusive jurisdiction on the Investment and Securities Tribunal to adjudicate on all capital market disputes in Nigeria. The challenges in the Nigerian capital market include lack of depth and breadth, high transaction costs, cumbersome market processes, illiquidity, poor savings culture, weak infrastructure, low investor confidence and low level of awareness.

REVIEW QUESTIONS

1. Briefly describe the stages for companies in accessing the capital market.
2. Explain FIVE ways by which companies in Nigeria can access the capital market.
3. Enumerate common disputes in the secondary market
4. What are the major challenges facing the Nigerian capital market?
5. State the advantages of e-dividend to the capital market in Nigeria
6. Distinguish between trading suspension and technical suspension
7. Briefly explain what you understand by the following:
   a. Underwriting
   b. Dematerialization
   c. All-Share Index

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CHAPTER 16

REGULATORY INSTITUTIONS

INTRODUCTION

Regulation is a key component of any country's financial system. In fact, the failure of regulation was partly blamed for the global financial crises of 2008. In this chapter, we examine the regulatory institutions in Nigeria namely the Federal Ministry of Finance, the Central Bank of Nigeria, the Nigerian Deposit Insurance Corporation, the Securities and Exchange Commission, the National Insurance Commission and the National Pension Commission. Also examined here are the Corporate Affairs Commission and the Economic and Financial Crimes Commission.

THE FEDERAL MINISTRY OF FINANCE (FMF)

Federal Ministry of Finance is the Government Department charged with the administration of Government fiscal policies, planning and managing of government projects, national budget, incomes and liabilities accruable to the Government. The Ministry advises the Federal Government on its fiscal operation and co-operates with ***CBN*** in monetary matter.

The management and control of all Federal Government finances as prescribed by the constitution of the country is the responsibility of the Federal Ministry of Finance. However, certain financial matters are regulated by other laws created by the National Assembly such as the Finance (Control and Management Act, 1958, as amended) as well as the Annual Appropriation Law,

Supplementary Appropriation Law and Allocation of Revenue Act of 1981 as amended. The Ministry is organized to deliver on the above responsibilities of managing, controlling and monitoring revenues and expenditures of the country.

Vision & Mission

The vision of the *FMF* is "to be the most prominent Ministry in service delivery". Its mission is "to manage the nation's finance in an open, transparent, accountable and efficient manner that delivers on the country's development priorities.

Functions/Responsibilities

The broad functions and responsibilities of the ministry as provided by the Act fall into the following categories:

1. General Supervision and control of public funds of the Federation, including Development and Contingencies Funds.
2. Management and control of Consolidated Revenue Funds.
3. Securing and managing the investments of the Federation.
4. Preparation of Annual (Budgetary) estimates in Appropriation Bill including Supplementary and Unexpected votes.
5. Control and management of public expenditures.
6. Control and management of external finances of the federation.

Services rendered

Statutorily, the ministry functions through its Department, Parastatal/Agencies, from where full details of its service Charter can be obtained. The following is therefore only a summary of services rendered by the Ministry:

1. The Collection of Government Revenue and formulation of Tax polices.

2. Quarterly/release of appropriate fund.
3. Formulating and implementing fiscal policies and processing Tariff matters.
4. Preparation of Annual Accounts of Ministries, Extra-Ministerial Departments etc.
5. Budget formulation, preparation, defense, implementation monitoring and Evaluation.
6. Managing the international economic relations of the country.
7. Managing the country's foreign and domestic debts.
8. Processing applications from public institutions for foreign exchange.
9. Monitoring projects financed by bilateral and Multilateral Institutions.
10. Regulating the capital market.
11. Involvement in the management of cooperate entities in which the government has interest

THE CENTRAL BANK OF NIGERIA (CBN)

The role of the Central Bank of Nigeria in the financial system has been extensively discussed in Chapter eight. Nevertheless, it is important to point out that with particular reference to the capital market, the ***CBN*** is the biggest player in the Nigeria's bonds market. It advises the Federal Government as to the timing and size of new debt instruments, advertises for public subscription to new issues, redeems matured stocks, pays interest and principal as and when due, collects proceeds of issues for and on behalf of the Federal Government, and sensitizes the Government on the implications of the size of debt. The ***CBN*** oversees the Debt Management Office in the management of the country's debt.

Furthermore, the ***CBN*** regulates the banking industry and nearly all banks in Nigeria are quoted on the Stock Exchange. The overall responsibility of the financial markets (money and capital markets) and indeed the country's financial system rests with the Central Bank of Nigeria.

FINANCIAL SERVICES REGULATION COORDINATING COMMITTEE (FSRCC)

The ***CBN*** in April 1994 undertook to facilitate a formal framework for the co-ordination of regulatory and supervisory activities in the Nigerian financial sector by establishing the Financial Services Coordinating Committee (***FSCC***) to address more effectively, through consultations and regular inter-agency meetings, issues of common concern to regulatory and supervisory bodies. On 27th May, 1994, the name of the Committee was changed to Financial Services Regulation Coordinating Committee (***FSRCC***). The Committee was accorded legal status by the 1998 amendment to Section 38 of the ***CBN*** Act 1991 and formally inaugurated by the Governor of the ***CBN*** in May 1999.

The members of the Financial Services Regulation Coordinating Committee (***FSRCC***) are the ***CBN***, the Federal Ministry of Finance, Corporate Affairs Commission, Federal Inland Revenue Service, National Insurance Commission, National Pension Commission, Nigeria Deposit Insurance Corporation, Securities and Exchange Commission, Abuja Securities and Commodity Exchange and the Nigerian Stock Exchange.

SECURITIES AND EXCHANGE COMMISSION (*SEC*)

In Nigeria, the apex regulator of the capital market is the Securities and Exchange Commission (***SEC***) established by Section 1 of the Investments and Securities Act (***ISA***) No. 29 of 2007 (the most recent re-enactment of previous statutory regimes of capital market regulation that started with the Capital Issues Commission Decree of 1973). It, however, operates under the supervision of the Federal Ministry of Finance

Historical Development

The origin of the Securities and Exchange Commission dates back to 1962, when an ad hoc consultative and advisory body, known as the Capital Issues Committee, was established under the aegis of the Central Bank of Nigeria (***CBN***). Its mandate was to examine applications from companies seeking to raise capital from the capital market and recommend the timing of such issues to prevent issues clustering which could overstretch the market's capacity. The Committee operated within the Central Bank of Nigeria unofficially as a capital market consultative and advisory body with no regulatory framework.

An increase in the level of economic activities, coupled with the promulgation of the Nigerian Enterprises Promotion Decree in 1972, necessitated the establishment of a body backed by law to regulate capital market activities hence the creation of the Capital Issues Commission to take over the activities of the Capital Issues Committee. The Capital Issues Commission was established with the promulgation of the Capital Issues Commission Decree in March 1973. The new body had a board of nine members, including a representative of the Central Bank of Nigeria who served as Chairman, while the other eight members were drawn from some Federal Ministries, the industrial and financial sectors of the economy.

In order to cope with emergent challenges, the powers of the Capital Issues Commission had to be further enhanced. A Financial System Review Committee was set up by the federal government to review capital market activities and recommend ways of developing the market. The recommendations of the Financial System Review Committee in 1976, led to the establishment of the Securities and Exchange Commission following the promulgation of the Securities and Exchange Commission Decree No. 71 of 1979 to supersede the Capital Issues Commission in 1979.

The Commission had more powers to regulate and develop the Nigerian capital market, in addition to determining the prices of issues and setting the basis for allotment of securities. Unlike its

two predecessors, the Commission at this stage was excised from the ***CBN***, although it continued to receive funding from the apex bank. It also had an enlarged 12-member board with a ***CBN*** representative as Chairman. Other members were drawn from the Ministries of Finance, Trade and Industries, the Nigerian Stock Exchange and the Nigerian Enterprises Promotion Board; other members were nominated on the basis of individual merit.

The Commission took off effectively on January 1, 1980 with 51 staff out of which seven were seconded (for a period of three years) from the Central Bank of Nigeria (***CBN***) while a few senior and support service staff were recruited. Nine years after the establishment of the Securities and Exchange Commission, the enabling law, Decree No. 7 of 1979, was re-enacted as ***SEC*** Decree No. 29 of 1988 with additional provisions to address observed lapses in the previous arrangement and to enable the Commission pursue its functions more effectively.

To further enhance the Commission's pursuit of its objective of investor protection, a review of the capital market was carried out in 1996 by a seven - man panel headed by Chief Dennis Odife. Based on the panel's recommendations, a new Act known as 'The Investment and Securities Act No. 45 of 1999' was promulgated on May 26, 1999. The Act repealed the ***SEC*** Act of 1998. The new Act was expected to promote a more efficient and virile capital market, pivotal to meeting the nation's economic and developmental aspirations. The Investment and Securities Act (***ISA***) was further reviewed, amended and subsequently passed into law in 2007. The ***SEC*** currently derives its powers from the ISA 29 of 2007.

The Securities and Exchange Commission (***SEC***) joined the International Organisation of Securities Commissions (***IOSCO***) in June 1985. The ***IOSCO*** is a body of Securities Commissions with the goal of cooperating in developing, implementing and promoting adherence to internationally

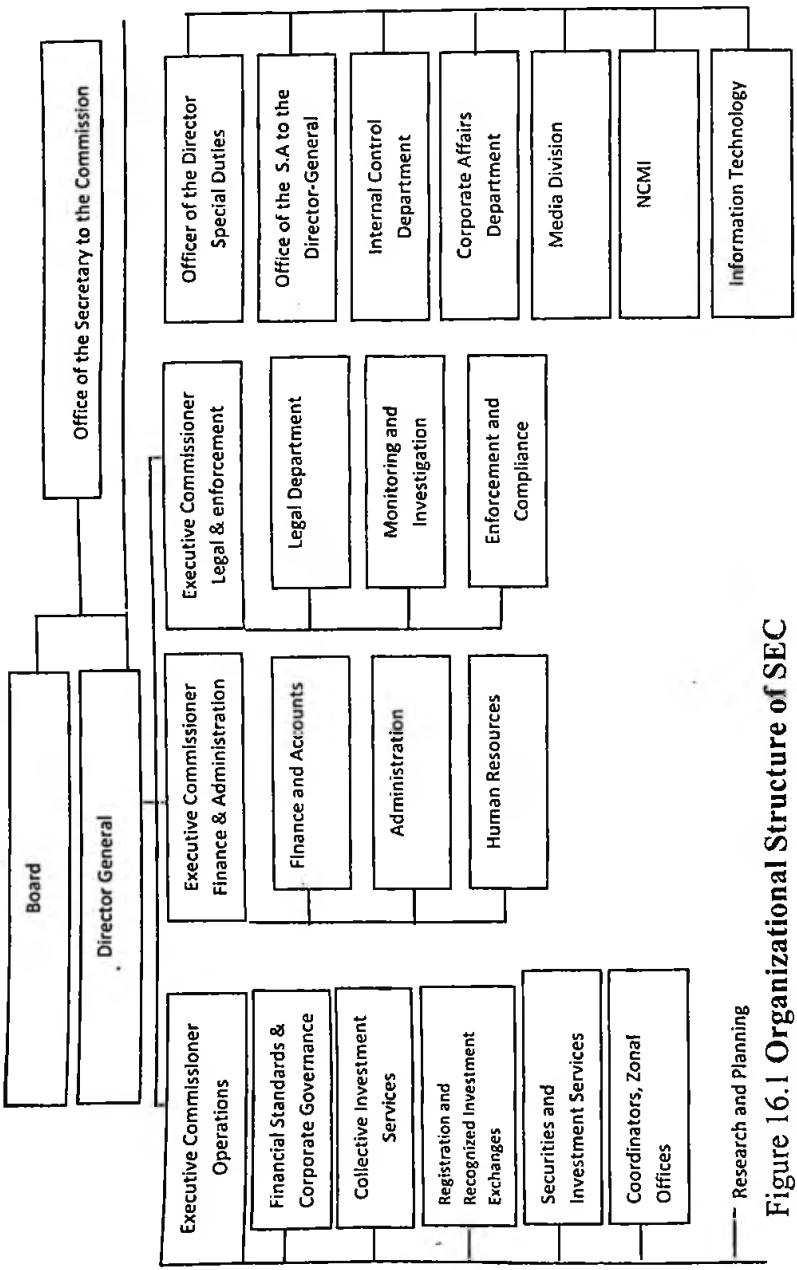


Figure 16.1 **Organizational Structure of SEC**
Source: SEC, Abuja

recognised and consistent standards of securities market regulation. The Nigerian ***SEC*** qualified as an Appendix 'A' Signatory to the ***IOSCO MMOU*** in 2006 and has continuously been benchmarking its market rules and regulations against those of ***IOSCO***, the global international standards setter.

Vision & Mission

The Vision of ***SEC*** is 'to be a leading Capital Market Regulator' while its Mission is 'to develop and regulate a world class Capital Market with the capacity to contribute to the Nation's economic development'.

Statutory Functions and Powers of SEC

The functions and powers of the Commission are spelt out in section 13 of the 2007 Act which provides that the Commission shall be the apex regulatory organization for the Nigerian capital market and shall carry out the functions and exercise all the powers prescribed in the Act and, in particular, shall:

1. Regulate investments and securities business in Nigeria as defined in this Act.

2. Register and regulate Securities Exchanges, Capital Trade Points Futures, Options and Derivatives Exchanges, Commodity Exchanges and any other recognized investment Exchanges.

3. Regulate all offers of securities by public companies and entities.

4. Register securities of public companies.

5. Render assistance as may be deemed necessary to promoters and investors wishing to establish Securities Exchanges and Capital Trade Points.

6. Prepare adequate guidelines and organize training programmes and disseminate information necessary for the establishment of securities exchanges and capital trade points.

7. Register and regulate corporate and individual capital market operators as defined in this Act.

8. Register and regulate the workings of venture capital funds and collective investment schemes in whatever form.

9. Facilitate the establishment of a nationwide system for securities trading in the Nigerian capital market in order to protect investors and maintain fair and orderly markets.

10. Facilitate the linking of all markets in securities with information and communication technology facilities.

11. act in the public interest having regard to the protection of investors and the maintenance of fair and orderly markets and to this end establish a nationwide trust scheme to compensate investors whose losses are not covered under the investors protection funds administered by the securities exchanges and capital trade points.

12. Keep and maintain a register of foreign portfolio investments.

13. Register and regulate securities depository companies, clearing and settlement companies, custodians of assets and securities, credit rating agencies and capital trade points.

14. Protect the integrity of the securities market against all forms of abuses including insider dealing;

15. Promote and register self regulatory organizations including securities exchanges, capital trade points and capital market trade associations to which it may delegate its powers.

16. Review, approve and regulate mergers, acquisitions takeovers and all forms of business combinations and affected transactions of all companies as defined in this Act.

17. Authorize and regulate cross – border securities transactions.

18. Call for information from and inspect, conduct inquiries and audit of securities exchanges, capital market operators, collective investment schemes and all other regulated entities.

19. Promote investors education and the training of all categories of intermediaries in the securities industry.

20. Call for, or furnish to any person, such information as may be considered necessary by it for the efficient discharge by it of its functions.

21. Levy fees, penalties and administrative costs of proceedings or other charges on any person in relation to investments and securities business in Nigeria in accordance with the provisions of this Act.

22. Intervene in the management and control of any capital market operator which it considers has failed, is failing or in crisis including entering into the premises and doing whatsoever the Commission deems necessary for the protection of investors.

23. Enter and seal up the premises of persons illegally carrying on capital market operations.

24. In furtherance of its role of protecting the integrity of the securities market, seek judicial order to freeze the assets (including bank accounts) of any person whose assets were derived from the violation of this Act, or any securities law or regulation in Nigeria or other jurisdictions.

25. Relate effectively with domestic and foreign regulators and supervisors of other financial institutions including entering into co - operative agreement on matters of common interest.

26. Conduct research into all or any aspect of the securities industry.

27. Prevent fraudulent and unfair trade practices relating to the securities industry.

28. Disqualify persons considered unfit from being employed in any arm of the securities industry.

29. Advise the minister on all matters relating to the securities industry.

30. Perform such other functions and exercise such other powers not inconsistent with this Act as are necessary or expedient for giving full effect to the provisions of this Act.

Pursuant to this provision, the Commission, in summary, carries out the following regulatory functions:

1. Registration of Operators and Instruments

2. Monitoring/Surveillance of Market activities

3. Investigation of Complaints
4. Enforcement of relevant Laws and Rules
5. Collaboration with Law Enforcement Agencies
6. Rule Making
7. Public Enlightenment Programmes
8. Market Development (school debates, essay competitions, sponsoring capital market studies in secondary and tertiary institutions)
9. Capacity building (via the Nigeria Capital Market Institute – NCMI)
10. High Level involvement in the activities of the International Organization of Securities Commissions (IOSCO)
11. Sharing of information with other regulators in the financial industry

THE NATIONAL PENSION COMMISSION (PENCOM)

Historical Background

Prior to the enactment of the Pension Reform Act 2004, pension schemes in Nigeria had been bedevilled by many problems. The Public Service operated an unfunded Defined Benefits Scheme and the payment of retirement benefits were budgeted annually. The annual budgetary allocation for pension was often one of the most vulnerable items in budget implementation in the light of resource constraints. In many cases, even where budgetary provisions were made, inadequate and untimely release of funds resulted in delays and accumulation of arrears of payment of pension rights. It was

obvious therefore that the Defined Benefits Scheme could not be sustained.

In the private sector on the other hand, many employees were not covered by the pension schemes put in place by their employers and many of these schemes were not funded. Besides, where the schemes were funded, the management of the pension funds was full of malpractices between the fund managers and the Trustees of the pension funds. This scenario necessitated a re-think of pension administration in Nigeria by the administration of President Olusegun Obasanjo. Accordingly, the administration initiated a pension reform in order to address and eliminate the problems associated with pension schemes in the country. The outcome of the reform was the enactment into law of the Pension Reform Act 2004.

Vision & Mission

"To be a world-class organisation that ensures the prompt payment of retirement benefits and promotes a sustainable pension industry that positively impacts on the economic development of Nigeria". Its mission is "To be an effective regulator and supervisor that ensures the safety of pension assets and fair return on investment utilizing appropriate technology, with highly skilled and motivated staff"

Objectives

The main objectives and features of the Pension Reform Act 2004 are:

1. To ensure that every person who worked in either the Public Service of the Federation, Federal Capital Territory or Private Sector receives his retirement benefits as and when due.

2. To assist individuals by ensuring that they save to cater for their livelihood during old age thereby reducing old age poverty.

3. To ensure that pensioners are not subjected to untold suffering due to inefficient and cumbersome process of pension payment.

4. To establish a uniform set of rules, regulations and standards for the administration and payments of retirement benefits for the Public Service of the Federation, Federal Capital Territory and the Private Sector.

5. To stem the growth of outstanding pension liabilities.

The pension reform programme is governed by the key principles of sustainability, safety and security of benefits, transparency, accountability, equity, flexibility, inclusivity, uniformity and practicability.

Functions of the Commission:
The Pension Reform Act 2004 established the National Pension Commission (PenCom) as the body to regulate, supervise and ensure the effective administration of pension matters in Nigeria.
The functions of the Commission include:

1. Regulation and supervision of the Scheme established under the Act.

2. Issuance of guidelines for the investment of pension funds.

3. Approving, licensing, regulating and supervising pension fund administrators, custodians and other institutions relating to pension matters as the Commission may, from time to time, determine.

4. Establishing standards, rules and guidelines for the management of the pension funds under the Act.

5. Ensuring the maintenance of a National Data Bank on all pension matters.

6. Carrying out public awareness and education on the establishment and management of the Scheme.

7. Promoting capacity building and institutional strengthening of pension fund administrators and custodians.

8. Receiving and investigating complaints of impropriety levelled against any pension fund administrator, custodian or employer or any of their staff or agents.

9. Performing such other duties which, in the opinion of the Commission, are necessary or expedient for the discharge of its functions under the Act.

Powers of the Commission

The Commission shall have the power to:

1. Formulate, direct and oversee the overall policy on pension matters in Nigeria.

2. Fix the terms and conditions of service including remuneration of the employees of the Commission.

3. Request or call for information from any employer or pension fund administrator or custodian or any other person or institution on matters relating to retirement benefit.

4. Charge and collect such fees, levy or penalties, as may be specified by the Commission.

5. Establish and acquire offices and other premises for the use of the Commission in such locations as it may deem necessary for the proper performance of its functions under the Act.

6. Establish standards, rules and regulations for the management of the pension funds under the Act.

7. Investigate any pension fund administrator, custodian or other party involved in the management of pension funds.

8. Impose administrative sanctions or fines on erring employers or pension fund administrators or custodians.

9. Order the transfer of management or custody of all pension funds or assets being managed by a pension fund administrator or held by a custodian whose licence has been revoked under this Act or subject to insolvency proceedings to another pension fund administrator or custodian, as the case may be.

10. Do such other things which in its opinion are necessary to ensure the efficient performance of the functions of the Commission under the Act.

Pension Fund Administrators

The new pension scheme requires pension funds to be privately managed by licensed Pension Fund Administrators. Pension Fund Administrators (***PFAs***) have been duly licensed to open Retirement Savings Accounts for employees, invest and manage the pension funds in a manner as the Commission may from time to time prescribe, maintain books of accounts on all transactions relating to the pension funds managed by it, provide regular information to the employees or beneficiaries and pay retirement benefits to employees in accordance with the provisions of the Pension Reform Act 2004. Before it is issued with an operating licence, the ***PFA*** must be a limited liability company whose sole object is the management of pension funds. To discourage frivolous applications and to ensure credibility, such company must have a paid up share capital of N1billion and demonstrate professional

capacity to mange pension funds and administer retirement benefits.

Pension Fund Administrators in Nigeria include:

a. Arm Pension Managers
b. ***IBTC*** Pension solution
c. Pensure PFA Limited
d. Pension Alliance Limited
e. First Guarantee Pension Limited
f. Crusader Pension
g. Trust Fund Pension Fund
h. Premium Pension Limited
i. Sigma Vaughn Sterling Pension Limited
j. First Alliance Pension and Benefits
k. Legacy Pension Managers Limited
l. ***NLPC*** Pension Fund Administrator Limited

The pension fund assets shall be invested in any of the following:

1. Other securities or guaranteed by the federal government or ***CBN***.

2. Bonds, Debentures, redeemable preference shares or other debt instruments issued by corporate entities and listed on the ***NSE*** which are registered under ***ISA*** 1999 as amended.

3. Ordinary shares of public limited company listed on the stock Exchange and registered under ***ISA*** with good track records having declared and paid dividend in the preceding 5 years.

4. Bank deposit and bank securities.

5. Investment certificate of close-ended investment funds or hybrid investment fund listed on the Stock Exchange.

6. Units sold by open ended investment fund listed on the Stock Exchange and recognized by the Commission.

7. Real estate investment.

8. Such other investments which may be prescribed

Pension Fund Custodians

Pension Fund Custodians (***PFCs***) will be responsible for the warehousing of the pension fund assets. The ***PFAs*** shall not be allowed to hold the pension funds assets. The employer sends the contributions directly to the Custodian, who notifies the ***PFA*** of the receipt of the contribution and the ***PFA*** subsequently credits the retirement savings account of the employee.

The Custodian will execute transactions and undertake activities relating to the administration of pension fund investments upon instructions by the ***PFA***. The custodian shall hold pension fund assets on trust for its clients. For the same reason adduced in the case of the ***PFA***, a stakeholder of the Custodian must be a licensed financial institution and have a minimum net worth of N5,000, 000, 000 and a total balance sheet of not below N125, 000,000,000. The shareholders of a Custodian must guarantee the pension fund assets held by it. Pension fund Custodians include: (1) UBA Pension Custodians; (2) First Custodian Limited; (3) Zenith Pension custodian Limited; and (4) Diamond Pension Fund Custodian Limited

NATIONAL INSURANCE COMMISSION

The National Insurance Commission is a statutory agency of the Federal Government of Nigeria established by the law to regulate and supervise the Nigerian Insurance Sector. The Commission derives its regulatory powers from the National Insurance Commission Act 1997 and the Insurance Act 2003. The principal object of the Commission is to ensure the effective administration, supervision, regulation and control of insurance business in

Nigeria. Accordingly, insurance/reinsurance companies, Insurance Brokers, Loss Adjusters and Agents fall within the regulatory purview of the Commission. Vision & Mission. The vision of ***NAICOM*** is "To be among the leading Regulators of the Insurance sector in the emerging markets." Its mission is "Effective supervision of the Nigerian Insurance Industry for the attainment of a high ethical standard needed to position the Industry as a leading market in the global economy."

Objects, Functions and Powers of the Commission

The principal object of the Commission is to ensure the effective administration, supervision, regulation and control of insurance business in Nigeria. The functions of the Commission include the following:

1. Establish standards for the conduct of insurance business in Nigeria;
2. Approve rates of insurance premiums to be paid in respect of all classes of insurance business;
3. Approve rates of commissions to be paid in respect of all classes of insurance business;
4. Ensure adequate protection of strategic Government assets and other properties;
5. Regulate transactions between insurers and reinsurers in Nigeria and those outside Nigeria;
6. Act as adviser to the Federal Government on all insurance related matters;
7. Approve standards, conditions and warranties applicable to all classes of insurance business;

8. Protect insurance policy- holders and beneficiaries and third parties to insurance contracts;

9. Publish, for sale and distribution to the public, annual reports and statistics on the insurance industry;

10. Liaise with and advise Federal Ministries, Extra Ministerial Departments, statutory bodies and other Government agencies on all matters relating to insurance contained in any technical agreements to which Nigeria is a signatory;

11. Contribute to the educational programmes of the Chartered Insurance Institute of Nigeria and the West African Insurance Institute; and

12. Carry out such other activities connected or incidental to its other functions under this Decree.

The Commission is also empowered to:

1. Establish a Bureau to which complaints, against any insurer, reinsurer, insurance broker or loss adjuster (in this Decree referred to as "insurance institution") may be submitted by members of the public;

2. Requests or call for information from Federal Ministries, Extra-Ministerial Departments, statutory bodies and other Government agencies on matters relating to insurance;
3. Borrow such sums of money as the Commission may, from time to time, require for performing its functions under this Decree; and

4. Acquire offices and other premises for the use of the Commission.

History

The first major step at regulating the activities of Insurance business in Nigeria was the report of J.C. Obande Commission of 1961, which resulted in the establishment of Department of Insurance in the Federal Ministry of Trade and which was later transferred to the Ministry of Finance. The report also led to the enactment of Insurance Companies Act 1961, which came into effect on 4th May 1967. The 1961 Act focused mainly on the activities of direct Insurers, made provisions for Registration and Record keeping. In 1968, Insurance Companies regulations was put in place to facilitate the implementation of Act No 58 of 1961 which then classified Insurance business into different classes for registration purpose and relevant forms for record keeping.

Insurance Decree No 59 of 1976 was enacted putting together the provisions of the various laws. The 1976 Decree among others made the following provisions: Condition for authorization of Insurers, Mode of operation, Amalgamation and Transfer, Administration and Enforcement, Penalties. The Insurance Decree No 59 of 1976 constituted the first All-embracing Law for the regulation and Supervision of Insurance business in Nigeria. In 1968, concern was given to life Insurance business and it led to the enactment of Decree 40 of 1988 which made provisions among others for Assignment of Life Insurance Policy, named beneficiary on Life insurance policy document.

The Federal Government of Nigeria promulgated the Insurance Special Supervisory Fund (***ISSF***) decree 20 of 1989 to strengthen the manpower need of the Insurance Supervisory Board. That decree mandated all insurance companies to contribute 1% of their gross earning to the Fund. Decree No 58 of 1991 was enacted improving provisions of Decree No 58 of 1979 and No 40 of 1988. The major highlights of 1991 Decree include; Increased paid-up share capital of insurers and Re-insurers in respect of non-life business and life business respectively, compulsory membership of trade associations; management of security fund by ***NIA***; Practice of no-premium, no-cover.

In 1992, the Insurance Special Supervision Fund decree No 62 was enacted, establishing a body known as National Insurance Supervisory Board, bringing out Insurance supervision outside core civil service, changing designation of Chief Executive from Director of Insurance to Commissioner for Insurance and setting up the Board of Directors to oversee the affairs of the established Body. All this provisions were made to attract high level manpower. The provision of Decree No 62 of 1992 and 58 of 1991 were reviewed for effective supervision and efficient Insurance market, bringing into enactment Decree Numbers 1 & 2 of 1997, National Insurance Commission and Insurance Decree respectively.

The following provisions were made in reviewing decree No 62 of 1992, decree No 1 of 1997; change of name from National Insurance Supervisory Board to National Insurance Commission, Establishment of Governing Board, Staffing, Source and application of funds, control and management of failed and failing Insurance companies, supervisory functions and powers. Decree No 58 of 1991 was improved on with decree No 2 of 1997 in the following areas; by raising the paid up share capital for different categories of Insurance companies, qualification of Chief Executive, Insurance of Government properties and so on.

CORPORATE AFFAIRS COMMISSION (CAC)

Corporate Affairs Commission is the body charged with the responsibility of administrating the Companies and Allied Matters Act, including the regulation and supervision of the formation, incorporation, registration, management, winding- up of companies. The corporate affairs commission was established by the companies and Allied Matters Act, which was promulgated in 1990 to regulate the formation and management of companies in Nigeria. The establishment of the Corporate Affairs Commission as an autonomous body was as a result of perceived ineffectiveness of the erstwhile company Registry, a department within the Federal Ministry of commerce and Tourism which was then responsible for

the registration and administration of the repealed Companies Act of 1968.

Vision and Mission

The Vision of the Corporate Affairs Commission is "to be a World Class Companies Registry". The Mission of the Commission is "to provide Excellent Service Delivery through the best Technology, driven by a Motivated Workforce"

Functions of the Commission

The function of the commission as set out in section 7 of the Companies and Allied Matter Act include the following:

1. To administer the act, including the regulation and supervision of the formation, incorporation, management and winding up of companies.

2. To establish and maintain companies' registry and office in all states of the federation adequately equipped to discharge its function under the Act.

3. Arrange and conduct an investigation into the affairs of any company where the interest of shareholders and the public so demand.

4. To undertake such other activities as are necessary or expedient for giving full effect to the provisions of the Act.

5. The Commission also registers Business Names and Incorporated Trustees as well as provides a wide range of ancillary services.

ECONOMIC AND FINANCIAL CRIMES COMMISSION (*EFCC*)

The ***EFCC*** is charged with the responsibility of investigating and enforcing all laws against economic and financial crimes in Nigeria. The commission is also the designated Financials

Intelligences Unit (***FIU***) in Nigeria which is charged with the responsibility of coordinating the various institutions involved in the fight against money laundering and enforcement of all laws dealing with economic and financial crimes in Nigeria. The council, which provides the general policy for the operations of the commission, is composed of:

1. The Executive chairman
2. Member representing Central Bank of Nigeria (***CBN***).
3. Member representing Ministry of Foreign Affairs,
4. Member representing Ministry of Finance,
5. Member representing Ministry of Justice,
6. Member representing Chairman National Drug Law Enforcement Agency (***NDLEA***),
7. Member representing Director-General Nigeria Intelligence Agency (***NIA***),
8. Member representing state security service (***SSS***),
9. Member representing Director-General, Security and Exchange Commission (***SEC***),
10. Member representing Commissioner of Insurance,
11. Member representing Post Master General of Nigerian Post Service (***NIPOST***),
12. Member representing Chairman, National Communication Commission (***NCC***),

13. Member representing comptroller General Nigerian Customs Service (*NCS*),

14. Member representing Comptroller-General Immigration Service (*IS*)

15. Member representing Inspector General of police (*IGP*) and

16. Four eminent Nigerians with cognate experience in finance, accounting and banking.

Functions of the *EFCC*

The major functions as set out in the enabling Act includes:

1. Enforcement and due administration of the provision of this act.

2. Investigation of all financial crimes such as Advanced Fee Fraud (otherwise known as 419), money laundering, counterfeiting, illegal charge transfer, future market fraud, fraudulent encashment of negotiable instrument, fraudulent diversion of funds, computer credit card fraud, contract scam, forgery of financial instruments, issuance of dud cheques.

3. Adoption of measures to identify, freeze, confiscate, or seize proceeds, derived from terrorist activities, economic and financial crimes related offences, or the properties, the value of which correspond to such proceeds.

4. Adoption of measures to eradicate and prevent the commission of economic and financial crimes with a view to identify individuals, corporate bodies or groups involved.

5. Facilitation and rapid exchange of scientific and technical information geared towards the eradication of economic and financial crimes.

6. Collaboration with government bodies within and outside Nigeria carrying out the functions wholly or in part analogous with those of the commission.

7. Dealing with matters connected with extradition, deportation and mutual legal or other assistance between Nigeria and any other country involving economic and financial crimes.

8. The collection of all report relating to suspicious financial transaction, analyze and disseminate to all relevant government agencies.

9. Maintaining liaison with the office of the Attorney General of the federation, Nigeria Customs service, Immigration and prison service Board, central Bank of Nigeria, Nigeria Deposit Insurance Corporation, National Drug Law, Enforcement Agency (*NDLEA*), all government supervisory institutions, in the eradication of economic and financial crimes.

10. Carrying out and sustaining rigorous public enlightenment campaign against economic and financial crimes within and outside Nigeria.

11. Any other such activities as are necessary to give effects to the functions conferred on the commission under the Act.

Powers of the *EFCC*

The commission has the power to:

1. Cause investigation to be conducted as to whether anybody has committed an offence under this Act.

2. Investigate whether any one is in the process of committing offence under the Act.

3. Investigate the properties of any person if it appears to the commission that the person's lifestyle and extent of the properties are not justified by his source of income.

4. Enforce the provisions of the following laws:
   i. Money Laundering Amendment Act 2003
   ii. The Advanced Fee Fraud and other related offences Act 199 as amended.
   iii. The failed bank (Recovery) debts and financial malpractices in Bank Act 1994 as amended.
   iv. The Banks and other financial Institutions Act, 1991 as amended.
   v. Miscellaneous Offences Act (cap. 410LFN)
   vi. Any other law or regulation relating to economic and financial crimes, including the criminal code and penal code.

As part of its efforts to combat money laundering and financing of terrorist activities in Nigeria, the Federal Government has set up the Nigeria Financial Intelligence Unit (***NFIU***) domiciled in the Economic and Financial Crimes Commission (***EFCC***). This is a precondition for the removal of Nigeria from the Financial Action Task Force (***FATF***) list of Non-cooperative countries and Territories (***NCCTs***). The ***NFIU*** will operate as an autonomous central national agency. It will receive and analyze financial information-currency Transaction Reports (***CTRs***) and suspicious Translation Report · (***STRs***) from financial institutions and designated non-financial institutions with a view to disseminating intelligence information arising thereof to law enforcement agencies (***LEAs***) and other stakeholders.

The major return to be rendered by Reporting institutions to ***NFIU*** are: (1) Suspicious Transaction Reports (***STRs***); (2) Currency Transaction Reports (***CTRs***) above a prescribed threshold

of: ₦1, 000,000 or its equivalent in the case of individual; and ₦ 5, 000,000 or its equivalent in the case of a cooperate body; and (3) Any transfer to or from a foreign country of funds or securities of a sum exceeding USS10, 000 or its equivalent.

SUMMARY

The financial system in Nigeria is largely regulated by the following bodies:

1. Federal Ministry of Finance (***FMF***) is the Government Department charged with the administration of Federal Government fiscal policies, planning and managing of Government projects, national budgets, incomes and liabilities accruable to the Federal Government of Nigeria.

2. Central Bank of Nigeria (***CBN***) is the body charged with the function of issuing legal tender currency, promote monetary stability and sound financial system, and act as banker and financial adviser to the Federal Government.

3. Corporate Affairs Commission (***CAC***) is the body charged with the responsibility of administering the provisions of the Companies and Allied Matters Act, including the regulation and supervision of the formation, incorporation, registration, management, and winding-up of companies.

4. National Insurance Commission (***NAICOM***) is the body charged with the responsibility of ensuring the effective administration, supervision, regulation and control of insurance business in Nigeria.

5. National Pension Commission (PenCom) is a body mandated to regulate, supervise and ensure the effective administration of pension matters in Nigeria.

6. Securities and Exchange Commission (***SEC***) is a corporate organisation charged with the function of registering all securities proposed for subscription by the public or to be sold in the market. it also has responsibility to maintain surveillance over securities market as well as protect its integrity.

7. Abuja Securities and Commodity Exchange (***ASCE***) is an exchange for commodities and futures in Nigeria.

8. The Nigerian Stock Exchange (***NSE***) is the exchange that provides the platform for the trading in stocks and the settlement of transactions resulting thereafter.

9. The ***EFCC*** is charged with the responsibility of investigating and enforcing all laws against economic and financial crimes in Nigeria.

REVIEW QUESTIONS

1. Briefly explain the roles of the following organizations in the Nigerian capital market :
   a) National Pension Commission
   b) National Insurance Commission

2. State FIVE statutory functions of the Securities and Exchange Commission

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CHAPTER 17

SELF- REGULATORY ORGANIZATIONS

INTRODUCTION

Self-Regulatory Organizations (***SROs***) provide training and advocacy as well as enforce codes of ethics and standards for their members. In the Nigerian capital market, they include the current four platforms for trading in securities namely the Nigerian Stock Exchange, Abuja Securities and Commodities Exchange, the National Association of Securities Dealers and the Financial Markets Dealers Association. This chapter examines these ***SROs*** as well as trade groups in the capital market which are self-regulatory.

NIGERIAN STOCK EXCHANGE (NSE)

The Nigerian Stock Exchange (***NSE***) is a private, non-profit making organization, limited by Guarantee and owned by about 500 members comprising Dealing members (Stockbroking firms) and Ordinary members - financial institutions and individual Nigerians of high integrity who have contributed to the development of the capital market and the Nigerian economy. The NSE is still a mutual organization although it has begun plans to demutualize (that is to become a publicly owned company with shares listed on the stock exchange like other public companies). It was incorporated in 1960 as the Lagos Stock Exchange and was renamed the Nigerian Stock Exchange in December 1977. At present, it has thirteen branches in major cities of the country. The table below shows the trading floors of the ***NSE*** with the dates they were opened.

Table 17.1 NSE Trading floors and dates established

S/N	*Trading Floor*	*Date opened*
1	Kaduna	June, 1978
2	Port Harcourt	April, 1979
3	Kano	May, 1989
4	Onitsha	Feb, 1990
5	Ibadan	Aug, 1990
6	Abuja	Oct, 1999
7	Yola	April, 2002
8	Benin	Jan, 2005
9	Uyo	May, 2007
10	Ilorin	Jan, 2008
11	Abeokuta	Nov, 2008
12	Owerri	Feb, 2009
13	Bauchi	March, 2009

Source: compiled from NSE Factbook, various issues

The Exchange started operations in June 1961 with 19 securities listed for trading and an authorized share capital of N10,000 divided into 500 shares of N20 each. Transactions in the stock market are guided by the following legislations among others: (1) Investments & Securities Act 2007; (2) Companies and Allied Matters Decree 1990; (3) Nigerian Investment Promotion Commission Decree, 1995; and (4) Foreign Exchange (Miscellaneous Provisions) Decree, 1995.

Objectives

The memorandum of association states the objectives of the Exchange as seeking to: (1) create an appropriate mechanism for capital formation and efficient allocation of resources among competing projects; (2) maintain fair price for securities; (3) maintain discipline in the capital market; and (4) broaden share ownership practice.

Functions

The functions of the *NSE* include to:

1. Enhance the mobilization of private and public savings for investment through trading in shares and stocks.

2. Serve as a broad communication arena for its constituencies and the dual role of overseeing the markets and their member-firm participants on one hand and self-regulating itself on the other hand.

3. Ensure fair dealings in securities through its rules, regulations and operational codes which help to protect the public from shady deals.

4. Maintain broad, liquid secondary markets for corporate securities thereby helping to build public confidence and participation in the market.

5. Enhance issuers' ability to raise capital in the primary market and understanding the importance of efficient capital management.

6. Serve as a forum or mechanism for the implementation of indigenization programme.

Membership

Membership of the Exchange is either ordinary or dealing members. Ordinary members are individuals and institutions who have acquired at least five shares of N20 each out of the issued share capital of the exchange and have been admitted to the register of members in line with the exchange articles of association. On the other hand, dealing members are individuals or institutions that apart form being admitted as members, are also licensed by the council of the exchange to transact business in stocks, shares, debentures, bonds and other securities on the floors of the exchange in accordance with the rules and regulations of the

exchange. This category of members is represented by authorized dealing clerks on the floor of the exchange.

Management

The Nigerian Stock Exchange being a non-profit making organization, a private company limited by guarantee has a national council with the responsibility for quotation, regulations and general discipline of the capital market. The Director General with the assistance of other Directors takes care of the day-to-day running of the Exchange.

Operation & Technology

The ***NSE*** has been operating an Automated Trading System (***ATS***) since April 27 1999, with dealers trading through network of computers connected to a server. The ***ATS*** has facility for remote trading. Consequently all branches of the exchange across the country are connected for online real time trading. The Securities and Exchange Commission (***SEC***) is also connected for remote surveillance from it offices. In September 2013, the ***NSE*** introduced a new trading engine known as the X-Gen which is a modern and robust trading platform with multifunctional capabilities. Trading on The Exchange starts at 9.30 a.m. every business day and closes at 2.30 p.m. Data on listed companies' performances are published daily, weekly, monthly, quarterly and annually.

In order to encourage foreign investment into Nigeria, the government has abolished legislation preventing the flow of foreign capital into the country. This has allowed foreign brokers to enlist as dealers on the Nigerian Stock Exchange, and investors of any nationality are free to invest. Nigerian companies are also allowed multiple and cross border listings on foreign markets. In 2014, Seplat, a quoted company in the oil and gas sector, also became listed on the London Stock Exchange.

Pricing

The Nigerian Capital Market was deregulated in 1993. Consequently, prices of new issues are determined by issuing houses and stockbrokers, while on the secondary market prices are made by stockbrokers only. The market/quote prices, along with the All-Share Index plus *NSE* 30 and Sector Indices, are published daily in The Stock Exchange Daily Official List, The Nigerian Stock Exchange *CAPNET* (an intranet facility), newspapers, and on the stock market page of the Reuters Electronic Contributor System.

Table 17.2 NSE Milestones

IMPORTANT DATES AND KEY EVENTS OF THE NIGERIAN STOCK EXCHANGE	
1961	Commencement of trading on Lagos Stock Exchange
1978	Lagos Stock exchange renamed Nigeria Stock Exchange
1978	Port Harcourt Trading floor opened
1984	All share index launched
1985	The Second-tier Securities Market (SSM) was launched
1986	Opening of the new Lagos trading floor
1987	NSE hook up with Reuters Electronic Contributors system
1989	Kano trading floor was opened
1990	Onisha and Ibadan trading floors opened
1993	Deregulation of the Nigeria Capital Market
1994	Introduction of dress code for authorized and unauthorized Dealing Clerks
1995	Promulgation of Nigeria Investment Promotion Action
1997	Commencement of Central Securities Clearing System (CSCS)
1998	Trading in Rights commenced
1999	Switch over from open Cry System i.e. call-over
1999	NSE signed MoU with Jonesburg Stock Exchange
1999	NSE listed MNET/Super sport first cross border listing

2000	Appointment of first female DG of NSE – Dr. (Mrs.) Ndi Okereke Onyiuke (OON)
2000	NSE hosted ASEA Conference
2000	NSE signed MoU with Nairobi Stock Exchange
2000	T+3 Settlement cycle commenced
2000	Trade Guarantee trust Fund commenced
2000	Kano Trading Floor commenced remote trading online, real time.
2000	NSE/National Essay Competitions
2000	All share Index hit 10,000 points
2000	NSE signed MoU with London and Egyptian Stock Exchange
2001	Port Harcourt remote trading opens
2002	Opening of Yola Trading floor
2002	NSE Launched e-biz portal
2003	All Share index hit 20,000 mark
2004	Listed companies grew to 169
2005	Deluge of bank offers
2005	Warehoused Afribank share sold on the floor of the Nigeria stock Exchange
2005	Trade alert was introduced
2006	Opening of Kaduna Trading floor
2006	All Share index hit 30,000 mark
2006	Ibadan remote trading opened
2008	Abeokuta trading floor was commissioned.
2008	Market capitalization reached an all time high of N12.6 trillion, even though it ended the year at N7.0 trillion in the wake of financial crisis.
2010	Changed trading hours to 9.30am to 2.30pm
2011	The NSE market segmentation which reduced the sectors on the Exchange from 32 to 12 became operational
2011	The first Exchange Traded Fund (ETF) product- New Gold ETF- was admitted on the Daily official list of the Exchange.
2012	Lotus Islamic Index was launched

2012	Introduction of market making to boost market liquidity
2013	Introduction of a new trading engine X-Gen, a modern and robust trading platform
2013	Commencement of retail bond trading
2013	Introduced the first ever issuers portal in the Nigerian capital market known as X-Issuer
2014	Seplat, a quoted company in the oil and gas sector, became listed on the London Stock Exchange
2014	The NSE became a full member of the World Federation of Exchanges

Source: compiled from NSE Factbook, various issues

Financing the Nigerian Stock Exchange

The financing of the *NSE* comes from the following sources:

1. Transaction fees paid by members on every sell side (0.3% of consideration)
2. Fees paid by firms when their securities are originally listed
3. Annual listing fees by issuers of listed securities
4. Annual fees paid by dealing members based on the number of stockbrokers employed in each house and a flat fee to cover the cost of maintaining the trading booth.
5. Entrance fees from new members
6. Subscription to Official Website
7. Sale of historic trading and market information
8. Sale of Publications: Annual Factbook, Monthly Report and Nigerian Journal of Securities & Finance
9. Penalties by quoted companies and stockbroking firms.

CENTRAL SECURITIES CLEARING SYSTEM (CSCS)

The Central Securities Clearing System Limited is a subsidiary of the Nigerian Stock Exchange (*NSE*) as well as the clearing house of the Nigerian Stock Market. It was incorporated on July 29, 1992 while it commenced operations on April 14, 1997. *CSCS* Ltd was

incorporated to implement a computerized Stock Exchange Management System (***SEMS***) as a way of tackling some of the bottlenecks experienced in the manual processing of transactions done on the floor of the Nigerian Stock Exchange. The emphasis of this initiative was the dematerialization of share certificates in a Central Securities Depository (***CSD***) and the elimination of the unnecessary difficulties encountered between registrars and company executives in issuing new certificates to investors.

Functions of the CSCS

The Nigerian Stock Exchange incorporated the ***CSCS*** limited as its subsidiary company in a bid to achieve comparability, reliability and transparency of information as it relates to clearing, settlement and delivery system. The ***CSCS*** is charged with the following functions:

1. ***CSCS*** provides central depository for all share certificates of quoted securities including new issues. Also securities not quoted on the Nigerian Stock Exchange can be deposited with ***CSCS*** Ltd for safe keeping as well as certificates for foreign investors.

2. It acts as a sub-registry for all quoted securities in conjunction with the registrars of quoted companies. Shareholders can always ascertain their holdings through a ***CSCS*** statement obtained from their stock brokers.

3. ***CSCS*** functions as clearing house for settlement of stocks market 'transactions and also it issues clearing House numbers and account numbers to stock brokers and investors.

Indeed, the concept of Central Securities Clearing System Ltd provides for an integrated central securities depository (***CSD***), clearing (electronic/book-entry transfer of shares from seller to buyer) and settlement (payment for bought securities) for all stock market transactions. All securities listed on The Nigerian Stock

Exchange must have their certificates deposited in ***CSCS*** before transaction can take place on them on the floors of The Nigerian Stock Exchange.

The transactions are processed and concluded within four (4) days (i.e.T+3) in electronics book entry form. Dematerialized certificates are recycled to the registrars for scrutiny and retention. ***CSCS*** sends transaction up-date to relevant registrars to constantly up-date the registers of members of listed companies. ***CSCS*** provides Central Depository for all share certificates of quoted securities including new issues. Securities not quoted on The Nigerian Stock Exchange can be deposited with ***CSCS*** Ltd for safe keeping (custodianship) as well as certificate for foreign investors. ***CSCS*** is a sub-registry for all quoted securities in conjunction with the registrars of quoted companies. Shareholders can always ascertain their holdings held electronically in particular security by requesting for a statement from ***CSCS*** Ltd through their stock broking firms.

Benefits of CSCS

a) To Investors

i. Investor settlements of stock position are issued every quarter free of charge or on demand for a token fee.

ii. Use of stock position as collateral for loan facility after T + 3 settlement cycle. In effect, a settlement of stock position is obtainable from ***CSCS*** 4 days after transaction.

iii. Investors can speculate more and take advantage of capital appreciation in their investment because of the T + 3 settlement cycle.

iv. Reduced risk of loss of share certificate.

b) To Quoted Companies

i. Huge cost associated with the production of share certificates for transaction through the secondary market has been significantly reduced.

ii. Before *CSCS*, a single transaction on a certificate leads to the cancellation and re-issuance of such certificates as many times as possible depending on allotments made. This is no longer so since few shareholders request for certificates.

iii. Amalgamation of several accounts for a shareholder on the register leading to reduction of cost to the company.

c) To Stock Broking Firms

i. Prompt inter-member money and stock-settlement.

ii. The problems associated with delivery of shares are minimized.

iii. Increased efficiency and profit.

iv. Reduction in operational cost.

ABUJA SECURITIES & COMMODITIES EXCHANGE (ASCE)

The Abuja Securities and Commodity Exchange (*ASCE*) – now known as the Abuja Commodities Exchange (*ACE*)- was originally incorporated as a Stock Exchange on June 17, 1998. It was converted into a commodity exchange in August 2001. This was in part due to recognition that the securities market in Nigeria was at that time too thin to support two viable stock exchanges. The conversion was also intended to create an alternative institutional arrangement that would facilitate marketing of agricultural produce as well as enable market players to manage price risk.

The need for this type of market institution became evident following the abolition of the commodity boards in Nigeria in

1986. Prior to that, while marketing of food crops was largely left to the informal market, the commodity boards controlled the marketing of cash (export) crops. As in other African countries, the commodity boards fixed commodity prices, often without reference to international market prices or local production costs, hence distorting producer incentives. Abolition of commodity boards was to redress these problems, but their exit created an institutional vacuum in commodity marketing in Nigeria which was expected to be filled with the promotion of a commodity exchange. An Inter-Ministerial Technical Committee which was set up at the behest of the Central Bank of Nigeria (*CBN*) to examine the prospects for setting up an agricultural commodity exchange recommended conversion of the stock exchange in Abuja into a commodity exchange.

The *ASCE* was expected to contribute to the transformation of the agricultural economy of Nigeria by promoting standardization in trading, offering market-based instruments to mitigate price risk and improving access to agricultural finance. These developments were to enlarge the formal segment of agricultural markets and catalyze commercial farming in the country. It was planned that the Exchange would start operations as a spot market and eventually evolve into a futures market, trading commodity futures and options. Though its primary focus was to be on trading contracts in agricultural produce, it was also expected to trade in solid mineral products, energy, financial indices and currencies. It commenced spot trading in agricultural commodity contracts in July 2006.

The *ASCE* is wholly owned by the Federal Government of Nigeria as a parastatal under the Ministry of Commerce. It has three categories of members namely: Ordinary members, Trading members and Institutional trading members. While Ordinary members are by the Rules of the Exchange not allowed to execute or initiate trades on their own accounts or on behalf of others, the Trading members can do so. The Ordinary members can only trade on the Exchange through registered Trading members.

The Trading members include stock and commodity brokers and dealers as well as Commodity merchants, who trade in agricultural commodities and are restricted to trading only on the cash market and on their own accounts. The Institutional Trading Members can only trade on their own accounts but not on behalf of other members or clients. They include agro-processors, financial institutions, large-scale commodity traders, importers and exporters. Membership of the Exchange is open to individuals and corporate entities. The registration requirements, membership rights and fees are prescribed in the ***ASCE*** Bye-laws, Rules and Regulations.

The ownership and management of ***ASCE*** are completely separated from the rights of members. Policy matters related to the Exchange as a company are determined by its Board of Directors, while market decisions relating to operations are delegated by the Council. Membership of the Council includes members of the Exchange, commodity associations, warehouse operators and collateral managers, clearing banks and other financial institutions. The Council operates through four standing Committees, namely: Membership and Finance Committee, Trading Committee, Clearing House Committee and Arbitration and Vigilance Committee. The Managing Director/***CEO*** is ultimately responsible for the day-to-day management of the Exchange. The exchange operates through six main departments: Market Development, Membership and Client Relationship, Risk Management and Market Surveillance, ***IT*** and Communications, Accounts and Finance, and the Human Resources Departments.

Activities of the ***ASCE*** are regulated by the Nigeria Securities and Exchange Commission (***SEC***). The regulatory function of the ***SEC***, in particular in registering and regulating the activities of brokers, complements the self-regulatory role of the ASCE in ensuring its members comply with rules and procedures that guarantee the integrity of trade contracts. The benefits of a viable and vibrant commodities exchange cannot be over-emphasised. Besides, providing a standardised mechanism for pricing and market stabilisation of agricultural produce, raw

materials and other commodities, it also acts as a risk mitigation platform for farmers, agro-commodity processors and marketers in terms of income enhancement. The sourcing of raw materials, particularly agricultural produce by agro-allied industries, will be better organized if the ***ASCE*** is properly positioned to deliver on its mandate.

Trading System of the ASCE

The ***ASCE*** primarily offers a platform for trading contracts on agricultural commodities and solid mineral products. The Exchange started operations with a manual floor-based call-over trading system. Sellers were required to deposit their commodities at ***ASCE***-designated warehouses for approved assayers to certify the quality. Thereafter, samples of the commodity and the quality certificate are delivered to brokers, who present the certificates and samples to the Assaying Officer of the Exchange for a second assessment of the quality prior to trading. Selling and buying brokers deposit 5 percent of the value of the commodity to be traded in the trading margin account as a means of ensuring contract performance. Deliveries are completed within 10 and 20 working days after the trade, depending on the volume of the transaction.

An electronic trading system has been adopted by the ***ASCE***, allowing trading members to submit online "buy" or "sell" orders for various tradable commodities. Selling brokers are expected to forward their delivery notices to the Exchange within five working days after the trade and commence delivery within 6-9 working days. Buyers are also required to pay for commodities bought within 10-19 days through the Exchange, which has to ensure that sellers are paid latest by the 20th working day after the trade.

A similar electronic system has been adopted by the ***ASCE*** for its "Policy Auction" platform, which is used to facilitate bulk procurement by Government and international relief agencies and ***NGOs***. Brokers participating in this trade make offers against the quantity on the auction up to the limit of their margin account with

the Exchange. The system electronically allocates quantities based on the price and time priority and successful offers are transcribed into valid contracts. Despite the adoption of the electronic trading system, the back-office activities related to quality assurance remain virtually the same as in the case of the manual trading system. The institutional infrastructure and operating systems which the *ASCE* has developed to support trading include:

Standardizing /Quality assurance system

Commodities standards and grades provide means for measuring levels of quality and value for agricultural commodities. These standards provide a basis for domestic and international trade and promote efficiency in marketing and procurement. Quality grading is based on the standard developed for each product. The *ASCE* has quality standards defined for the following commodities: maize, sorghum, soya beans, groundnut, cotton seed, sesame seeds, cocoa and coffee. Quality parameters for different categories of the commodities are prescribed. The categories are defined by the purpose for which the particular commodity is utilized. For instance, maize and sorghum are categorized according to uses such as for brewing, feedstock production, flour and production of infant food.

Clearing and Settlement System

Members of the *ASCE* maintain clearing accounts with appointed clearing banks of the Exchange, exclusively for settlement purposes. Trading members also contribute to a Settlement Guarantee Fund which is used to guarantee completion of settlement. Clearing house means a department or a section of the Exchange where the claims and liabilities of members and registered non-members to each other in respect of ready delivery contracts in listed commodities transacted on the Exchange are received, cleared and settled. Clearing member means a member of the Clearing House and includes all categories of clearing members as may be admitted as such to the Clearing House.

Risk Management and Arbitration System

Trading members are required to deposit margins in their accounts, representing 5 percent of the value of the trade exposure. The Risk Management and Surveillance Division of the ***ASCE*** monitors closely the trading position of the members to avoid non-compliance with the relevant regulations. Since all contracts and transactions executed through the Exchange are subject to its Byelaws, Rules and Regulations, all claims, differences and disputes arising from such transactions are compulsorily referred to a panel of arbitrators nominated by the Council of the Exchange and from which the parties choose their arbitrator.

Warehousing /Physical Delivery System

A Certified warehouse is an independent commercial warehouse registered and authorized by the Exchange, ***SEC*** or any other regulatory body established by an Act of the National Assembly to accept commodities for storage and issue certified warehouse receipt on behalf of the beneficial owners. The ***ASCE*** designates specific warehouses as delivery locations. Criteria for certification of warehouses and operators by the Exchange are prescribed in the Rules and Regulations for Warehouse Operators. The certified operators are also required to comply with inspection and audit procedures prescribed in the Rules and Regulations.

Market information system

The ***ASCE*** disseminates market information through the brokers, its official website (www.abujacomex.com), radio broadcasts and newspaper publications. The information disseminated includes the following:

i. ***ASCE*** news – basically information on buy and sell orders

ii. Commodity prices in major market towns and cities.

iii. Prices of major commodities traded in major West African markets, including cereals and cocoa.

iv. General and agricultural news – encompassing news reports with relevance for the commodity sector.

v. Lists of brokers, warehouse operators/collateral managers, location of designated warehouses, commodity associations etc.

vi. Market information – including exchange rates, weather forecast, and transport costs between major cities and towns and average market handling charges in major markets in the country.

The *ASCE* produces and disseminates regularly updated crop budgets that track demand and supply of the traded commodities as well as analysis of main factors that affect the market.

CHALLENGES OF COMMODITIES TRADING IN NIGERIA

The constraints to commodities trading in Nigeria include the following:

Lack of efficient storage facilities

Lack of efficient storage facilities is one of the factors which limit temporal arbitrage and contribute to high seasonal price variability in Nigeria. As a consequence, storage in food surplus-producing areas is largely undertaken by ill-equipped smallholder farmers, resulting in very high post-harvest losses.

Lack of inventory credit

Lack of inventory credit limits the capacity of traders to store while similarly discouraging producers from holding inventories, as they are compelled to sell the bulk of their output immediately after harvest, when prices are very low, primarily to meet the cash needs of farm households.

Poor Physical Infrastructure

Communications and transportation infrastructure is critical to a functioning exchange. Trade at a futures exchange requires a communications network that can provide traders with spot market information in order to estimate the basis. A commodity exchange also needs to be supported by a reliable system for transportation

and distribution, so that delivery location can be credibly specified in the contract. Moreover, transaction costs must be stable enough for traders to evaluate the spread between the spot and futures contract prices.

Infrastructure must not only support the exchange, but it must also link various spot markets if the exchange is to function successfully. Ideally, the physical and communications infrastructure will ensure information regarding product quality, quantity, form, and price in all relevant markets is available across various spot markets. In the absence of this information, price discovery in the spot markets may be erratic and price risk will not be manageable in a futures exchange.

Weak Legal and Regulatory Infrastructure

A commodity exchange must be supported by appropriate legal infrastructure, particularly: (1) a system of grades and standards; (2) a credible system of contract enforcement; and (3) governance in spot markets. In most African cereals markets including Nigeria, a system of grades and standards is not likely to evolve without government involvement. However, the real challenge will not be the development of grades but the enforcement of contracts that use those goods. The legal system must ensure contract enforcement and a regulatory system must ensure that warehouses do not issue multiple receipts for a single lot. For futures contracts, participants must have confidence that contracts will be recognized by the legal system and that contract obligations will be enforced.

Commercial and Financial Sectors Development

A commodity exchange relies on a developed financial system. For an exchange to operate successfully there must be an adequate number of potential hedgers and speculators in the economy. These individuals must understand risk-taking and trading and must have financial capacity. Moreover, the exchange itself must have access to a clearinghouse with sufficient capital to serve as a guarantor of all transactions. These requirements imply a generally well-functioning financial sector. Available indicators suggest that

financial sectors in most countries in Africa including Nigeria are either shallow or constrained by repressive regulations.

Farm Size and Production Organizations

In Nigeria, agriculture is dominated by smallholders. It is well recognized that smallholders do not access commodity futures markets directly. They may lack know-how, have insufficient collateral for margins, and have difficulty monitoring prices.

High Transactions Costs

Transaction costs are very high in agricultural markets in Nigeria. For traders, search and transportation costs tend to be the highest costs mainly because transactions often entail personal interaction with producers.

NATIONAL ASSOCIATION OF SECURITIES DEALERS (NASD)

The *NASD* Plc was established in July 2013, as an alternative trading platform created by the National Association of Securities Dealers to bring more liquidity to Nigeria's capital market by facilitating secondary market trading of all securities of unquoted public companies in Nigeria. The platform is licensed by the Securities and Exchange Commission to trade a broad range of instruments over-the-counter, including bonds and securities not listed on the Nigerian Stock Exchange.

Operators include Issuers of equity and fixed income instruments, Institutional and individual investors, accredited Authorized Traders and their Participating Institutions, Settlement banks, Clearing systems, private equity and venture capital firms with a view to increasing liquidity. Clearing is provided by the Central Securities Clearing System while settlement is done through some designated banks.

The following securities are now trading on the ***NASD-OTC*** platform in the anticipation that more non-quoted stocks will be added to this list in the future: (1) Consolidated Breweries Plc; (2) Niger Delta Exploration & Production (***NDEP***) Plc; (3) Industrial and General Insurance (***IGI***) Plc; (4) Foods Concept Plc;

(5) Friesland Campina ***WAMCO*** Nigeria Plc; (6) Geo Fluids Plc; (7) ***SWAP*** Technology Telecomms Plc; and (8) ***BGL*** Plc. The activities of ***NASD OTC*** are open to unlisted companies and investors who intend to buy and sell shares of these companies.

FINANCIAL MARKETS

DEALERS QUOTATION (FMDQ)

FMDQ Plc (***FMDQ***) is a Securities and Exchange Commission (***SEC***) licensed over-the-counter (***OTC***) market securities exchange. ***FMDQ*** is owned by the Central Bank of Nigeria (***CBN***), all the Nigerian banks, discount houses and the Nigerian Stock Exchange, through its subsidiary ***NSE*** Consult Ltd. The inter-bank markets which are under ***FMDQ*** governance are: Foreign Exchange, Money Market, Treasury bill and Bond.

TRADE GROUPS

Trade groups in the capital market are also ***SROs*** to the extent that they provide training and advocacy as well as enforce codes of ethics and standards for their members. A frontline trade group in the Nigerian capital market is the Chartered Institute of Stockbrokers.

The Chartered Institute of Stockbrokers

The Chartered Institute of Stockbrokers was established in 1990 and chartered by Act 105 of 1992. Prior to the granting of the Charter, the Institute was known as the Nigerian Institute of Stockbrokers, a company limited by guarantee and hence did not have an Issued capital.

The Institute is the professional body statutorily responsible for regulating the practice of stockbroking in Nigeria. The Institute has a Governing Council responsible for the administration and general management of the Institute. The Council consists of the following members: (1) the President of the Institute who is the chairman; (2) the two Vice-Presidents of the Institute; (3) a representative of the ***SEC***; (4) a representative of The Nigerian Stock Exchange; (5) two representatives of the Banker's Committee; (6) twelve persons to be elected by the Institute; (7)

two persons to represent institutions of higher learning in Nigeria offering courses leading to an approved qualification to be appointed by the Minister; (8) a representative each of the Ministries of Finance, Education and Women Affairs and Youth development; and (9) past Presidents of the Institute who shall be entitled to serve on the Council for a maximum period of three years from the expiration of their terms of office as President of the Institute.

A major responsibility of the ***CIS*** is to discipline members for offences through the establishment of Disciplinary Tribunal and Investigating Panel. The tribunal is known as the Chartered Institute of Stockbrokers Disciplinary Tribunal charged with the duty of considering and determining any case referred to it by the Investigating Panel.

Other Trade Groups

Other trade groups that enforce code of ethics and standards for members in the Nigerian capital market include the: (1) Chartered Institute of Bankers of Nigeria (***CIBN***); (2) Association of Stock broking Houses of Nigeria (***ASHON***); (3) Association of Issuing Houses of Nigeria; (4) Institute of Capital Market Registrars; (5) Association of Corporate Trustees; (6) Institute of Chartered Accountants of Nigeria (***ICAN***); (7) Association of National Accountants of Nigeria (***ANAN***); (8) Capital Market Solicitors Association; and (9) Association of Pension Operators.

SUMMARY

At present (2014), there are four securities trading platforms in Nigeria. They are: the Nigerian Stock Exchange (***NSE***), The Abuja Commodities Exchange (***ACE***), ***NASD*** Plc and ***FMDQ OTC*** Plc. These four platforms have specific roles to play in the quest by Nigeria to become the financial hub in sub-Saharan Africa. While the ***NSE*** basically trades equities and bonds, the ***ACE*** trades in commodities like the Chicago Mercantile in the United States. On its part, the ***NASD*** Plc deals with equities that are not publicly quoted but wants liquidity for its shareholders. Just like the ***NASD***

Plc, the ***FMDQ*** Plc is also an over-the–counter (***OTC***) market where fixed income instruments are exchanged.

REVIEW QUESTIONS

1. State FIVE functions of the Nigerian Stock Exchange

2. Explain the benefits of the Central Securities Clearing System to investors and quoted companies in Nigeria.

3. Why was the Abuja Securities and Commodities Exchange set up? What are the challenges of commodities trading in Nigeria?

4. What roles are undertaken by the ***NASD*** Plc and ***FMDQ*** Plc in the Nigerian capital market?

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CHAPTER 18

VARIABLE INCOME INSTRUMENT: EQUITY CAPITAL

INTRODUCTION

The traditional form of capital is equity capital which provides ownership rights to ordinary shareholders. Also known as ordinary shares or common stock, ordinary shares are legal documents that evidence ownership in a company. Every share of a common stock represents a proportional ownership, or *equity*, in a company. If a company has only one share of common stock and an investor owns it, the investor owns the entire company and is entitled to one hundred percent of the company's profits. If a company has 100,000 shares of common stock and an investor owns one of them, then the investor owns 1/100,000th of the company, and as such, has an interest in 1/100,000th of the company's profits.

Ordinary shareholders are the legal owners of the company. As a result they have residual claims on income and assets of the company. They have the right to elect the board of directors and maintain their proportional ownership in the company called the pre-emptive right/subscription right/subscription privilege. This pre-emptive right of the ordinary shareholder is maintained by raising new equity funds through rights offering/issue.

Shareholders bear a huge portion of risks associated with the company; hence they earn a higher rate of return than most other providers of finance. They are entitled to a share of the profits of the

company in the form of dividends after all prior claims have been met. The ordinary shareholders have voting rights attached to their investments and they cannot redeem or reclaim their investment except by selling their shares.

Ordinary shares could also be subdivided into Preferred and Deferred ordinary shares. Preferred ordinary shares normally receive a fixed rate of dividend before the other ordinary shareholders, and they may also be entitled to a further share of the profit after their fixed entitlement. Deferred ordinary shares are residual recipients after all claims including preferred ordinary shareholders have been settled. Deferred shares could be given to the owners of a company acquired by another company. They serve as deferred payment for the purchase of the company held back until enough profit emerges. Deferred ordinary shares are also known as Founders Shares. Ordinary shares or equities represent a major variable instrument traded in the Nigerian capital market. In fact, this instrument dominates the market as most transactions are on equities.

FEATURES OF ORDINARY SHARES

The following represent the characteristics of ordinary shares:

1. Ordinary shareholders have the right to control the company through their votes. They have the right to elect board of directors.

2. Holders possess limited liability. A shareholder is not liable for the debts of the company beyond the amount of capital contributed unless the shareholder owes the company some unpaid subscription on the shares.

3. They are the most important element of corporate equity and are far more numerous in the capital structure of companies in Nigeria.

4. There are two sources of return to ordinary share investors: dividend and capital gains. In lieu of cash dividends,

investors can be paid stock dividends which translate to more shares.

5. Ordinary shares are the perpetual capital of companies

6. Holders have claims upon the residual profits of a company

7. Equity holders' rank last in the distribution of the company's assets in the event of bankruptcy or liquidation

RIGHTS AND PRIVILEGES OF ORDINARY SHAREHOLDERS

1. To participate in decision making
2. To participate in company profit sharing
3. To remove a director before the expiration of his/her tenor
4. To fix directors' remuneration
5. Power to replace and appoint a new director
6. Power to ask director to account for secret profit
7. To inspect the minutes of any general meeting

ADVANTAGES OF EQUITY FINANCING (From the company's viewpoint)

Equity capital is the most important long-term source of financing and embodies the following advantages:

1. Source of Permanent Capital: since ordinary shares are not redeemable, the company has no liability for cash outflow associated with its redemption. It is therefore a permanent capital that is available for use as long as the company exists.

2. Increases the Company's Borrowing Base: equity capital increases the company's financial base and by extension its borrowing limit. Lenders generally lend in proportion to the company's equity capital. By issuing ordinary shares

the company increases its financial capability that will enable it borrow when it needs additional funds.

3. Dividend Payment is at the Discretion of the Company: companies are not legally obliged to pay dividends. In times of financial difficulties, they can reduce or suspend payment of dividend thereby avoiding cash outflow associated with dividend payment to ordinary shareholders.

DISADVANTAGES OF EQUITY FINANCING

The disadvantages involved in equity financing include:

1. The company incurs a higher cost through floatation costs since such costs are higher on ordinary shares than on debt. Also dividends are not tax deductible as interest payments.

2. High Level of Risk: ordinary shares are riskier from investor's point of view since there is uncertainty regarding dividend and capital gains. Therefore ordinary shares require a relatively higher rate of return.

3. Earnings Dilution: The issue of new ordinary shares dilutes the existing shareholder's earnings per share if the profits do not increase immediately in proportion to the increase in the number of ordinary shares.

4. Ownership Dilution: The issuance of new ordinary shares may dilute the ownership and control of the existing shareholders. While the shareholders have a preemptive right to retain their proportionate ownership, they may not have funds to invest in additional shares.

Benefits of Investing in Equities
(From the investor's viewpoint)

An investor in equities derives the following benefits:

1. Is a part owner of the company and has right to attend and vote at shareholders meetings. Each share carries the right to one vote at the meetings.

2. Participates in the fortunes of the company through dividends which forms part of the company's profit. Dividends payable are often expressed in terms of kobo per share.

3. Investor can receive bonus shares which are extra shares fully paid out of reserves which are distributed to existing shareholders.

4. Enjoys capital appreciation as market prices of equities increase.

5. Holder can use share certificate as collateral for borrowings

6. Holder gets the feeling of satisfaction in contributing to business and economic growth.

7. Investment minimize the adverse effect of inflation on savings as equities over a long period of time produce compound yields that exceed the rate of inflation.

8. Most common stocks are very liquid meaning that they can be bought and sold quickly at a fair price.

9. Although past performance is not a guarantee of future performance, ordinary shares have historically offered very high returns in relation to other investments.

10. Equities offer limited legal liability. Shareholders, who take no active part in the running of the company, are protected against any liability stemming from the company's actions beyond their financial investment in the company.

Disadvantages

While there are numerous advantages, equities, like all investments, have some distinct disadvantages which investors must be aware of:

1. Ordinary shares are very risky investments because there can be no dividend paid during or at the end of the year.

2. Since common stock represents ownership of a business, stockholders are the last to get paid, like all other owners. A company must first pay its employees, suppliers, creditors, maintain its facilities and pay its taxes. Any money left can then be distributed among its owners.

3. Investors in a company may not know all that there is to know about the company. This limited information can sometimes cause investment decision-making to be difficult.

4. Stock prices tend to be volatile. Prices can be erratic, rising and declining quickly. Such declines often cause investors to panic and sell, which actually only serves to lock in their losses.

5. The shareholders bear the operational risks of the company.

6. The issue of new shares may result in diluting the shares held by the existing shareholders.

Investors' confidence is gradually returning to the Nigerian equities market following the near market failure in the wake of the global financial crisis. The presence of foreign investors is significant while that of retail investors remain low.

FACTORS THAT INFLUENCE STOCK PRICE MOVEMENTS

The price of shares and other financial assets is an important part of the dynamics of economic activity, and can influence or be an indicator of the state of an economy. Rising share prices, for instance, tend to be associated with increased business investment and vice versa. They are partly a result of the supply and demand for securities. Investor psychology, government involvement in the economy and changes in economic activity also drive the market up or down. These forces combine to make investors bid higher or lower prices for stocks. Specifically, the factors determining share prices in the capital market can be enumerated as follows:

Company–related factors

1. The growth potential of the company
2. The quality of the company's management
3. Merger and acquisition arrangements
4. Labour unrests
5. Market conditions for raw materials , components and finished goods and technological breakthroughs
6. Innovations

Industry–related factors

1. The demand/supply situation for the industry's products

2. Raw materials costs and regularity of supply for the industry
3. Effect of government policies, bank credit availability to the industry.

Economic–Related Factors

1. The general economic outlook and business performance
2. Interest rates, inflation and changes in money supply
3. Budget directions on employment and balance of payments
4. Level of investments and consumption
5. Strength of the currency vis-à-vis other international currencies

Political factors

1. Political stability and the possibility of loss of investment and drop in business activities as a result of outbreak of hostilities.
2. Change of governments and possibilities of new government policies that might affect business activities.

Volume of trading

The volume of trading to some extent actually measures the degree of investors' emotions regarding a stock and sometimes it takes volume of trading to really move the price of a stock.

Money Supply

There tends to be a close relationship between money supply and stock prices because as the supply increases, disposable income also increases, in line with an increase in the general price level. The demand for variable income securities in the form of shares is

also likely to increase. This causes the nominal prices of stocks to increase at the same rate as the general price level.

Earnings and dividends
Both earnings and dividends tend to lead to increases in stock prices in Nigeria as they act as measures of the attractiveness of a stock. Basically the movement of stock prices in the market is generally perceived as the prime indicator of the private sector's evaluation of current and future business conditions.

SUMMARY

Ordinary Shareholders enjoy an unlimited participation in the company's earnings by way of dividends and bonuses, can easily transfer their shares and are entitled to vote at annual general meetings. They however have a residual claim on the earnings and assets of the company.

REVIEW QUESTIONS

1. Why are ordinary shares referred to as 'variable income securities?

2. State the advantages and disadvantages of investing in ordinary shares

3. Explain FIVE factors that influence ordinary share prices in Nigeria.

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CHAPTER 19

FIXED INCOME SECURITIES: BONDS AND PREFERENCE SHARES

INTRODUCTION

Bonds and Preference shares are regarded as fixed income securities because investors are entitled to fixed income- interest in the case of bonds and dividends with regard to preference shares. In this chapter, we take a close look at these fixed income securities.

BOND MEANING/TYPES

A bond is a loan and the investor or holder of the bond is the lender. It is a security (similar to *IOU*) issued in connection with a borrowing arrangements which obligates the issuer to make specific payments (coupon payments) to the holder over a period of time usually semi-annually). It is important to note that the subscribers of a bond issue are like creditors to the issuer. They do not have voting powers. The payment of the interest is therefore regarded as cost to the issuer and is paid from the before-tax income of the issuing authority.

From 1999 to date there has been some encouraging level of bond floatation in the Nigerian Capital Market. For instance, the Federal Government came to the market in 2003 to raise N150 billion. Many state governments have also accessed the market for funds to finance various development projects. A number of companies have also issued bonds though the level of private sector participation in the bond market is still low.

Bonds around the world commonly have maturities up to 30 years. In Nigeria, the ***FGN*** bonds have maturity ranges from a few months to 20 years. Corporate and State bonds in Nigeria have maturities up to 7 years, but can be longer. Bonds can be bought on a Securities Exchange or the over-the-counter markets in Nigeria.

Types of Bonds

Bonds can be categorized according to their issuer as follows:

Government Bonds

In Nigeria, as in any other country, federal, State and local Governments can raise funds in the capital market through the issuance of long-term financial instruments.

Federal Government (sovereign) Bonds

These are issued by the federal government. They are regarded as the safest bond investment for the simple reason that they are backed by the full faith and credit of the federal government, but they may not yield the highest returns in comparison with other types of bonds. They are usually used as benchmark by other bond issuers in determining the interest rates and maturity of their bonds. The bond market in Nigeria is dominated by the federal government bonds. For this reason, they are considered in detail in the next chapter.

Government Agency Bonds

These are issued by government agencies or privately owned corporations that are sponsored by government agencies. They are also considered safe bond investments and have higher yields than sovereign bonds. Examples of such bonds are mortgage backed bonds. Bonds issued by the Asset Management Corporation of Nigeria (***AMCOM***) also fall into this category.

Government Sponsored Enterprise Bond

These are Agency bonds that help support project relevant to public policies, such as helping certain groups, such as farmers,

homeowners, students, etc to raise money for financing specific projects. These bonds do not carry the full-faith and-credit of government. The investors are likely to hold them in high regard because they have been issued by a government agency.

State and Local Government Bonds

These are issued by state and local governments. They are also called sub-national or municipal bonds. They can be general obligation or revenue bonds. General obligation bonds are issued to finance the various projects of the government, and backed by the income of the specific project for which the bond was issued. Some state bonds are backed by the tax authority of the state, while others rely on earning income to pay the bond interest and principal. State Bonds issued in Nigeria are issued with an Irrevocable Standing Payment Order (***ISPO***), a credit enhancement tool which is backed by the full faith and credit of the Federal Government of Nigeria. In other words, the ***ISPO*** improves the credit rating of the instrument and enhances the attractiveness of the instrument to prospective investors.

Corporate Bonds/Debentures

These are loans of a long-term nature. Apart from issuing of shares, companies also issue debt instrument to raise funds to finance their various projects. A corporate bond is an interest-bearing debt instrument issued by corporate bodies. It involves a promise to make periodic interest payment to the subscribers and also the repayment of the initial amount borrowed at maturity of the bond. The subscribers of the bond issue are like creditors to the issuer who do not have voting powers. Corporate bonds otherwise called *debentures* (if not secured) are the riskiest of fixed income securities because of the possibility that the issuing company can delay or default in payment of the interests and principal due to unforeseen financial downturn.

The bond market in Nigeria is still dominated by the government sector. In fact the total amount of bonds issued in the private sector is less than 2 trillion naira. Considering the size of

Nigeria's economy (rebased ***GDP*** estimates puts it at about 80 trillion naira or 510 billion US dollars), this is indeed small and is a reflection of the inability of companies to issue bonds, secured by their assets or debentures issued on the strength of their balance sheets, to mobilize critical funding outside of the banking system. The table below shows the Corporate Bonds issued in Nigeria from 2005 and 2012.

Table 19.1: Corporate Bonds issued in Nigeria 2005 to 2012

Company	Coupon	Yr of Issue	Yr of Maturity	Amount Nm
Cadbury Nig Plc	Zero coupon	2005	N/A	5,000
Access Bank Plc	1.5 (above 3 months LIBOR)	2005	2013	1,900
Access Bank Plc	12% (and 2% spread)	2006	N/A	13,500
Crusader (Nig) Plc	12%	2008	2013	4,179
GTB	13.50%	2009	2014	13,165
Custodian & Allied Insurance	Variable Coupon	2008	N/A	1,170
C & I Leasing Plc	Variable Coupon	2009	2014	2,240
UACN Property Dev Co. Plc	10%	2010	2015	15,000
United Bank for Africa Plc	14%	2010	2017	20,000
Flour Mills Nigeria Plc	12%	2010	2015	37,500
Chellarams Plc	14%	2010	2016	1,500
Tantalizers Plc	Floating Rate	2010	2017	1,050
Dana Group of Companies	Floating Rate	2010	2015	8,010
Tower funding plc	Floating Rate MPR +7	2011	2017	3,630

Tower funding Plc	Floating Rate MPR+5.25	2011	2017	1,000
Lafarge (WAPCO) Nig. Plc	11.50%	2011	2014	11,880
Sterling Bank Plc	13%	2011	2018	7,500
Nigerian Aviation Handling Co	13%	2011	2016	2,150
UBA Plc	14%	2011	2018	35,000
Crusader Nigeria Plc	Zero coupon	2011		
Challeram Plc	MPR+5%	2011	2019	540
Vital Products Plc	MPR+5%	2011	2017	550
C&I Leasing Plc	18%	2012	2017	940
International Finance Corp	10.20%	2012	2017	12,000

Source: Debt Management Office

REASONS FOR ISSUING BONDS

Some of the reasons why corporate bodies, government and agencies issue bonds are given below:

1. It is used to finance capital projects with long gestation period such as upgrading of information Technology (*IT*), construction of roads, provision of rural electrification, etc.

2. It is used to re-establish a more rational strategy for financing the local currency portion of government budget deficits and other long-term programmes.

3. It is used to reduce local and external debt stocks .By issuing bonds the proportion of treasury bills in government debt profile is reduced.

BOND FEATURES

General Features of a bond include:

1. It is an ***IOU*** for a fixed amount.

2. It is a debt instrument with a par/face value printed on the face of the selling document. This is the amount paid to the holder on maturity of the bond.

3. It usually has a redemption / maturity date. This is the date on which the issuer is obligated to pay the bondholder. The periodical application of money towards redemption of the bonds before maturity is known as sinking fund.

4. It is a negotiable instrument. This means that it can be transferred to a third party either through sale at the stock exchange or through a nominal transfer to a blood relation.

5. It has a market price which may be different from its face value. The initial market price is the price at which the bond was sold in the primary market, while the subsequent market price is that at which it is sold on a stock exchange (which is dependent on the forces of demand and supply).

6. It has a coupon/interest (except for zero-coupon bonds). This is the annual/semi-annual naira interest paid to the bondholder. The interest payment is usually twice a year.

Bonds can be described as:

Redeemable or Irredeemable Bond: With a redeemable feature, the principal of the debt instrument is redeemed or paid back to the creditors on a specified date or at specified intervals. With an irredeemable feature, there is no such arrangement to pay back the principal to the creditors. The debts have no fixed date of maturity and could be held forever but interest will continue to be paid on the debt, and if the holders so wish, they can sell off their holdings to other interested investors.

Fixed or Floating Interest Rate Bond

A bond with a fixed interest rate means that the stated percentage of the nominal /face value of the bond will be paid as interest to the bondholders yearly prior to the maturity of the bond. Whereas interest rate payment on a floating rate bond will vary from year to year depending on a benchmark interest rate which could be the Monetary Policy Rate (*MPR*) of the Central Bank of Nigeria (*CBN*).

Convertible or Non convertible Bond

The convertible feature gives the investors the right to convert the interest- bearing securities to other securities (particularly equities) usually within a specified period. A Non-convertible debt security cannot be converted into any other form of securities.

Secured or Unsecured

A secured debenture is guaranteed against certain assets of the company and in case the company winds up during the life of the secured debt, the holder of the security has a preferential claim over the specified assets of the company. An unsecured bond means there is no pledge against the assets of the company. In the case of liquidation, secured debt securities holders are considered first, followed by unsecured debt securities holders.

ATTRACTION OF BONDS OVER EQUITIES

Preference for bonds over equities could be due to the following:

1. Bonds are loans repayable over a relatively long period of time, hence frees the issuer from short term funding problems thereby permitting long term capital investment.

2. The interest charge paid by the issuing company is deducted as an expense from profits before the computation of corporate taxes (tax deductible).

3. Interest on bonds are typically paid semi-annually while equity holders are risk bearers.

4. Guarantees steady cash flow to the investor as opposed to equities where dividends may not be paid.

5. In the extreme case of liquidation, bondholders are creditors; hence have a claim ahead of equity holders

BENEFITS FOR CORPORATIONS ISSUING BONDS

1. Less costly than a bank loan, including fees, debt service, and expenses.

2. Longer term financing available because the tenor is more than that of a bank loan (generally a year or two).

3. The Tax Waiver will provide tax benefits to the issuer and to the investor.

4. A company will not dilute existing share ownership with a bond issuance.

5. A company can issue through a shelf registration offering (a medium term note program) a first tranche now and later (within two years) issuing other tranches, e.g., when interest rates fall at lower coupon rates.

6. Greater exposure/enhanced public relations for a company; can be traded or quoted on an exchange.

BENEFITS OF INVESTING IN STATE AND CORPORATE BONDS

Some of the benefits of investing in state and corporate bonds are:

1. Income stream: A predictable income stream is paid to investors on a regular basis (i.e., interest) and the principal is returned at maturity. Corporate and State bonds generally pay higher returns than ***FGN*** bonds and bank deposits, but the risks may be higher too.

2. Diversity: Corporate and State Bonds help achieve balance in an investment portfolio weighted with equities. Bonds provide an opportunity to choose from a variety of sectors, structures, and credit-quality characteristics to meet investment objectives; some institutions have fixed liabilities in the future, e.g., pension funds and insurance companies, and therefore can match liability timeframes with asset maturities.

3. Safety: Corporate and State bonds are evaluated and assigned a rating based on credit history and ability to repay obligations. The higher the rating, the safer the investment as measured by the likelihood of repayment of principal and interest. If a company goes bankrupt, debt holders are ahead of shareholders in the line to get paid. In a worst-case scenario such as bankruptcy, the creditors (debt holders) usually get at least some of their money back, while shareholders often lose their entire investment.

4. Planning for life events: Zero coupon bonds are bought at a discount from par value and pay off at maturity the interest accrued plus principal. Some life events such as children's university educations, weddings, and retirement may be (partially) financed through investments in these bonds. During retirement, bonds with coupons will provide a steady stream of income.

REQUIREMENTS FOR ISSUING BONDS BY STATES AND LOCAL GOVERNMENTS

For state and local governments to issue bonds, they must ensure that they meet up or comply with the requirements of the Securities and Exchange Commission some of which are stated below:

1. The loan must be project-tied and authorized by the approving authority of the issuer.

2. The total amount of loan outstanding of the issuer including the proposed loan shall not exceed 50 percent of the revenue of the issuer during the life of the bond. This is to ensure that the issuer is able to meet its obligations while not being placed in a difficult financial position.

3. The issuer must lodge a copy of an Irrevocable Standing Payment Orders (***ISPO***), giving the Accountant-General of the Federation, the authority to deduct from its statutory allocation in the event of default in meeting its payment obligations under the loan agreement as contained in the Trust Deed.

4. The issuer must establish a sinking fund for the loan with periodic contributions made for the purpose of redeeming the loan. Any amount deducted from the statutory allocation by the Accountant-General shall also be paid into the sinking fund account.

5. The loan obligations shall be charged on and payable out of the general revenue and assets of the body concerned and or the general revenue and assets of the body concerned and of the assets or projects which is the beneficiary of the loan.

6. Details of the loan must be in a gazette or published in any other official document.

7. The lifespan of the bond shall not exceed 25years. This is intended to prevent the issuing of bonds with unduly long maturity dates.

8. A bond holder shall be issued with a Bond Certificate evidencing the amount of his holding.

9. Other information to be provided by the issuer include, name of the beneficiary (i.e. the proposed project), the amount to be raised, the mode of raising the loan, the interest rate and payment dates, the redemption date, the time at which the appropriation of the general reserves and assets of the entity or project of the entity shall be made as a contribution to the debt's repayment.

RISKS ASSOCIATED WITH INVESTING IN BONDS

Some of the risks that are associated with investing in bonds include:

1. Default/credit risk: This is the risk that the issuer will default in paying the stated interest and principal amount as at when due. The *FGN* bond is considered to have the least credit risk of all bond issuers in Nigeria. Corporate and State bonds are rated by the credit ratings agencies on an "alphabetical" scale.

2. Market Risk and Liquidity Risk – Bonds may be sold if there is a willing buyer. In some cases, the bond investor may not be able to find a buyer for bonds to be sold. The more difficult it is to convert to cash the more the liquidity risk. Additionally, bonds are not 'risk free' as the market prices of bonds may decline, e.g., reacting inversely to factors such as higher interest rates, which may produce lower prices than at which the investor purchased.

3. Maturity risk: This is an investing risk associated with the tenure or maturity period of the bond. The longer the tenure, the higher the risk assumed; the shorter the risk the lesser the risk assumed.

4. Interest rate risk: This is an investment risk related to fluctuation in interest rates. For instance when interest rates rise, the prices of existing bonds rise.

5. Inflation risk: This is a risk that has to do with the reduction in the real value of returns on investment in bonds due to an increase in the rate of inflation .Since the interest payment is usually a fixed amount, a rise in the rate of inflation will reduce the value of the interest payment.

6. Call Risk - An issuer may redeem a bond, i.e., call a bond, earlier than its original maturity date if the bond is issued with a call feature. This risk is more relevant during periods of declining interest rates, where the investor receives the principal from the higher-coupon bond and may have to invest in a lower-coupon bond.

It should however be noted that the higher the risks the higher the prospect of return on such bonds.

RISK RATING FOR CORPORATE AND STATE ISSUED BONDS

A credit rating agency (***CRA***) such as 'Augusto' analyzes each bond issued in Nigeria as to its capabilities of paying off interest and principal on a timely fashion. If a company or State does not pay interest and principal on a timely basis, that bond is deemed to be in default. A ***CRA*** operating in Nigeria must have the approval of ***SEC***. The ***SEC*** also recognizes international ***CRAs*** for their ratings, such as those from Standard and Poors, Moody's, and Fitch. The *SEC* requires that all publicly traded bonds be issued with at least an "investment-grade" rating, i.e., "***BBB***" rating or above. The PenCom requires that all bonds purchased by pension funds have at least two investment grade ratings.

Ratings are generally provided from the highest of "***AAA***", then "***AA***", then "A", then "***BBB***", etc., down to the lowest (i.e., in default) of "D". Like grades in school, these ratings have graduations of "-" and "+". Regardless of the ***CRA*** rating(s), an individual investor should always perform his/her own due diligence or would rely on a third party to perform such due

diligence as to the creditworthiness of a particular bond, i.e., whether or not the company or State will be able to pay interest and principal on a timely basis. It is highly recommended that professional investors such as banks, pension funds, collective investment schemes, and insurance companies, have the capability to perform its own risk assessment due diligence.

FACTORS TO CONSIDER IN BOND INVESTMENT

In choosing which bond to invest in, an investor needs to consider the following: (1) the tenure (maturity date of the bond); (2) the interest rate payable in relation to the price of purchase; (3) if any special feature is attached to the bond (such as call or conversion clause); and (4) the credit rating of the issuer (i.e. the ability of the issuer to pay interest and principal obligations on the bond vis-à-vis its income).

PREFERENCE SHARES

Preferred Shares are also fixed income securities in that an investor in preference shares receives a fixed rate of dividend.

Types of Preference shares

Preference shares could take any of the following forms:

Cumulative preference share

Most preference shares are cumulative, and indeed a preference share will be cumulative unless it is expressly stated to be non-cumulative. The right to any unpaid dividend continues indefinitely, in that no dividend can ever be paid on lower-ranking capital, such as ordinary shares, until the preference shareholders have received their full arrears of dividend. There is no limit with cumulative preference shares and for some unsuccessful companies there are many years of overdue preference dividend to be paid before the ordinary shareholders can receive any dividend payment at all.

Non cumulative preference shares
For non-cumulative preference shares once dividend is not paid for a particular period, it is lost forever. In the following year the preference shareholder would be entitled to one year's dividend only, only the ordinary shareholders could receive a dividend that year provided that the current year's preference dividend had been paid in full.

Participating preference shares
These shares carry the right to an 'extra' dividend when the available profits exceed a stated amount. While the terms of the issue of such shares differ widely, there is generally an upper maximum dividend per share. Financially troubled companies sometimes use participating preferred share as a 'sweetener' to facilitate the sell of the share.

Redeemable preference Shares
As the title implies, these shares are redeemable, but only subject to certain conditions. While there may be a set date for redemption, or redemption may be at the company's discretion, it may take place only if there are sufficient profits available or if the necessary cash can be raised from the proceeds of a new issue. Thus there is no guaranteed capital gain from the purchase of a redeemable preference shares at less than its nominal value.

Convertible preference shares
Convertible preference shares are preference shares that carry the right to be exchanged into ordinary shares on the terms set out in the issue. As with all preference shares, the rate of dividend is as stated in the title.

Zero-dividend preference shares
These preference shares are issued by investment trusts as one of the types of shares issued by a spilt-level investment trust. The zero-dividend shares (commonly called 'capital shares') set a redemption date and do not pay any dividend during their life.

When the trust is wound up, the zero dividend preference shareholders receive the remaining capital after all other claims have been paid.

SUMMARY

A bond is an *IOU* for a fixed amount as subscribers of a bond issue are like creditors to the issuer. They can be categorized according to their issuer as government bonds or corporate bonds. Bonds can be described as redeemable or non-redeemable, fixed or floating, convertible or non-convertible, secured or unsecured. Preferred Shares are also fixed income securities in that an investor in preference shares receives a fixed rate of dividend. Preference Shares can be described as cumulative or non-cumulative, participating or non-participating, convertible or non convertible, redeemable or non redeemable.

REVIEW QUESTIONS

1. Distinguish between corporate bonds and preference shares as instruments of long term finance for companies in Nigeria.

2. Enumerate the regulatory requirements for issuing bonds by state and local governments in Nigeria.

3. What critical factors should be considered before investing in a bond?

4. Explain FIVE risks associated with bond investment

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CHAPTER 20

FEDERAL GOVERNMENT OF NIGERIA (FGN) BONDS

INTRODUCTION

Federal Government of Nigeria (***FGN***) bonds are securities issued under the authority of Debt Management Office (***DMO***). Since 2003, ***DMO*** has been regulating the activities of the ***FGN*** bonds market, while the Central Bank of Nigeria acts as the Issuing House and the Registrar. The bonds are listed and traded on the floors of the Nigerian Stock Exchange. The Central Securities Clearing Systems Ltd acts as the depository of the bonds listed on the Nigerian Stock Exchange. The ***FGN*** has an obligation to pay the bondholder the principal and agreed interest as they fall due. The ***FGN*** bond is considered as the safest of all investments in domestic currency securities market because it is backed by the 'full faith and credit' of the government. They have no default risk, meaning that it is virtually certain interest and principal will be paid as and when due. The ***FGN*** bonds form the bulk of the bonds available to investors in the debt market in Nigeria hence this chapter takes a closer look at ***FGN*** Bonds.

GENERAL PURPOSE OF FGN BONDS

The Government issues Bonds for the following reasons:

1. To finance government deficits in a non-inflationary and sustainable manner.

2. To enhance fiscal discipline and for the management of monetary policies.

3. To restructure the existing debt stock of short term debt to longer term obligations.

4. To establish a benchmark yield that acts as a reference for pricing other bonds issued by other bodies.

5. To develop the domestic bond market on a sustainable basis.

6. To enhance and deepen the savings and investment opportunities.

Table 20.1: Federal Government Domestic Debt Stock as at March 31, 2014

INSTRUMENT	AMOUNT (N)	PROPORTION (%)
FGN Bonds	4,132,037,710,000.00	57.52
Nigerian Treasury Bills	2,735,748,536,000.00	38.09
Nigerian Treasury Bonds	315,390,500,000.00	4.39
TOTAL	7,183,176,746,000.00	100.00

Source DMO Abuja

Special Purpose FGN Bonds

Special Purpose ***FGN*** bonds are bonds issued to meet specific needs of the federal government. For instance, following the approval of the President, special purpose bonds were issued to selected banks for settlement of N75 billion pension arrears in 2006. Five deposit money banks participated in the private placement arrangement. In addition, in 2006 ***FGN*** floated bonds for the payment of debt owed to local contractors worth N91.7 billion. Recently, ***FGN*** indicated interest to raise funds through

bonds for funding specific projects such as revival of textile industry, building of infrastructural facilities, etc.

FEATURES OF FGN BONDS

The following represent the major features of ***FGN*** bonds:

a) Denomination: minimum subscription of N10,000.00 and in multiple of N1,000.00 thereafter

b) Yield: - Interest payment
   i. Fixed interest rates: Most ***FGN*** bonds have fixed interest rates which are paid semi-annually:
   ii. Floating interest rates: Some ***FGN*** bonds (e.g. 3rd & 4th tranches of the 1st ***FGN*** bonds) have floating rates of interest which fluctuates around a reference rate(***NTB*** rates) on the basis of specified parameters
   iii. There are also zero-coupon bonds whereby both interest and principal are repaid at the final maturity date of the bond

c) Tenor: Minimum of two (2) years. There are bonds with maturities of 3. 5, 7 and 10 years, in issue.

d) Default Risk: ***FGN*** bonds as a sovereign debt are the safest investment instrument. Default risk is nil. The Government always pays what is due to subscribers on the agreed date.

PROCEDURE FOR INVESTING IN FGN BOND

A prospective investor in the ***FGN*** bond should be made aware of the following:

1. Application forms can be obtained from any of the authorized dealers (***PDMMs***), or downloaded from the ***DMO's*** website.

2. After completion, the application forms are submitted through any of the ***PDMMs***.

3. Common- price auction system is normally employed as opposed to multiple price auctions
4. Payments for the allotment are payable in full on application.
5. Minimum of N10,000.00 and multiple of N1,000 thereafter.
6. Investors can also access the ***FGN*** bonds after the auction through the secondary market.
7. ***FGN*** bonds purchase is confirmed by registration in the depository (***CSCS***) or by issue of certificates.
8. Interest is paid semi-annually until the maturity date when the principal amount is repaid.
9. Payment of interest is through issue of interest warrant (cheque) or direct transfer to current or savings bank accounts.
10. Bondholders who do not want to hold the bonds until maturity date can sell them at any time on the floors of the Nigerian Stock Exchange or Over the Counter (***OTC***), through, any of the ***PDMMs***.

Investors can purchase bonds either from the Primary or secondary markets. The primary market is for securities that are newly issued in the market. These securities are sold directly to purchasers, usually through Primary Dealers/ Market Makers. On the other hand, Secondary market is for securities that are already issued and are traded among existing holders. Currently, Primary market offerings are issued through bond auctions, while ***PDMMs*** undertake or facilitate secondary market trading by making two-way quotes under all market conditions.

BENEFITS OF FGN BOND

To the investors

1. Serves as risk-free investment.
2. It's income is tax exempt.
3. Provides relatively high and stable returns.
4. The principal element (collected at maturity) can be used as collateral for securing credit facilities from banks.
5. Bondholders that want cash can trade the bonds on the floor of Nigeria Stock Exchange (*NSE*) for immediate cash before maturity.
6. It qualifies as liquid assets for banks from two years to maturity

To the Government

1. Helps government fund its deficits in a non-inflationary manner.
2. Provides benchmark yield-curve for pricing other securities/bonds.
3. Engenders rational management of Government's fiscal and monetary operations.
4. Provides the basic infrastructure for the development of the financial system and the overall economy.
5. Strengthens the implementation of monetary policy by the Central Bank of Nigeria.
6. It introduces transparency, discipline and stability in the financial system.

To the Economy

1. Fosters economic development by promoting the use of long-term funds for long-term investment in the economy.

2. Serves as an efficient way of mobilizing domestic financial resources for productive investment in a non-inflationary manner.

3. It allows self reliance of the country by reducing over reliance on short-term borrowing form ***CBN*** & commercial banks.

4. Provides basic infrastructure for the development of the financial system and the overall economy.

5. It serves as a diversified portfolio investment outlet to corporate and individual investors.

BOND AUCTION

This is a process where the bonds are offered to diverse investors for subscription. Upon subscription, allotment is made to investors at the lowest price/highest yield that clears the market otherwise called marginal rate. The investor base for ***FGN*** bond is developing. It comprises mainly deposit money banks, foreign investors, pension funds, insurance funds, etc. Domestic individuals are yet to be fully involved in the market. ***FGN*** Bonds of various maturities are auctioned on a monthly basis. Amounts issued vary depending on the quantum of bonds to be issued for the year.

Auction can be done through single pricing (Dutch Auction) or multiple pricing (Competitive Auction). ***DMO*** currently uses the Dutch Auction, which, is conducted on a yield, single price basis, where successful bidders are allotted bonds at the lowest price/highest yield that clears the market. Common price auction system is often used instead of the multiple price system. Here, though each bidder quotes different yields, all successful bids are allotted securities at the marginal rate/cut-off price. All investors submit their bids to appointed agents (Primary

Dealers/Market Makers) who bid for their agents and on behalf of their clients.

Table 20.2: Auction Result for the 13.05% FGN AUG 2016 (Re-opening), 14.20% FGN MAR 2014 (Re-opening) and 12.1493% FGN JUL 2024 (new Issue 20-y-Year Bond)

	13.05% FGN AUG 2016	14.20% FGN MAR 2024	12.1493% FGN JUL 2034
Auction date:	July 16, 2014	July 16, 2014	July 16, 2014
Settlement Date:	July 18, 2014	July 18, 2014	July 18, 2014
Maturity Date:	August 16, 2014	March 14, 2024	July 18,2034
Tenors:	3-years	10-Years	20-Years
Term-To-Maturity:	2 Years, 1 million	9 Years, 8 Months	20 Years
Amount Offered:	₦15.00 billion	₦50.00 billion	₦35.00 billion
Total Bids:	81	102	98
Successful Bids:	28	66	36
Subscription:	47.87 billion	114.58 billion	101.46 billion
Amount Allotted:	₦15.00 billion	₦50.00 billion	₦35.00 billion
Range of Bids:	10.0000%-13.0500%	11.198% - 13.5000%	11.5000% - 14.0000%
Marginal Rates:	11.0000%	12.1940%	12.1493%

Source: Debt Management Office

THE PRIMARY DEALER AND MARKET MAKERS (*PDMMs*)

In 2006, in order to achieve liquid and broad primary and secondary markets of the government bonds, the ***DMO*** appointed

fifteen local financial institutions (banks and discount houses) as primary dealers/market markers (***PDMM***). The ***PDMMs*** are the only authorized institutions to deal directly with the ***DMO*** in bond auctions and are expected to play an active role in the issuance, sale and marketing of all Federal Government bonds to be issued subsequent to their appointment as ***PDMMs***.

The eighteen ***PDMMs*** institutions are: (1) Access Bank Plc; (2) Afribank Nigeria Plc; (3) Associated Discount House Ltd; (4) Citi Bank Nigeria Limited; (5) Consolidated Discount House Ltd; (6) Express Securities Discount House Ltd; (7) Ecobank Nigeria Plc; (8) Fidelity Bank Nigeria Plc; (9) First Bank Nigeria Plc; (10) First City Monument Bank Plc; (11) First Security Discount House Ltd; (12) Guaranty Trust Bank Plc; (13) Kakawa Discount House Ltd; (14) Platinum Habib Bank Plc; (15) Stanbic-IBTC Bank Plc; (16) Union Bank of Nigeria Plc; (17) United Bank of Nigeria Plc; and (18) Zenith Bank Plc.

Another set of five institutions were also appointed after a year to make the number twenty. The primary dealers were mandated to underwrite issuances and create active and liquid daily trading platform by providing a 2-way quote system of bid/ask prices to their clients and other ***PDMMs*** within the guideline set by the Financial Market Dealers Association of Nigeria (***FMDA***) and ***DMO***.

REGULATORS/ AND GOVERNMENT AGENCIES IN THE FGN BOND OPERATION

These include:

Debt Management Office (DMO)

DMO is the Agency authorized by statute to issue FGN Bonds on behalf of the Federal Government. The ***DMO*** also regulates the activities of the bond market and the Primary Dealer/Market Makers.

Central Bank of Nigeria (*CBN*)
The Central Bank of Nigeria acts as the issuing House and the Registrars for ***FGN*** Bonds.

The Nigerian Stock Exchange (*NSE*)
FGN bonds are listed and traded on the Floors of the Nigerian Stock Exchange.

Central Securities Clearing Systems Ltd (*CSCS*)
Acts as the depository of the bonds listed on the Nigerian Stock Exchange. Investors who opted for physical certificates at the issue must have their certificates deposited in ***CSCS*** before transactions on them on the floors of the Nigerian Stock Exchange.

Securities and Exchange Commission (*SEC*)
It regulates the activities of all operators as far as operations and their transactions in the market are concerned.

SUMMARY

Federal Government of Nigeria (***FGN***) bonds are securities issued under the authority of Debt Management Office (***DMO***). Investors can purchase bonds either from the Primary or secondary markets. The primary market is for securities that are newly issued in the market. On the other hand, Secondary market is for securities that are already issued and are traded among existing holders. The ***PDMMs*** are the only authorized institutions to deal directly with the ***DMO*** in bond auctions and are expected to play an active role in the issuance, sale and marketing of all Federal Government bonds

REVIEW QUESTIONS

1. State FIVE reasons why governments issue bonds

2. Outline the procedure for investing in FGN bonds

3. What are the benefits of FGN bond to the investor?

4. Briefly explain the role of the licenced Primary Dealer and Market Makers (PDMMS) in the bond market.

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CHAPTER 21

MUTUAL FUNDS

INTRODUCTION

A mutual fund, also known as a collective investment scheme (*CIS*) or a unit trust, can be defined as an entity that pools cash from a variety of investors for the sole purpose of investing the cash in shares, bonds, treasury bills, other securities/assets or a combination of these investments. The combined holdings the mutual fund owns are known as its portfolio. Each share represents an investor's proportionate ownership of the fund's holdings and the income those holdings generate.

Mutual funds create investing expertise through the appointment of professional managers and make it available to the general investing public. The fund managers are knowledgeable about the market and are in a better position than individual investors to build a portfolio of stocks and other securities by taking advantage of market developments. Mutual Fund can be operated by the investment arm of banks, stock brokerage firms and investment banks. The profit derived from the diversified pool of investments is shared to investors in the funds annually or semi-annually or as stipulated in the fund prospectus. The investor in mutual funds can earn money in three ways:

Dividend Payments

A fund may earn income in the form of dividends and interest on the securities in its portfolio. The fund then pays its shareholders nearly all the income (minus disclosed expenses) it has earned in the form of dividends.

Capital Gains Distributions
The price of the securities a fund owns may increase. When a fund sells a security that has increased in price, the fund has a capital gain. At the end of the year, most funds distribute these capital gains (minus any capital losses) to investors.

Increased Net Asset Value (*NAV*)
NAV is the net asset value of the fund. It represents what the unit held by an investor is worth at current market prices. If the market value of a fund's portfolio increases after deduction of expenses and liabilities, then the value (*NAV*) of the fund and its shares increase. The higher *NAV* reflects the higher value of the investment. Net asset value is determined by subtracting total liabilities of a fund from its total assets. The net asset value is further divided by the total number of units of the fund to determine the unit price.

TYPES OF MUTUAL FUNDS
Mutual Funds can be open-ended or close-ended.

Open Ended Mutual Funds
These are funds that are open to continuous issuance of shares to investors. Operators of the fund continue to issue shares to the public to buy into the fund. Investors in the fund who do not wish to participate any further will simply resell their shares to the fund at the subsisting Net Asset Value. They can also reinvest in the funds whenever they want. Some Open Ended Funds also mandate the investor to keep money with them for a specified period of time before the investment can be sold. Open Funds are mostly unregulated and are not traded on the floor of the stock exchange. They are mostly floated by reputable organisations with a track record of performance

Closed Ended funds
These are funds that have limited number of shares that are sold at the initial public offering (*IPO*). Once the *IPO* is over, the fund

closes sale of its shares to the public. Being a regulated fund, the shares are traded on the stock exchange like the shares of any quoted company. So, if an investor decides he wants his money back he will simply put up his shares for sale. The share price of a closed fund is determined by both the value of the portfolio as well as the sentiments of investors towards demand and supply. This is unlike the Open Funds that are determined by simply dividing the value of the portfolio by the number of shares issued by the fund. Their share prices are published daily on the pages of newspapers and can also be found on the Internet. Mutual funds typically invest in three main categories of funds namely:

Fixed Income Funds – These are funds that are meant mostly for investment in fixed income securities. Fixed Income Securities are investments that pay a fixed return on an investment. For example, treasury bills offered by the Government can be issued at a coupon (rate) of say 10% per annum which means that they pay an interest of 10 per cent on any amount invested. Fixed Income Funds are safe investments since they are involved with government securities. However, their returns are typically low due to the nature of government securities.

Equity Funds – These are Mutual Funds that invest mostly in ordinary shares of quoted companies. Some funds can also use fund assets to subscribe shares in private placements. Equity Funds offer high returns but are associated with high risk.

The investment focus of equity funds could be any of the following:

1. *Growth* funds focus on stocks that may not pay a regular dividend but have the potential for large capital gains.

2. *Income* funds invest in stocks that pay regular dividends.

3. *Index* funds aim to achieve the same return as a particular market index, such as the *NSE* 30 index, by investing in all or a representative sample of the companies included in an index.

4. *Sector* funds may specialize in a particular industry segment, such as technology or consumer products stocks.

Mixed Income Funds
Mixed Income funds are a hybrid of Equity Funds and Fixed Income Funds. Because of their diversified nature, they offer low risk to investors with attendant low returns.

PARTIES TO A MUTUAL FUND
The major entities involved in a mutual fund include:

Sponsor
Any registered company or a financial institution promoting the fund is called a sponsor and must have a good financial record.

Trustees
Mutual Funds have a Board of Trustees to run the fund. The Asset Management Company (*AMC*) is appointed by the trustees.

Asset Management Company
The Asset Management Company (*AMC*) manages all the investments made by the investors including maintaining records of pricing and accounting data. It also calculates the Net Asset Value of the funds.

Fund Managers/ Portfolio Managers:
Within the Asset Management Company are Fund Managers or Portfolio Managers who invest the funds and take necessary decisions related to the investments made by the investors. They have to be approved by the Securities and Exchange Commission.

Custodian:
The Custodian is an independent entity that holds and safe keeps the assets. Mostly financial institutions or banks act as custodians.

Brokers
Brokers/Distributors have responsibility of marketing the Mutual Fund. Their role is to get subscription into the fund.

FEATURES OF MUTUAL FUNDS

Mutual funds carry two price quotes: the selling or the offer price and the buying or the bid price. The offer price is the current price the fund managers will sell a unit of the fund to subscribers. The bid price is the price they will buy a unit of the fund from those intending to sell their holding. The quotes carry a spread of 3 to 5 per cent in between them which covers fund dealing expenses and commission. The offer and bid prices change on a continuing basis just as share prices do. The price changes can create capital gains over and above the initial price quotation if the fund is doing well. They will create capital losses when the price declines below previous levels.

The rise and fall of the price of the units reflect changes in the net asset value. As earlier mentioned, the Net asset value is the current market value of the portfolio less outstanding liabilities. The net value is divided by the volume of units outstanding to arrive at net asset value per unit. Generally, the bid and offer prices of mutual funds follow a long-term uptrend and tend to build huge capital gains over time.

All rights and privileges of shareholders accrue to subscribers in respect of the funds they have bought their units. They are entitled to annual general meetings, take part in electing Directors and receive dividend from profit made from the fund. However, individual subscriptions made to a mutual fund are not identifiable within the investment assets of the fund itself. They do not attach directly to the underlying investments which the management has made. The fund may have invested in several securities in different companies, including government bonds and

treasury bills. There is however no direct link between the funds contributed by subscribers to the shares and any other investments where the pool of resources has been invested.

BENEFITS OF MUTUAL FUND INVESTMENT

For investors that do not have in-depth knowledge of the capital market or the time and expertise to analyze and invest in stocks and bonds, mutual funds offer various benefits which include:

Professional management

Mutual funds managers have access to crucial corporate information which individual investors cannot access and are therefore in a better position to manage the investments and get higher returns. The fund's manager analyzes several securities and makes decisions on what to buy, when to buy, and when to sell.

Diversification

Diversification is an investing strategy that avoids putting "all eggs in one basket." It minimizes risk of loss by spreading money across various industries. It is rare for all the stocks to decline at the same time and in the same proportion. A mutual fund invests in several securities and it would be difficult for the average investor to buy such a wide variety of investments individually because the cost would be prohibitive. Owning many different securities – including shares, bonds, and cash equivalents– helps to manage the overall investment risks as diversification reduces exposure to any one security.

Affordability

Mutual funds generally buy and sell securities in large volumes which allow investors to benefit from lower trading costs. The smallest investor can get started on mutual funds because of the minimal investment requirements. By pooling money from a

number of people, a mutual fund can provide greater buying power for each investor. Also, because the fund buys and sells many securities at a time, its brokerage costs are often lower than what an individual investor would pay. An investor can start with a low minimum initial investment and make subsequent investments in small increments.

Liquidity

With open-end funds, all or a fraction of the investments can be redeemed at any time. Funds are more liquid than most investments in shares, bank deposits and bonds. The investor does not have to wait for the fund company to find a buyer for his shares, because it is ready to issue new shares or redeem existing shares at any time. Mutual fund investors can readily redeem their shares at the current net asset value.

Transparency

The performance of a mutual fund is reviewed by various publications and rating agencies, making it easy for investors to compare funds to one another. Besides, all mutual funds are required to register with the Securities and Exchange Commission and are obliged to follow strict regulations designed to protect investors.

DEMERITS OF MUTUAL FUNDS INVESTMENT

Mutual funds have features that some investors might view as disadvantages such as:

High Transaction costs

Some mutual funds attract high transaction costs regardless of their performance due to the involvement of professional fund management.

Exclusion of certain instruments
Some mutual funds exclude certain instruments based on factors such as religious beliefs. These excluded instruments could yield high rate of returns.

Lack of Control
Investors typically cannot ascertain the exact make-up of a fund's portfolio at any given time, nor can they directly influence which securities the fund manager buys and sells or the timing of those trades.

Mutual fund risks
The major risk associated with mutual funds is 'market risk'. When the market is bearish (decline in equity prices) most of the 'equity funds' will also experience a downturn. However, mutual funds diversify market risks by investing in a variety of financial instruments.

Another risk associated with mutual fund is 'liquidity risk'. Liquidity risk is the risk that the Manager may have difficulty selling securities the Fund holds at the time it would like to sell, and at the value the Fund has placed on those securities. In addition, economic policies such as interest rates affect mutual funds. For example, an increase in interest rates could affect the value of 'fixed income funds'.

MUTUAL FUNDS OPERATIONS IN NIGERIA

Mutual funds operations in Nigeria began during the early 1990s as a result of the rapid growth in the financial sector induced by the deregulation policy of the mid 1980s. They emerged as part of the financial markets innovations that followed the policy of deregulation with the commercial banks engaging in competitive floatation and management of mutual funds. The activities of mutual funds however remained relatively insignificant with limited impact on the capital market until the banking consolidation of 2005 which provided a boost to the sector such

that by the end of 2012, there were about forty eight mutual funds registered by the Securities and Exchange Commission. The Nigerian mutual fund industry has expanded to N186.5 billion, going by the official asset size values released by the Securities and Exchange Commission (*SEC*) for August 2014.

IBTC Nigerian Equity Fund, one of the pioneers in the industry, is among the biggest mutual funds in Nigeria. The fund, which is managed by ***IBTC*** Asset Management Limited, commenced operations in 1997. The equity fund is mainly capital market-based and requires a minimum subscription of N50,000. Its primary objective is to achieve long-term capital appreciation by investing in high quality securities quoted on the Nigerian Stock Exchange and in other instruments approved by the *SEC*.

Some other relatively large mutual funds in operation in Nigeria include:

1. ***ICON*** *Paramount Equity Fund* formerly known as ***ICON*** Unit Trust Scheme which commenced operations in April 1991 and changed to its present name in June 2004. It is managed by Denham Asset Management Limited.

2. *ARM Discovery Fund*, established in 1995 and was initially named equity growth fund. The open-ended fund is managed by Asset and Resources Management Company Limited [*ARM*].

3. *Coral Growth Fund*, set up in 2001 and managed by ***FSDH*** Asset Management Limited.

4. *Fidelity Nigfund* was established in 2002 and managed by Fidelity Bank Plc.

5. *Legacy Fund*, floated in February 2006 and managed by ***CSL*** Stockbrokers Limited.

6. **UBA** *Equity Fund* established in September 2006 and listed on the Nigerian Stock Exchange Memorandum quotations in December 2006.

7. ***UBA*** *Balanced Fund* is another mutual fund managed by ***UBA*** Asset Management Limited and was established in September 2006.

Mutual Funds in Nigeria typically have an investment band depending on the nature of the fund. Some can be as low as a minimum of N5,000, whilst some others can be N100,000 and others N1,000,000. An investor can invest by approaching a registered broker of mutual funds or the respective offices of the mutual funds in that particular town/city. An application form has to be filled providing required information along with the cheque for the amount to be invested. Most mutual funds in Nigeria are open ended, which means there is no limit to the volume of units the managers can issue. Applications can be made to the fund managers any time for any volume of units the intending subscriber wants to buy on a continuing basis. Likewise, unit holders are free to sell any volume of their holdings back to the fund managers any time they wish.

In Nigeria, mutual funds' regulation by the Securities and Exchange Commission (***SEC***) derive from the Investment and Securities Act of 2007 and other enabling laws such as the Trustees Act and the Companies & Allied Matters Act 1990 as amended which provide for their registration as a trust or a trust company. The unit trust scheme is governed by rules normally articulated in a Deed. The Deed sets out the investment scope of the fund, names the unit trust management company and the trustees. It provides details of how the unit trust scheme is to operate including the maximum fee payable, the type of investment that a particular scheme can make, and how the value of a unit in the scheme can be determined. To facilitate flexibility in unit trust holdings, the Deed

also describes how the price of a unit sold to unit holders and thereafter bought from them can be calculated.

Essentially, the Deed contains a self modification mechanism by outlining the steps that should be taken when a need arises to make changes to the Deed itself. This forestalls all acrimonious relationship that could arise between the unit trust holders and the management company and the trustees of the trust and enhances transparency, accountability and trust. The Unit Trust Management Company reports to the trustee about the purchase, sale and management of investments in the Unit Trust Scheme. They also promote and sell units of investors (also known as "Unit Holders") and buy back units from investors who wish to sell back the units. The management company keeps record in order to calculate the selling and buying prices and to determine the amount of distribution payable to the investors.

The Unit holders or investors supply the capital to be invested by the unit trust management company on their behalf. They are responsible for paying a fee to the management company and the trustee. Unit holders hold units, the value of which is determined by the formula set out in the deed which is based on dividing the market value of the net assets of the scheme by the number of units in circulation. Unit holders buy units in the scheme by completing the application form contained in the Unit Trust Scheme prospectus. The trustee is responsible to the Unit holders to safeguard their investment and to ensure that the money is invested according to the terms of the deed. They supervise the operations to ensure that the objectives are followed by the Unit Trust management company. The Trustees also approve and monitor all financial transactions, hold title documents of all the assets of the Unit Trust Scheme and collect all income there-from on the investments.

The Investment and Securities Act contains some provisions made to protect the interest of the investing public, including disclosure requirements, operating modalities that ensure transparency and other prudential norms that govern investments by mutual funds. The investments of a mutual fund should be

managed by an asset management company registered under the companies act in accordance with the regulations of ***SEC***. A code of conduct is specified for mutual funds that governs advertisement of the funds. The regulatory objective is to prevent mutual funds from making unfounded claims and use same to attract investments from the public. Mutual funds are also required to submit their audited accounts to ***SEC*** every year and make full disclosures of their investment assets. ***SEC*** undertakes inspection and audit of their operations as well as valuation of their assets.

Mutual funds in Nigeria are commonly categorized by the class of assets that forms the primary focus of their investments. Thus, there are equity funds, money market funds, bond funds, real estate funds, ethical funds and balanced funds among others. The major money market fund players are Stanbic ***IBTC*** Money market fund, ***FBN*** Money market fund, ***UBA*** Money market fund, and ***ARM*** Money market fund. Money market funds primarily invest in short term liquid assets like Nigerian treasury bills and commercial papers.

EXCHANGE TRADED FUNDS

Of recent, one of the new collective investment schemes that are becoming prominent in the international capital market is the Exchange Traded Fund (***ETF***). Exchange Traded Funds are funds consisting of a collection of stocks or securities that track a market, sector, commodity or industrial index. They are hybrid products combining some of the features of stocks and mutual funds. ***ETFs*** are listed on a stock exchange and trade like other stocks through a brokerage account. Each ***ETF*** has a net asset value (***NAV***), which is determined by the total market capitalization of the securities or other products in the portfolio, plus dividends and interest but minus managerial and operational expenses, divided by the number of shares issued by the fund. Exchange Traded Funds are usually tailored to specific array of sectors, commodities, bonds and other asset classes. Some of the features of ***ETFs*** include:

1. ***ETFs*** are hybrid products and like open-ended funds, issue redeemable shares at new asset value (***NAV***).

2. The shares are issued or redeemed in large blocks known as creation units.

3. Investors generally do not purchase or redeem Creation units with cash but the units are purchased or redeemed with a basket of securities that comprise the ***ETF's*** portfolio. Creation units are mostly purchased by institutional investors.

4. Like a closed-end fund, the individual shares are traded in the secondary market at negotiable prices (above or below the ***NAV***) depending on market forces.

5. ***ETFs*** like any other type of investment companies have prospectus. All investors that purchase Creation units receive a prospectus. Some ***ETFs*** also deliver a prospectus and are required to give investors a document known as a Product Description, which summarizes key information about the ***ETF*** and explains how to obtain a prospectus. All ***ETFs*** deliver a prospectus upon request.

Exchange Traded Funds are still new in the Nigerian capital market.

SUMMARY

A mutual fund, otherwise known as a collective investment scheme (***CIS***), is an entity that pools cash from investors for the purpose of investing in a variety of financial instruments with a view to minimizing risk and maximizing returns for the contributors known as unit holders. Mutual Funds can be open-ended or close-ended. In Nigeria, mutual funds' regulation by the Securities and Exchange Commission (***SEC***) principally derives from the Investment and

Securities Act of 2007 and other enabling laws which provide for their registration as a trust company. The benefits of investing in mutual funds include affordability, liquidity, professional management and diversification. However, there are risks which the investor should take into cognizance. These include liquidity risks and high transaction costs which could affect possible returns.

REVIEW QUESTIONS

1. What is a mutual fund?
2. Distinguish between an open-ended mutual fund and a close-ended mutual fund
3. What are the merits and demerits of investing in a mutual fund?
4. Write short note on the following:
    a. Fixed income fund
    b. Equity fund
    c. Mixed Income fund

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CHAPTER 22

RECENT FINANCIAL SECTOR REFORMS IN NIGERIA

INTRODUCTION

In this chapter, we highlight major financial sector reforms witnessed in Nigeria especially in the last decade with regard to the Banking, Insurance, Pension and the stock market.

BANKING SECTOR REFORMS

Major banking sector reforms, in recent times, began with the banking sector consolidation which was driven by the desire to reposition deposit money banks in Nigeria to cope with the challenges of an increasingly globalized banking system. It was based on the above premise that banking consolidation was embarked upon in Nigeria from 2004. The Bank consolidation was aimed at ensuring competition and safety of the system and proactively positioning the industry to perform the role of intermediation and facilitation of economic development. The reform was designed to ensure a diversified, strong and reliable banking sector which will ensure the safety of depositors' money, play active developmental roles in the Nigerian economy, and be competent and competitive players in the African, regional and global financial system.

Following the banking sector consolidation, notable achievements were recorded in the financial sector among which was the emergence of 25 well capitalized banks from the former 89 banks. The banks raised N406.4 billion from the capital market. In

addition, the process attracted foreign inflow of capital. The liquidity engendered by the inflow of funds into the banks induced interest rate to fall significantly, while an unprecedented 30.8 per cent increase was recorded in lending to the real sector in 2005. With a higher single obligor limit, Nigerian banks now have a greater potential to finance large value transactions. More banks now have access to credit from foreign banks. Ownership structure has been positively affected such that the problems of insider abuse and corporate governance have been reduced.

With virtually all banks now publicly quoted, there is wider regulatory oversight with the inclusion of the Securities and Exchange Commission and the Nigerian Stock Exchange in the regulatory team as resources are now committed to the regulation of few and more stable banks in an efficient and effective manner. The banks have begun to enjoy economies of scale and, consequently, are passing on the benefit in the form of reduced cost of banking transactions. In general, the reform efforts had engendered stable macroeconomic environment evidenced by low inflation and relative stable exchange rates. However, not long after, the global financial and economic crises came in 2007, leading to the collapse of many financial institutions across the globe. The financial crisis reduced the gains made in the Nigerian financial services sector from the banking sector consolidation exercise as bank stocks were hard hit on the market with second round effects on their balance sheets and lending capabilities. In the wake of the high oil prices, a section of the industry that was excessively exposed to the oil and gas sector was also badly affected. As at December 2008, banks total exposure to the oil industry stood at over N754.0 billion, representing over 10.0 per cent of the industry total and over 27.0 per cent of the shareholders' funds. The excessive exposures resulted in serious liquidity problems exhibited by some of the banks towards the end of 2008.

As part of its liquidity support, the *CBN* Discount Window was expanded in October 2008 to accommodate money market instruments, such as Bankers Acceptances and Commercial Papers.

As at June 2009, the banks total commitment under the Expanded Discount Window (***EDW***) was over N2,688.84 billion, while the outstanding commitments was over N256.0 billion, most of which was owed by less than half of the banks in operation. When the ***CBN*** closed down the ***EDW*** and, in its place, guaranteed inter-bank placements, it was observed that the same banks were the main net-takers under the guarantee arrangement, indicating that they had deep-rooted liquidity problems.

In order to stabilize the financial system, a joint special examination by the ***CBN*** and ***NDIC*** was conducted in May 2009. The results showed that of the 24 banks, 10 had substantial non-performing loan; poor corporate governance; weaknesses in capital adequacy and illiquidity. It was against this background that the ***CBN*** moved decisively to strengthen the industry, protect depositors and creditors funds, safeguard the integrity of the industry and restore public confidence. In that regard, the ***CBN*** replaced the chief executives/executives directors of the banks identified as the source of instability in the industry and injected the sum ofN620.0 billion into the banks in an effort to prevent a systemic crisis. Arrangements were also made to recover non-performing loans from banks debtors, while guaranteeing all foreign credits and correspondent banking commitments of the affected banks.

Furthermore, the ***CBN*** proposed the establishment of the Asset Management Corporation of Nigerian (***AMCON***). The ***AMCON*** Bill was passed by the National Assembly and signed into law by the President. The ***AMCON*** as a resolution vehicle was expected to soak the toxic assets of troubled banks. The replacement of the Chief Executives/Executive Directors of the banks, and injection N620.00 billion was the first phase of a two-phased approach to addressing the problem. The second phase was termed the "Alpha Project. The ***CBN*** articulated a blue print for reforming the Nigerian financial system in the next ten years. The blueprint which is built on 4 pillars of enhancing the quality of banks, establishing financial stability, enabling healthy financial sector evolution and ensuring that financial sector contributes to

the real economy highlighted the direction for the reforms. With regards to enhancing the quality of banks, the ***CBN*** initiated a five-part programme to enhance the operations and quality of banks in Nigeria. Industry remedial programmes were adopted to repair the key causes of the crisis, a risk based supervision approach was put in place, the regulations and regulatory framework was reformed, consumer protection was enhanced and the internal transformation of the ***CBN*** was undertaken.

The universal banking (***UB***) model adopted in 2001, allowed banks to diversify into non-bank financial businesses. Following the consolidation programme, banks became awash with capital, which was deployed to multiples of financial services. In effect, the laudable objectives of the ***UB*** Model were abused by operators, with banks operating as financial supermarkets to the detriment of core banking practices.

In order to address the observed challenges and enable a healthy financial sector, the ***CBN*** reviewed the basic one size-fits-all model of banking (universal banking) with a view to refocusing banks to their core mandate. Banks were mandated to streamline their operations and no longer allowed to invest in non-bank subsidiaries, while banks with such investments would be required to either divest or spin-off the businesses to holding companies that would be licensed by the ***CBN*** as other financial institutions. Unlike the Universal Banking (***UB***) model, which allowed banks to diversify into non-bank financial businesses, they were mandated to apply for licenses to suit their mode of operation. This included the international, national, regional, and specialized licenses such as Islamic banks, etc, with different capital requirements, commensurate to the depth of their activities.

To further engender public confidence in the banking system and enhance customer protection, the ***CBN*** established the Consumer and Financial Protection Division to provide a platform through which consumers can seek redress. In the first three months of its operation, about 600 consumer complaints were received by the Division which was a manifestation of the absence of an effective consumer complaints resolution mechanism in

banks. The ***CBN*** also issued a directive to banks to establish Customer Help Desks at their head offices and branches. In addition, the ***CBN*** commenced a comprehensive review of the Guide to Bank Charges with a view to making the charges realistic and consumer-friendly.

The ***CBN*** also took steps to integrate the banking system into the global best practices in financial reporting and disclosure through the adoption of the international Financial reporting Standards (***IFRS***) in the Nigerian Banking Sector by 2012. This was meant to enhance market discipline and reduce uncertainties, which limit the risk of unwarranted contagion. This was in collaboration with other stakeholders like the Nigerian Accounting Standard Board (***NASB***), Federal Ministry of Finance (***FMF***), ***NDIC, SEC, NAICOM, PENCOM***, Federal Inland Revenue Service (***FIRS***), and the Institute of Chartered Accountant of Nigerian (***ICAN***) among others.

INSURANCE SECTOR REFORMS

The Nigerian Government envisions an insurance industry that will rank amongst the twenty largest markets in the world by the year 2020. To this end, the government has, taken measures towards actualizing this objective, particularly the strengthening of the National Insurance Commission (***NAICOM***) which derives its regulatory powers from the National Insurance Commission Act, 1997 and the Insurance Act of 2003.

In 2003, the insurance industry embarked on its first recapitalization programme which was in line with the passing of the 2003 Insurance Act. Insurance companies were required to raise their capital base from N20million to N150million for Life businesses, N70million to N300million for Non-Life businesses and N150million to N350million for Re-Insurance businesses. However, prior to this recapitalization exercise in December 2002, there were 117 insurance companies, out of which 14 were liquidated after the recapitalization exercise as they were unable to scale through the recapitalization hurdle.

In September 2005, a new capitalization requirement was again announced increasing the capital base from N150million to N2billion for Life Insurance businesses; N300million to N3billion for Non-Life businesses and N350million to N10billion for the Re-Insurance companies. After the recapitalization exercise, the industry witnessed quite a number of consolidations with the number of insurance companies dropping by 52.4% from 103 to 49 companies.

Prior to the regulatory induced recapitalization, the Nigerian insurance sector was characterized by many challenges. These challenges were mostly responsible for the sector's inability to attract sufficient businesses both locally and internationally. The distressed state of the industry also affected its ability to retain a significant proportion of risk emanating from assets domiciled in Nigeria. Premium flight was another key challenge for the sector as the underwriting capability of the existing companies was low compared to the available risks. The industry before the recapitalization exercise was made up of 103 insurance companies, 4 Re-Insurers, 527 Brokers and 28 Loss Adjusting companies who all were not well capitalized and positioned to cover big ticket transactions, hence the need to raise the bar.

Post recapitalization of the Nigerian insurance sector has continued to witness consolidation activities that have produced some major players capable of meeting claims' obligations which, hitherto, they were not able to meet. Also, the reforms have created a business environment to contain various brand activities, increased investment as well as growing public awareness of the benefits of insurance to the society at large. Current interest by foreign investors in Nigerian insurance companies is a testament to the ongoing reforms in the industry. The continuous implementation of the current reforms in the insurance sector is expected to significantly reduce the number of operators, increase competition and standard among existing players in the industry.

PENSION REFORMS

The Pensions Reform Act (*PRA*) of 2004 is the most recent legislation of the Federal Government of Nigeria which is aimed at reforming the pensions system in the country. It encompasses employees in both the public and private sectors. The *PRA* of 2004 came into being with a view to reducing the difficulties encountered by retirees in Nigeria under the old pension scheme. The new scheme is regulated and supervised by the National Pension Commission. The Commission has the power to formulate, direct and oversee the overall policy on pension matters in Nigeria. It also establishes standards, rules and regulations for the management of the pension funds .It approves, licenses, sanctions and promotes capacity building and institutional strengthening of the *PFA* and *PFCS*

The objectives of the Scheme according to Section 2, Part 1 of the *PRA* of 2004 include to:

1. Ensure that every person who worked in either the public service of the federation, federal capital territory or private sector receives his retirement benefits as and when due.

2. Encourage workers to save in order to cater for their livelihood during old age.

3. Establish a uniform set of rules, regulations and standards for the administration and payment of retirement benefits for the public service of the federation, federal capital territory or private sector.

4. Stem the growth of outstanding pension liabilities.

5. Secure compliance and promote wider coverage.

The new pension scheme is a contributory pension scheme for the payment of retirement benefits of employees who are eligible

under the scheme. Section 9 (1) specifies the contribution by the individual and the employer as follows:

1. In the case of public service of the Federation and the Federal Capital Territory a minimum of 7.5% by the employer and a minimum of 7.5% by the employee.

2. In the case of the military, a minimum of 12.5% by the employer and a minimum of 2.5% by the employee.

3. In other cases, a minimum of 7.5% by the employer and a minimum of 7.5% by the employee.

The Act empowers the employer to deduct at source the monthly contribution of the employee in his employment and remit the said amount not later than 7 working days from the day the employee's salary is paid to the custodian specified by the Pension Fund Administrator (***PFA***). The ***PFC*** is to notify the ***PFA*** to credit the employee's revenue savings account. There is 2% of total contribution fine on any employer who defaults for each month.

To encourage the employee, the contribution to the new scheme is to be part of tax deductable expense in the computation of the tax payable by the employee. The Act also empowers the ***CBN*** to establish, invest and manage the ***RBRF*** (Retirement Bond Redemption Fund) for the Federal public service and the ***FCT***. The Federal Government was to pay into the fund an equal amount of 5% of the total monthly wage bill payable to employee and the public service of the federation and the ***FCT***. The Redemption fund account was to be used by the ***CBN*** to redeem any bond issue in respect of accrued retirement benefit. Unlike the old scheme, the Act specifies an institutional framework for the proper management and custodian the pension assets –mainly based on the key principle of "ring fencing" to ensure effectiveness and effect in the administration by all those concerned.

First, the Pension Fund Administrators (***PFA***) opens and administers the ***RSA*** (Retirement Saving Account) for the employee in liaison with ***PENCOM*** and appoints the pension fund

custodian (***PFC***) who receives the total contributions and hold pension fund assets in safe custody on trust for the employees and beneficiates of the retirement benefits. They also execute transactions and undertake other related activates on behalf of ***PFA***. Both of them (***PFA*** and ***PFC***) were to keep proper books of accounts and submit audited financial accounts not later than four months (120 days) from the end of the financial year to ***PENCOM***. Allowance was also given for closed pension fund administration whereby organizations manage existing scheme for employees in their outfits. Only the Pension Commission was to regulate, and suspense the scheme; direct overall pension policy matters, approve, license and supervise the ***PFA, PFC*** and other institutions related to pension for maximum compliance.

The main concern of the new pension scheme is safety of the fund and the maintenance of fair returns on the amount invested. The need for safety is emphasized in determining the quality of the instrument to invest in and a ***PFA*** is expected to adopt a risk management profile in making investment decisions with due regard to the credit rating of companies registered under the investment and Securities Acts of 1999. ***PFA*** was expected to appoint risk management and investment strategy committees. The risk management committee determines the risk profile of investment portfolio and ensures adequate internal control measures and procedures. The investment strategy committee determines the portfolio mix consistent with the risk profile, evaluate and review the performance of investment on periodic basis.

Against the guaranteed structure, the ***PFA*** is to invest in the any of the following as specified by Section 73(1):

1. Bonds, bills and the securities issued by Federal Government or the Central Bank of Nigeria.

2. Bonds, debenture, redeemable preference shares and other debt instruments issued by listed corporate entities in Nigeria.

3. Ordinary shares of public limited companies listed on the Nigerian Stock Exchange.

4. Bank deposits and securities.

5. Investment certificates of closed-end investment fund or hybrid investment fund.

6. Quoted unitized investment.

7. Other investments prescribed by the pension commission

The Act creates another condition in which a contributor may be allowed to withdraw from his retirement account. An employee who disengages from employment or is disengaged before the age of 50 and is unable to secure employment within 4 months of disengagement is allowed to make withdrawals from the account although not exceeding 25% of the total amount credited to the retirement savings account.

Any employee aggrieved with his employer of ***PFA*** is obligated to approach the Commission for a redress before exploring arbitration or commencing an action at the National Industrial Court. Previously under the repealed Act, the avenues for dispute resolution were arbitral panels and the Investment and Securities Tribunal.

CAPITAL MARKET REFORMS

Following the shocks occasioned by the global financial crisis and the challenges in the Nigerian Capital Market, the Securities and Exchange Commission, in the performance of its developmental role, undertook a number of reforms to ensure that the market was on the path of sustainable growth and development. The reforms included:

Development of the Bond Market

Fixed income is a key investment class for institutional investors such as pension funds and insurance companies due to its near certainty of income. It is a major source of financing infrastructural and industrial development and hence critical to economic development. In recognition of the important role of the fixed income market the Commission introduced rules to guide book building and shelf registration which are expected to enhance market operators' ability to raise fixed income while giving investors' confidence.

It appointed a Fixed Income Adviser, Mr. Richard Dvorin, in 2010 to assist in regulatory matters, infrastructure as well as capacity building with regards to bond issuance. The adviser's mandate was essentially to develop the secondary bond market and other related fixed income activities through improved efficiency in issuance process. The recommendations of the Adviser, on how to improve the bond sector, were adopted by stakeholders for implementation in 2011. Furthermore, the Commission, in conjunction with other key stakeholders in the market obtained tax waivers from the Federal Government of Nigeria on all categories of bonds. It collaborated with the ***CBN*** and the Nigerian Stock Exchange (***NSE***) to reduce the cost of transactions particularly bond issuance so as to diversity funding sources away from banks, as well as attract more foreign portfolio investors into the sector.

Early in 2010, Capital Market Sub-Committees on Credit Rating Agencies and Custody of Securities were established. The sub-committee on Credit Rating Agencies was to enhance the activities of the agencies as they are key to the development of the bond market while that on Custody of Securities was to advise on how the introduction of custody services would help address the issue of wrongful disposal of, and dealings in investors' assets in the capital market.

Introduction of New Products

The Commission gave approval for the introduction of Exchange Traded Funds (***ETFs***) and Islamic Financial products. Also, the

Securitization Law was drafted to kick-start trading in securitized products in Nigeria which will assist in hedging investment risks.

Strengthening Market Institutions & Corporate Governance

As earlier noted, the global financial crisis affected the banking sector so much and in view of its huge presence in the Nigerian capital market (significant proportion of market capitalization), it brought about substantial decline in stock market capitalization and share prices. The stock market lost about 70 per cent of its market value in 2008. The price collapse within the market resulted in massive wealth destruction, loss of confidence in the stock markets.

In recognition of the importance of corporate governance in boosting investors' confidence ***SEC*** included a review of the 2003 Corporate Governance Code in its capital market reform in order to address weaknesses in current practices and strengthen governance and disclosure by public companies. Furthermore, the Commission recognized the fact that the integrity of any market was measured by the level of information disclosure, transparency, accountability and quality of governance of its institutions. Therefore it made serious efforts to ensure that market institutions were strengthened during the year. To this end, publicly listed companies and significant interest entities such as banks were required to adopt ***IFRS*** in reporting their financials by January 2012. The adoption of International Financial Reporting Standards (***IFRS***) by listed companies and regulated entities was meant to improve the quality of financial reporting in the country and give further credibility to the reports.

Reduction in transactions costs

High transaction costs act as a deterrent to organizations who may otherwise seek to raise funds and inhibit the growth of the capital market. Consequently, the ***SEC*** instituted a 40% downward review of fees and commissions charged with a view to making the market more attractive to participants.

Recapitalization by Market operators

As part of an effort to encourage market operators to contribute to the growth of the real sector, the minimum paid-up capital was reviewed upwards. The minimum capital requirement for Issuing House in Nigeria was increased from N150 million to N200 million; for Broker/Dealer from N70 million to N300million; for broker only, from N40 million to N200 million; while for dealer, it was increased from N30 million to N100 million. For a Registrar in the Nigerian capital market, the minimum capital requirement was increased to N150 million, from N50 million while in the case of Trustees business, it was increased to N300million, from N40 million. The new capital requirement was yet to take effect as at the time of writing this book.

SUMMARY

Recent reforms in the financial sector in Nigeria have been wide-ranging with the Banking and Insurance sectors witnessing recapitalization which reduced the number of players. The introduction of the contributory pension scheme (via the Pension Reform Act of 2004) was, by any yardstick, a revolution in the pension industry in Nigeria. With respect to the stock market, the reforms witnessed in recent years have been geared towards developing the bond market, introduction of new products, strengthening corporate governance, reduction in transaction costs as well as recapitalization of market operators.

REVIEW QUESTION

1. Discuss the key reforms in the Nigerian financial sector since year 2000

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SECTION FOUR:

THE OUTSIDE WORLD AND THE NIGERIAN FINANCIAL SYSTEM

CHAPTER 23

FOREIGN EXCHANGE MARKET

INTRODUCTION

Foreign exchange market is a market in which foreign currencies are bought and sold or exchanged for one another. The price of one currency in relation to that of another is known as the exchange rate. Suppose that a Nigerian trader wishes to buy a computer from the United States at the cost of US$500. If the exchange rate is US$1 = N150, the Nigerian trader will require N75,000 (ie 500 x 150) in order to obtain US$500. When the free market price of a currency falls in terms of foreign currencies, the exchange rate is said to depreciate. On the other hand, when the free market price of one currency rises in terms of another currency, the exchange rate is said to appreciate.

The naira increases in value when it appreciates. This is because its purchasing power goes up and a relatively fewer naira is needed to purchase the currency of other nations. A strong naira makes imports less expensive and helps to keep inflation in check. For instance, a strong naira makes imported oil, rice, and cement cheaper. Similarly, strong naira is good news for Nigerians travelling abroad. However, to exporters and manufacturing industries, a strong naira would not be desired because it makes "made in Nigeria" goods and services expensive in the global marketplace.

A weak naira equally has its merits and demerits for the economy. It would make "made in Nigeria" goods and services cheaper in the global marketplace which could mean increase in

exports for Nigerian firms in the export business. On the other hand, imports could decrease because foreign goods and services would become very expensive and thus drive up price of inputs leading to higher inflation. This situation is not good for consumers as they normally bear the additional cost.

DETERMINANTS OF EXCHANGE RATE

An understanding of the general factors that affect the exchange rate of a country's currency is vital in appreciating the dynamics in the country's foreign exchange market. These factors are essentially the market forces of demand and supply for the currency because just like every other commodity, when the demand for a currency exceeds the supply, its value increases and vice-versa. Demand and Supply forces are in turn influenced by macroeconomic factors such as interest rates, inflation and ***GDP***, trade levels of the country, public debt, government budgets, monetary & fiscal policies, speculation and political stability.

Other factors remaining the same, investors will tend not to invest in the country with lower differential interest rate over inflation if the excess of interest rate over inflation is lower in one country relative to another thereby decreasing the demand for that country's currency. On the contrary, if the excess of interest rates over inflation is higher in one country relative to another, then investors will tend to invest in the country with higher differential of interest rate over inflation and thereby increasing the demand for that country's currency. Also, other macroeconomic indices such as ***GDP*** when high have positive effect on a country's exchange rate and vice versa.

A critical factor that influences the exchange rate of a country is the level of trade. A favourable balance of trade, (a situation in which a country exports more than it imports) will increase the value of the domestic currency. On the other hand, a trade deficit, where the country imports more than it exports, devalues the currency. Also, huge public debts (especially when it is dominated by external debts) as well as persistent budget deficits

(case of expenditure exceeding revenue) tend to have an adverse effect on the value of a country's currency.

Similarly, economic and fiscal policies of the government are important factors that influence the exchange rate. The currencies of countries that follow sound economic policies will, other factors remaining constant, command a high value. Furthermore, speculation by traders can affect exchange rate movement. Generally, when a rumour spreads in the market that a particular currency is expected to increase in value, traders will buy and when more and more traders try to buy a strong currency, its demand increases thereby increasing the value of that currency. Finally, political stability affects the currency as the credibility of a country from the viewpoint of trading partners and international investors is negatively affected by political crisis and frequent regime changes.

NIGERIAN FOREIGN EXCHANGE SYSTEMS

The Exchange Control Act of 1962 as amended was the principal legislation governing foreign exchange transactions in Nigeria up to September 1986. The main objective of the Act was to prevent the outflow of funds from the country and to conserve the country's reserves of gold and foreign currencies. The Act vested overall authority with the Minister of Finance who would normally appoint the Central Bank of Nigeria as the principal agent to administer exchange control regulations. In addition, all licensed banks in the country were Authorized Dealers required to carry out their duties in accordance with Central Bank directives and instructions.

Fixed Exchange Rate System

Prior to 1986, Nigeria adopted the fixed exchange rate system under which the government fixed the exchange rate for the British pound and US dollar. The naira was £0.50 and US$1 to the pound and dollar respectively. Government directly supervised international trade by restrictive exchange controls such as import

licensing, import quotas and outright ban of certain foreign products.

Under the Exchange Control Act, 1962, all foreign exchange transactions, no matter how small in value, must be passed through the Central Bank. Nigerians were not allowed to keep any amount of foreign currency without surrendering it to the Central Bank through Authorised Dealers within 48 hours of their acquisition or on arrival in the country in the case of returning nationals from foreign countries. Private buying and selling of foreign currencies was a crime as only the ***CBN*** and its authorised agents were authorized to buy and sell foreign currencies. The ***CBN*** was the country's supplier of foreign currencies earned from exports. International settlements were made through ***CBN*** which released foreign currencies through the banks in exchange with naira, for payment to overseas creditors. Settlement of governments' international obligation was made by ***CBN*** to the governments concerned through their central banks.

The Second Tier Foreign Exchange Market (SFEM)

However, in October 1985, the Federal Government moved to deregulate and liberalize foreign exchange transactions with the introduction of the Domiciliary Accounts scheme. Under the scheme, residents, foreign nationals, Nigerian-registered companies, Embassies, High Commissions and other diplomatic missions were allowed to open and operate foreign currency accounts domiciled with selected Nigerian banks. The scheme also provided that foreign currency accounts could be opened and designated in US Dollars, ***UK*** Sterling, Deutsche Marks, French Francs, Swiss Francs or any other currencies that the Government may specify from time to time. Thus, foreign currency accounts became free from exchange control formalities. The depositor was free to determine the currency designation of his account, provided it was opened in any of the currencies specified above.

The benefits derivable from the scheme included easing the pressure on the official foreign exchange resources as people could

meet part of their requirements for foreign exchange through the domiciliary accounts as well as encouraging repatriation of capital and foreign currency holdings of Nigerians abroad. Following the introduction of the domiciliary accounts system which allowed individuals and corporate bodies to operate foreign currency accounts in Nigeria, the need for a free and open foreign exchange market became apparent. The Second-Tier Foreign Exchange Market (***SFEM***), established by a Decree in 1986, brought some flexibility to Nigeria's exchange rate system. It was a free market where anyone could buy or sell foreign exchange. 'Authorized Dealers' which were corporate organizations were appointed by the government to deal in the ***SFEM*** which was financed from funds accruing automatically to the market (i.e. all foreign exchange inflows including deposits in the domiciliary accounts) plus a proportion of the proceeds accruing directly to the Government from receipts of crude oil sales. The objective of the ***SFEM*** was to evolve a realistic market-determined exchange rate for the naira so as to reduce the demand for foreign exchange to the available supply.

SFEM operated side-by-side with the official Foreign Exchange Market. The official exchange market rate was only used for debt service payment, expenses of Nigerian Embassies abroad, contributions to international organization and other government foreign commitments while private sectors requiring foreign currencies were to go to ***SFEM*** which was conducted by auction of dollars by ***CBN*** at which Banks submitted bids (indicated how much naira they were prepared to buy a dollar and the total volume of dollars bidded for) on behalf of their customers. In other words, ***SFEM*** was operated on the floating exchange rate system, while the official market remained at the fixed exchange rate system. Thus a dual exchange rate regime was operated by the country.

Foreign Exchange Market (FEM)

The Dual exchange rate system was abolished in 1987 by the merger of the first and second forex markets into Foreign Exchange Market (***FEM***) with a single exchange rate system. But demand

pressures on the market and the depreciation of naira because of hyperinflation persisted.

Autonomous Foreign Exchange Market (AFEM)

AFEM was introduced in 1994 after the auction system was abandoned. Authorised dealers were allowed to trade on *FOREX* at rates mutually agreed between the parties. *CBN* intervened occasionally to buy or sell Forex depending on the direction the exchange rate went. Delivery of Forex was required to be made within 3 working days of transaction.

Inter-bank Foreign Exchange Market (IFEM)

IFEM was established in 1995 as a Forex market for banks only where buying and selling was done by one bank from the other. *AFEM* was allowed to run parallel with the *IFEM*. Under the *IFEM* the banks source their foreign currencies from other sources but sell to other banks only and the minimum that can be traded was US$1 million. However, the *CBN* reserves the right to intervene as a participant in the market. The other sources of this Forex is from bank's customers who sell from their domiciliary accounts, travellers from abroad who change their foreign currencies into the naira over the counter and purchases from authorised buyer such as hotels.

Unlike the *FEM* market which was later abolished, trading in *IFEM* is done over the telephone and is from bank to bank and no assemblage of all the buyers and sellers at a particular place unless when *CBN* wants to intervene. The price or the exchange rate in this market is therefore more likely to be market driven than in the *FEM* market. *IFEX* is an index of the foreign exchange rate at which prime banks are willing to trade among themselves in the inter-bank market. *IFEM's* exchange rate is called Nigerian Inter-bank Foreign Exchange (*NIFEX*) which is calculated by the Money Market Association of Nigeria.

BUREAU DE CHANGE (BDC)

Bureau de change is a much wider market than both the ***FEM*** and ***IFEM*** but deals in smaller sums of ***FOREX***. Trading at ***BDC*** is by bargaining and exchange rates are based on the official rates which explain why their rates are usually higher. The ***CBN*** recently released new capitalization requirements for licensed ***BDCs*** operating in the country. ***BDCs*** are allowed to source their funds from ***IFEM*** and are spot markets. As explained earlier, 'spot market' is a term used to describe an open market where a commodity is purchased and delivery is made on the spot.

PARALLEL MARKET

A common sight in front of major hotels, airports and at various corners of busy streets in the city centres are individuals who buy and sell foreign currencies. These individuals constitute what is known as the "parallel market" in foreign currency. It is an illegal market because they are not licensed dealers in foreign exchange, but they exist in spite of attempts by the government to stamp them out. The major customers of the parallel market are those returning from abroad who change their foreign currencies into naira and those travelling out who buy their foreign currency needs from them. The parallel market has its own exchange rates which are usually higher/lower (for buying) than the other markets in order to attract customers. The parallel market is also called "black market".

AUTHORIZED DEALERS

The Authorised Dealers as the name implies are approved primary buyers of dollars from the ***CBN***. They are dealers who have the authority to submit bids on behalf of the Bureau De Change (***BDC***) to the ***CBN*** for purchase of forex. Most commercial banks are registered Authorised Dealers with the ***CBN***.

DUTCH AUCTION SYSTEM

One of the methods applied by the ***CBN*** to determine the "market-driven" exchange rate is the Dutch Auction System (***DAS***). The

DAS is a public offering auction structure in which the price of the offering is set after taking in all bids and determining the highest price at which the total offering can be sold. In this type of auction, investors place a bid for the amount they are willing to buy in terms of quantity and price.

The Wholesale Dutch Auction System (***WDAS***) was introduced in February 2006. Before this time, the Retail Dutch Auction System (***RDAS***) was in use. The ***WDAS*** is a subset of the Dutch Auction System whereby the ***CBN*** receives bids from Authorized Dealers for purchase of forex. The Authorized Dealers on behalf of ***BDC's*** and other end users of forex (like corporates, importers etc) will submit bids to the ***CBN*** for purchase of forex during an auction. Once their bids are successful they then sell the dollars to the ***BDCs*** and other end users.

To illustrate, suppose the ***CBN*** during its auction offers a total dollar sale of US$200million. The apex bank offers foreign currency twice a week to keep the naira within a range of three percentage points above or below N155 per dollar. With this in mind, Authorised Dealers who have various needs for dollars approach the auction for dollar purchase. Some may be willing to buy US$20million: others US$10million and so on. During the auction each Authorised dealer tables an offer that may be below the N155/US$1 or above it depending on the forces of demand and supply. If there are more bids above the ***CBN's*** preferred N155, those bidders get to buy dollars while those who bid below lose out and vice versa. At the end of the Bid the ***CBN*** releases its results on its website. The Bid for ***WDAS*** which took place on September 30 was announced as follows:

Summary of ***WDAS*** No 74/2013 of 30th September, 2013

Auction No	9/30/2013 held on 74
Total Amount Offered	US$ 300,000,000.00
Total Amount Demanded	US$ 0.00
Total Amount Sold	US$ 300,000,000.00
Highest Successfull Bid Rate	US$ 155.78
Lowest Bid Rate	155.75
No. of Successful bids	17
No. of Unsuccessful bids	0
Marginal Bid	US$ 155.75
Number of Banks	17

Source: CBN

It is important to note however, that under the ***WDAS***, the Bids submitted by the Authorized Dealers need not match the total request by its end users. For example, the Authorized Dealers can purchase USD$2million from the ***CBN*** during an auction even though it only had confirmed requests of US$1million from its ***BDC's*** and other end users. Being a Wholesale Dealer, it believes it can continue to sell the balance of US$1million (in the interbank market) as the need arises without having to go back to wait for another auction to Bid.

According to the ***CBN***, in the case of Private ***BDCs***:

1. Each licensed ***BDC*** was required, to open a Naira Current Account with an Authorized Dealer of its choice, for the purpose of buying forex.

2. A Bureau-de-Change is allowed to purchase forex from the ***CBN*** through a presentation of the ***CBN*** cheque issued by their banks twice a week (Tuesdays and Thursdays).

3. The Bureau-de-Change purchase equivalent amount of forex from the ***CBN*** up to a maximum limit of US$200,000.00 twice a week.

With respect to Authorized Dealer ***BDCs***:

- The Authorized Dealer applies to ***CBN*** through the ***WDAS*** window on Mondays and Wednesdays for a maximum of US$2million.

- The forex purchased by the Authorized Dealers is disbursed in cash and the ***BDCs*** in turn sell to end-users for eligible transactions only, such eligible transactions include:
    - BTA at $5,000 per quarter and $20,000 per annum;
    - PTA at $4,000 per quarter and $16,000 per annum; and others include:
        - Mortgage monthly payment;
        - School fees abroad;
        - Medical fees abroad;
        - Credit Card payment;
        - Utility bills; and
        - Life Assurance premium payment.

In 2013, the Central Bank announced the reintroduction of the Retail Dutch Auction System ***(RDAS)*** and the replacement of the Wholesale Dutch Auction System (***WDAS***). As the name implies, the ***RDAS*** is a direct sale of Forex by the ***CBN*** through the banks to the end users of the forex. Unlike the ***WDAS***, the ***RDAS*** is based solely on actual demand of forex by the end users of the forex. As such, the Authorised dealers will only bid for forex based on the number of actual request it has received from its end users. For example, if an Authorised Dealer has received only US$1million of confirmed dollar requests from its ***BDC's*** and other end users it can only then bid for that US$1million from the ***CBN*** auction unlike the ***WDAS*** where it can bid for more.

The ***RDAS*** has the following advantages:

1. Only confirmed users of forex for legitimate uses have access to forex.

2. Round tripping is expected to be reduced as forex bought from the ***CBN*** is essentially monitored and can't be used for reason other than those specified during bid application.

3. Banks will not be able to speculate in the interbank market as all banks will basically know that the dollars bought in any particular auction will be utilised fully before the next auction.

4. It will be difficult to sell forex bought from the ***CBN*** to the parallel market

A major disadvantage of the ***RDAS*** is that by virtue of its limited status it can create an artificial scarcity of forex. Because the ***CBN*** only sells forex to confirmed users other arbitrary users of forex will not be able to buy readily. Importers of forex like tourist or travellers will more than likely sell forex at higher rates to the black market than they would if they sell to the ***BDC***. This has the tendency of promoting the parallel market.

SUMMARY

Foreign exchange market is a market in which foreign currencies are bought and sold or exchanged for one another. In other to appreciate the dynamics of a country's foreign exchange market, an understanding of the general factors that affect the exchange rate of a country's currency is vital. These factors are essentially the market forces of demand and supply for the currency which are in turn influenced by the level of trade, inflation and interest rates, monetary and fiscal policies, political stability among others.

Before 1986, Nigeria adopted the fixed exchange rate system under which the government fixed the exchange rate for the

British pound and US dollar. However, in October 1985, the Federal Government deregulated and liberalized foreign exchange transactions. Currently, the *CBN* applies the Retail Dutch Auction System (a direct sale of forex through the banks to the end users) in determining the "market-driven" exchange rate of the naira.

REVIEW QUESTIONS

1. What factors can influence the exchange rate of the naira?

2. Briefly explain the Retail Dutch Auction System. How does it differ from the Wholesale Dutch Auction System?

3. Would you recommend a fixed or flexible exchange rate system for Nigeria? Justify your answer.

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CHAPTER 24

NIGERIAN SOVEREIGN WEALTH FUND

INTRODUCTION

A Sovereign Wealth Fund (***SWF***) is an investment fund owned by a sovereign state with the mandate to invest in financial assets such as stocks, bonds, precious metals, property and other financial instruments. Sovereign Wealth Funds (***SWFs***) are usually created as a vehicle for stabilizing irregular revenue streams and managing surplus revenues which largely accrue from the sale of oil, gas or other natural resources. The structure and scope of investments of a sovereign wealth fund depends on the circumstances of each country as well as what the enabling law setting up the sovereign wealth fund permits. Sovereign wealth funds usually have long-term investment focus. However, their objectives might include providing liquidity stabilization funds as well as the funding of vital economic infrastructure projects. Most ***SWFs*** are found in countries that export oil or have commodities reserves and generate revenues from their sale.

Although, quite a good number of sovereign wealth funds were established in recent times, they have been around for quite some time. According to Drezner (2010), the very first SWF was the Kuwait Investment Authority, which was established in 1953 before Kuwait secured its independence from the United Kingdom. Besides Kuwait, other large funds, as shown in table below, are operated by Singapore, China, Norway and the United Arab Emirate.

Table 24.1: Some world's largest ***SWFs*** by investment volume, 2009

	Investment volume	Established
Kuwait Investment Authority	USD 250 billion	1953
Temasek Holdings (Singapore)	USD 108 billion	1974
Abu Dhabi Investment Authority (ADIA)	USD 875 billion	1976
Government of Singapore Investment Corporation	USD 330 billion	1981
Government Pension Fund – Global (Norway)	USD 322 billion	1990
China Investment Company Ltd.	USD 200 billion	2007.

Source: Drezner, 2010

Furthermore, within the ***OECD*** economies, Australia, Canada, New Zealand, Mexico and South Korea also have ***SWFs***. In fact, due to the sheer volume of their financial assets base, ***SWFs*** have become a major force to reckon with in the global financial markets.

NIGERIAN SOVEREIGN INVESTMENT AUTHORITY (NSIA)

Given Nigeria's dependence on oil with Petroleum exports accounting for about 80 percent of government revenue, its economy is susceptible to volatility in oil prices. Excess oil reserves were previously allocated to the Excess Crude Account (*ECA*) which was set up in 2004 as a stabilization fund to meet the country's yearly budget deficits and to contribute to the development of local infrastructure. Because the Excess Crude Account had no backing of the National Assembly, it was largely seen as an administrative arrangement without any clear legal or statutory framework. Its operation was arbitrary to the extent that claims and counterclaims on the account by the different tiers of government became a source of conflict. The establishment of the ***NSWF*** was therefore intended to address the drawbacks of the Excess Crude Account. It followed the signing into law of the

Nigerian Sovereign Investment Authority (*NSIA*) bill by the President in May 2011.

The *NSIA* commenced operations in October 2012 with an initial allocation of US$1 billion in seed capital. The Sovereign Wealth Fund (*SWF*) received a boost in February 2004 with the injection of an additional US$550 million by the federal government in a bid to strengthen its financial base thereby making it the third largest *SWF* in sub-Saharan Africa, after Botswana's US$6.9billion and Angola's US$5billion funds. The vision of the *NSIA* is 'to establish *NSIA* as a leading sovereign wealth fund globally playing a role in promoting Nigeria's economic development' while its mission is 'to play a leading role in driving sustained economic development for the benefit of all Nigerians through building a savings base for the Nigerian people, enhancing the development of Nigeria's infrastructure and providing stabilization support in times of economic stress.

In keeping with the vision and mission, the *NSIA* subscribed to the Santiago Principles which are a set of 24 guidelines that assign "best practices" for the operations of Sovereign Wealth Funds globally. The principles were proposed in 2008 through a joint effort between the International Monetary Fund (*IMF*) and the "International Working Group of Sovereign Wealth Funds". The principles have four key objectives and the *NSIA* act was drafted with these in view: (1) to help maintain a stable global financial system and free flow of capital and investment; (2) to invest on the basis of economic and financial risk and return-related considerations; (3) to comply with all applicable regulatory and disclosure requirements in the countries in which they invest; and (4) transparent & sound governance structure providing for operational controls and risk management and accountability.

THREE FUNDS MANDATE

The Nigerian Sovereign Wealth Fund is composed of three distinct funds or windows each with specific investment and development objectives namely:

Future Generations Fund

The purpose of the Future Generations Fund (*FGF*) is to preserve and grow the value of assets transferred into it – by investing in a diversified portfolio of appropriate growth investments – in order to provide future generations of Nigerians with a solid savings base for such a time as the country's hydrocarbon reserves are depleted.

Nigeria Infrastructure Fund

The Nigeria Infrastructure Fund (*NIF*) aims to invest in domestic infrastructure projects that meet targeted financial returns and contribute to the development of essential infrastructure in order to stimulate the growth and diversification of the Nigerian economy, attract foreign investment and create jobs for Nigerians. Potential areas for investments include healthcare, transportation, energy and power, water resources and agriculture, amongst others. The Authority may invest up to a maximum of 10% of the funds in *NIF* in social infrastructure projects, which promote economic development in underserved sectors or regions in the country.

Stabilization Fund

The Stabilisation Fund (*SF*) is intended to act as a buffer against short-term macro-economic instability. The *SF's* assets are therefore to be invested conservatively, striking a balance between generating a modest positive return and preserving capital in nominal terms. Given the unpredictable and short-term nature of the Fund's potential liabilities, immediate liquidity is also required. Withdrawals from the *SF* will be made at the direction of the Minister of Finance, upon satisfaction of the criteria set out in the *NSIA* Act.

In line with the provisions setting up the Nigerian Sovereign Investment Authority (*NSIA*), the *NSIA* is supervised by a Governing Council having no direct fund management responsibility. The Council consists of the president, the 36 state governors, the finance minister, attorney general, national planning minister, the Central Bank of Nigeria (*CBN*) governor and the chief economic adviser to the president. In addition, four private

sector representatives, two civil society representatives, two youth representatives and four academics sit on the Council.

The management board consists of nine directors identified by an independent committee made up of the finance minister and "distinguished, professional" Nigerians. By implication therefore, the ***NSIA*** is subject to two levels of governance, first and principally by a board of directors made up of experienced investment management professionals and second by a Governing Council with oversight responsibility. It has the power to invest in, purchase, maintain and sell assets and investments of any kind and open branches in Nigeria and abroad to achieve its objectives.

It is pertinent to note that within a very short time of existence, the ***NSIA*** is now rated second globally by Linaburg-Maduell transparency index administered by Sovereign Wealth Institute. The ***NSIA*** which was ranked alongside sovereign wealth funds from the ***USA***, France, South Korea, Brazil, and Malaysia is the only African sovereign wealth fund so ranked. More significantly, the improved transparency ranking was due to ***NSIA's*** commitment and adherence to the highest prescription of Santiago Principles with respect to corporate governance, investment strategy, disclosures and SWF best practices.

BENEFITS OF NIGERIAN SOVEREIGN WEALTH FUND

Because Nigeria derives a significant proportion of its foreign exchange earnings from crude oil sales, it is sensible to view the benefits of the fund through the prism of the three components of the ***NSWF*** namely: the Future Generation Fund, the Stabilization Fund and the Nigerian Infrastructure Fund. The future generation fund is expected to build an intergenerational savings based on investing in longer-term assets that would generate returns to the accumulated wealth for future generations of Nigerians.

Nigeria's heavy dependence on crude oil revenue for the funding of annual budgets and development plans exposes the economy to the vagaries of the international oil market. The economic stabilization fund is intended to shield the Nigerian

economy from the volatile nature of international crude oil prices as well as the uncertainties associated with daily crude output production. Aside shielding the country from crude oil price shocks, the stabilization Fund would help to protect annual national budgets by providing a stable, last resort source of financing during periods of fiscal deficit from a sustained fall in oil process.

The Infrastructure Fund which is expected to be the largest of the three is of vital importance to the overall development efforts of governments at all levels. For a country with dilapidated infrastructure, the Fund would provide financing for critical national infrastructure- power, roads, railways, housing etc. By so doing, the country would be utilizing the fund to finance the Vision 20:2020. Indeed, the establishment of the *NSWF* provides Nigeria with the opportunity to transform its economy. It has the potential of encouraging transparency and accountability in the management of the country's financial resources, strengthening fiscal framework and positioning the country to receive positive rating from global ratings agency which will act as a catalyst for both local and international investors. The resultant favourable investment climate will most likely attract other sovereign wealth funds to the country paving the way for the much-needed diversification of the Nigerian economy.

SUMMARY

The establishment of the *NSWF* followed the signing into law of the Nigerian Sovereign Investment Authority (*NSIA*) bill by the President in May 2011 and was intended to address the drawbacks of the Excess Crude Account. The benefits of the Fund can be seen in the light of the three components of the *NSWF* namely: the Future Generation Fund, the Stabilization Fund and the Nigerian Infrastructure Fund.

REVIEW QUESTIONS

1. 'The Nigerian Sovereign Wealth Fund is composed of three distinct funds or windows each with specific investment and development objectives'. State clearly the objectives of each of the funds.

2. What are the possible benefits of the Nigerian Sovereign Wealth Fund?

3. How would you justify the establishment of a Sovereign Wealth Fund for Nigeria?

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CHAPTER 25

MULTILATERAL DEVELOPMENT INSTITUTIONS

INTRODUCTION

As a member of international financial institutions, Nigeria has benefitted from development funds provided by Multilateral Institutions on more favourable terms than world financial markets typically provide. These institutions include the International Bank for Reconstruction and Development (*IBRD*), the International Monetary Fund (*IMF*), the International Development Association, the International Finance Corporation, Multilateral Investment Guarantee Agency (*MIGA*) and the African Development Bank. This chapter examines the roles of these institutions in the Nigerian financial system.

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (IBRD)

The International Bank for Reconstruction and Development (*IBRD*) is the first of five member institutions which compose the World Bank Group with its headquarter in Washington, D.C., United States. It was established in 1944 with the mission of financing the reconstruction of European nations devastated by World War II. Together, the International Bank for Reconstruction and Development and its concessional lending arm, the International Development Association, are collectively known as the World Bank as they share the same leadership and staff. Following the reconstruction of Europe, the Bank's mandate expanded to advancing worldwide economic development and eradicating poverty.

The ***IBRD*** is owned by 188 member countries which contribute to its capital, vote on matters of policy, and approve all of its activities. Each member state is a shareholder and the percentage of ownership share is determined by the size of its economy and the amount of capital contributed to support the Bank's borrowing activities among international capital markets. The United States of America is the ***IBRD's*** single largest shareholder and possesses exclusively the power to veto changes to the structure of the Bank. Although members contribute capital to the ***IBRD***, the Bank acquires funds primarily by borrowing on international capital markets by issuing bonds.

Services rendered by the IBRD

The ***IBRD*** provides concessional financing to its member countries to fund projects that seek to improve transportation and infrastructure, education, domestic policy, environmental consciousness, energy investments, healthcare, access to food and potable water, and access to improved sanitation. It also provides strategic coordination and information services to its borrowing member countries. The Bank only finances sovereign governments directly, or projects backed by sovereign governments. It offers flexible loans with maturities as long as 30 years and custom-tailored repayment scheduling. The ***IBRD*** also offers loans in local currencies. Specifically, the ***IBRD***:

1. Supports long-term human and social development needs that private creditors do not finance.

2. Preserves borrowers' financial strength by providing support in crisis periods, which is when poor people are most adversely affected.

3. Uses the leverage of financing to promote key policy and institutional reforms (such as safety net or anticorruption reforms);

4. Creates a favourable investment climate in order to catalyze the provision of private capital.

5. Provides financial support (in the form of grants made available from the ***IBRD's*** net income) in areas that are critical to the well-being of poor people in all countries.

Governance

The ***IBRD*** is governed by the World Bank's Board of Governors which meets annually and consists of one governor per member country (most often the country's finance minister or treasury secretary). The Board of Governors delegates most of its authority over daily matters such as lending and operations to the Board of Directors. The Board of Directors consists of 25 executive directors and is chaired by the President of the World Bank Group. The executive directors collectively represent all 188 member states of the World Bank. The president oversees the ***IBRD's*** overall direction and daily operations. As of July 2014, Jim Yong Kim serves as the President of the World Bank Group.

INTERNATIONAL MONETARY FUND (*IMF*)

The International Monetary Fund was initiated in 1944 at the Bretton Woods Conference and formally created in 1945 by 29 member countries. The ***IMF's*** stated goal was to assist in the reconstruction of the world's international payment system post–World War II. Its headquarters are in Washington, D.C., United States of America. The objectives of the ***IMF*** include to:

1. Promote international monetary co-operation.

2. Establish a code of conduct in international payment practices.

3. Provide financial resources to member countries to enable them support the foreign exchange value of their

currencies during temporary balance of payments difficulties.

4. Provide for the orderly growth of international liquidity through the Special Drawing Rights scheme (***SDR***).

Governance

Membership of the Fund consists of all the member countries of the World Bank. The Fund is run by a Board of Governors made up of the Finance Ministers or Central Bank Governors of the member countries. The Board normally meets once a year and is responsible for electing or appointing executive directors to the Executive Board. Twenty four Executive Directors make up the Executive Board. The Executive Directors represent all 188 member-countries in a geographically-based roaster. Countries with large economies have their own Executive Director, but most countries are grouped in constituencies representing four or more countries.

The ***IMF*** is led by a managing director, who is head of the staff and serves as Chairman of the Executive Board. The managing director is assisted by a First Deputy managing director and three other Deputy Managing Directors. Historically the ***IMF's*** managing director has been European and the president of the World Bank has been from the United States. But in 2011, the ***BRIC*** countries (Brazil, Russia, Indonesia and China), issued a statement declaring that the tradition of appointing a European as managing director undermined the legitimacy of the ***IMF*** and called for the appointment to be merit-based.

Table 25.1 below is a list of the Managing Directors of the ***IMF*** since it was established in 1946.

Dates	Name	Nationality
6 May 1946 – 5 May 1951	Camille Gutt	Belgium
3 Aug 1951 – 3 Oct 1956	Ivar Rooth	Sweden
21 Nov 1956 – 5 May 1963	Per Jacobsson	Sweden
1 Sept 1963 – 31 Aug 1973	Pierre-Paul Schweitzer	France
1 Sept 1973 – 18 June 1978	Johan Witteveen	Netherlands
18 June 1978 – 15 Jan 1987	Jacques de Larosière	France
16 Jan 1987 – 14 Feb 2000	Michel Camdessus	France
1 May 2000 – 4 March 2004	Horst Köhler	Germany
7 June 2004 – 31 Oct 2007	Rodrigo Rato	Spain
1 Nov 2007 – 18 May 2011	Dominique Strauss-Kahn	France
5 July 2011 – date	Christine Lagarde	France

Source: IMF

On 28 June 2011, Christine Lagarde was named managing director of the ***IMF***, replacing Dominique Strauss-Kahn.

Services rendered by the IMF

As spelt out in its objectives, the ***IMF*** is responsible for the creation and maintenance of the international monetary system, the system by which international payments among countries take place. It thus strives to provide a systematic mechanism for foreign exchange transactions in order to foster investment and promote balanced global economic trade. To achieve this, it focuses and

advises on the macroeconomic policies of a country which affect its exchange rate and its government's budget, money and credit management. The ***IMF*** also appraises a country's financial sector and its regulatory policies, as well as structural policies within the macro-economy that relate to the labor market and employment. In addition, as a Fund, it may offer financial assistance to nations in need of correcting balance of payments discrepancies.

Funding

Subscriptions to its capital stock are based on each member's quota in the ***IMF***, which is designed to reflect the country's relative economic strength especially in such areas as the volume of a country's international trade, fluctuations in its balance of payments and the level of its international reserves. From the pool of currencies the ***IMF*** lends to countries in balance of payments difficulties. The size of the quota determines the extent to which a country can draw currencies from the pool held by the ***IMF*** for purposes of settling its international debts.

Twenty-five percent of each country's quota is paid in the form of Special Drawing Rights (***SDRs***), which are a claim on the freely usable currencies of ***IMF*** members. Each member country is assigned a certain amount of ***SDRs*** based on how much the country contributes to the Fund. Before ***SDRs***, the Bretton Woods system had been based on a fixed exchange rate, and it was feared that there would not be enough reserves to finance global economic growth. Therefore, in 1968, the ***IMF*** created the ***SDRs***, which are a kind of international reserve asset. They were created to supplement the international reserves of the time, which were gold and the U.S. dollar. The ***SDR*** is not a currency; it is a unit of account by which member states can exchange with one another in order to settle international accounts. The ***SDR*** can also be used in exchange for other freely-traded currencies of ***IMF*** members. A country may do this when it has a deficit and needs more foreign currency to pay its international obligations.

Benefits

The ***IMF*** offers its assistance in the form of surveillance, which it conducts on a yearly basis for individual countries, regions and the global economy as a whole. However, a country may ask for financial assistance if it finds itself in an economic crisis, whether caused by a sudden shock to its economy or poor macroeconomic planning. A financial crisis will result in severe devaluation of the country's currency or a major depletion of the nation's foreign reserves. In return for the ***IMF's*** help, a country is usually required to embark on an ***IMF***-monitored economic reform program, otherwise known as Structural Adjustment Policies (***SAPs***). This was the experience of Nigeria in 1986 when it was compelled to embark on ***SAP*** in return for a loan from the ***IMF***.

Conditionality of loans

The ***IMF*** is not an aid agency, so all loans are given based on ***IMF*** conditionality which is a set of conditions that the ***IMF*** requires in exchange for financial resources. The ***IMF*** does not require collateral from countries for loans but rather requires the government seeking assistance to correct its macroeconomic imbalances in the form of policy reform. If the conditions are not met, the funds are withheld.(http://en.wikipedia.org/wiki/International_Monetary_Fund-cite_note-Jensen_2004.2C_April.2C_Issue_48-8) Some of the conditions for structural adjustment can include:

1. Cutting expenditures, also known as austerity
2. Focusing economic output on direct export and resource extraction
3. Devaluation of currencies
4. Trade liberalization, or lifting import and export restrictions

5. Increasing the stability of investment (by supplementing foreign direct investment with the opening of domestic stock markets)

6. Balancing budgets and not overspending

7. Removing price controls and state subsidies

8. Privatization, or divestiture of all or part of state-owned enterprises

9. Enhancing the rights of foreign investors vis-a-vis national laws

10. Improving governance and fighting corruption.

These conditions have also been sometimes labelled as the Washington Consensus.

INTERNATIONAL DEVELOPMENT ASSOCIATION (IDA)

The International Development Association (***IDA***) is an affiliate of the World Bank and was established in 1960. The World Bank had become aware of the urgent need for an institution that could provide development finance on terms more lenient and bearing less heavily on the balance of payments of developing countries than its own loans.

Membership in the ***IDA*** is open to all members of the World Bank. The funds used by the ***IDA*** - usually called 'Credits' - come mostly in the form of subscriptions, general replenishments from the ***IDA's*** more industrialized members and special contributions and transfers from the net earnings of the World Bank. The terms of ***IDA*** credits, which are made to governments only, are a 10-year grace period, 50 year maturities and no interest. However, an annual service fee or 0.75% is charged on the disbursed portion of each credit.

INTERNATIONAL FINANCE CORPORATION (IFC)

The International Finance Corporation (*IFC*), established in 1956, is the member of the World Bank group that encourages the growth of productive private enterprise in developing countries. Membership of the *IFC* is open to all governments which are members of the World Bank. The purpose of the *IFC* is to further economic development in its less developed member countries by investing directly in private enterprises in association with private investors. *IFC* assistance goes mainly to the private sector and in Nigeria, for instance, it has invested in the Arewa Textile Mill, Kaduna and the defunct Nigerian Industrial Development Bank (*NIDB*).

MULTILATERAL INVESTMENT GURANTEE AGENCY (MIGA)

The Multilateral Investment Guarantee Agency (*MIGA*) is an organization established in 1988 by the World Bank and based in Washington, D.C. The goal of Multilateral Investment Guarantee Agency (*MIGA*) is to promote investment in developing countries. The organization offers a variety of services in order to encourage foreign direct investment, including risk insurance against foreign exchange restrictions, outbreak of conflicts or wars. In addition to providing political risk insurance to corporations that want to invest in developing countries, *MIGA* offers advisory services to developing country governments. The organization advises on the policies and procedures these governments should follow and the best ways these countries can attract foreign investment. Other services by the *MIGA* include licensing arrangements, franchising and technology support.

AFRICAN DEVELOPMENT BANK (A_fDB)

The African Development Bank (*AfDB*) was established on August 4, 1963 in Khartoum, Sudan, by the then 23 newly independent African countries. The Bank began effective operations at its headquarters in Abidjan, Ivory Coast in July 1966 with

representative offices in London and Nairobi. Its major objective is to spur sustainable economic development and social progress in its regional member countries (***RMCs***), thus contributing to poverty reduction.

Membership of the ***AfDB*** Group, as of 2013, includes 53 independent African countries (regional members) and 25 non-African countries (non-regional members). Apart from capital subscriptions by member countries, other sources of Bank Group resources include borrowings from the international financial markets, as well as from incomes generated from loans.

Functions

The main functions of the Bank are:

1. To use the resources at its disposal to finance projects and specific investment programmes which enhance the economic and social development of its member countries. Priority is given as much as possible to projects and programmes which foster regional cooperation and integrated development within the member countries, especially those designed to make the economies of its members increasingly complementary, and to bring about an orderly expansion of their foreign trade.

2. To undertake or participate in the selection, study and preparation of projects, enterprises and activities contributing to such development.
3. To mobilise and increase in Africa, and outside Africa, resources for the financing of such investment projects and programmes.

4. To promote investment in Africa, of public and private capital, in projects or programmes designed to contribute to the economic development or social progress of its members.

5. To provide such technical assistance as may be needed in Africa for the study, preparation, financing and execution of development projects or programmes.

6. To undertake such other activities and provide such other services as may advance its purpose.

In addition to governments, other enterprises can also obtain loans from the bank provided their government guarantees the loan. The bank grants lines of credit to national and sub-regional development banks for on-lending in their respective countries. The bank may operate independently or jointly with other finance institutions. Under Article 8 of the Agreement establishing the ***AfDB,*** the Bank is authorized to establish or be entrusted with administering and managing special funds which are consistent with its purposes and functions. In line with this provision, the African Development Fund (***ADF***) was established with non-African states in 1972 and the Nigeria Trust Fund (***NTF***) with the Nigeria Government in 1976.

African Development Fund (ADF)

The African Development Fund (***ADF***) is the concessional window of the African Development Bank (***AfDB***) Group. Established in 1972, it became operational in 1974. Administered by the African Development Bank, it comprises 27 contributing countries and benefits 40 countries. The African Development Fund emerged as the solution to two major constraints which became apparent after the African Development Bank had commenced operations in 1974 namely the limited amount of resources which the Bank could provide and secondly the nature as well as the terms of the loans, which were not fully appropriate for the poorest of its member countries, especially for projects with long-term durations or non-financial returns

The ***ADF*** contributes to poverty reduction and economic and social development in the least developed African countries by providing concessional funding for projects and programs, as well

as technical assistance for studies and capacity-building activities. The Fund's resources consist of contributions from internal Bank resources and periodic replenishments by donor countries, usually on a three-year basis. The Board of Governors is the Fund's highest policy-making organ while the ***ADF*** Board of Directors oversees the Fund's general operations. It is composed of 14 Executive Directors; seven from donor countries (nominated by their constituencies) and seven Executive Directors representing the ***ADB***.

Nigerian Trust Fund (NTF)

The Nigeria Trust Fund (***NTF***) was created in 1976 by agreement between the Bank Group and the Nigerian government. The ***NTF*** is a self-sustaining revolving fund. Its objective is to assist the development efforts of the Bank's low-income regional member countries whose economic and social conditions and prospects require concessional financing. The ***NTF*** only provides concessional loans. Only low income countries are eligible to loans. ***NTF*** resources are allocated to projects, and not to countries (unlike the African Development Fund). Proposals concerning the poorest ***ADF*** countries, countries with small ***ADF*** allocations, and fragile states are particularly encouraged. A call for proposal is launched annually in October. ***NTF*** resources can be used for:

a) Concessional loan operations with long-term maturity, to which the following financial terms apply: no interest charges; a service charge of 0.75 percent per annum on outstanding balances; a commitment fee of 0.5 percent per annum on un-disbursed commitments; and a 20-year repayment period with a 7-year grace period (i.e. a total of 27 years repayment period).

b) Concessional loan operations with short-term maturity, to which the following financial terms apply: no interest charges; a service charge of 0.75 percent per annum on outstanding balances; a commitment fee of 0.5 percent per

annum on un-disbursed commitments; and a 15-year repayment period with a 5-year grace period (i.e.: a total 20-year repayment period).

c) Private sector operations. The financial terms are the same as the ***AfDB*** private sector window, taking into consideration the provisions of the Bank Group's policies and guidelines for private sector financing as well as the risk analysis of the project.

The ***AfDB*** has also been instrumental in the establishment and promotion of other African development institutions such as Africa Re-insurance Corporation, Shelter Afrique, Association of African Development Finance Institutions (***AADFI***), Federation of African Consultants (***FECA***), the Africa Project Development Facility (***APDF***), the International Finance Company for Investments in Africa (***SIFIDA***), African Management Services Company (***AMSCO***), African Business Round Table (***ABR***), African Export-Import Bank (***AFREXIMBANK***), African Capacity Building Foundation, Joint Africa Institute, ***PTA*** Bank, the Network for Environment and Sustainable Development in Africa (***NESDA***).

The Bank has also been the lead agency for ***NEPAD*** infrastructure development, a respected guide in the development of banking and financial standards as well as the strategic partner of the African Peer Review Mechanism (***APRM***). In 2000, all multilateral development institutions agreed on a same set of objectives called the Millennium Development Goals (***MDG***) namely: (1) Eradicate extreme poverty and hunger; (2) Improve maternal health; (3) Achieve universal primary education; (4) Combat ***HIV/AIDS***, malaria and other diseases; (5) Promote gender equality and empower women; (6) Ensure environmental sustainability; (7) Reduce child mortality; and (8) Develop a global partnership for development. The ***MDGs*** timeline is the year 2015.

SUMMARY

Multilateral Development Institutions provide to their clients, including Nigeria, access to capital on favourable terms in larger volumes, with longer maturities, and in a more sustainable manner than world financial markets typically provide. These institutions include the International Bank for Reconstruction and Development (***IBRD***), the International Monetary Fund (***IMF***), the International Development Association, the International Finance Corporation, Multilateral Investment Guarantee Agency (***MIGA***) and the African Development Bank.

REVIEW QUESTIONS

Write short notes on the major functions of the following multilateral development institutions:

1. The international Bank for Reconstruction and Development
2. The International Monetary Fund
3. The African Development Bank

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World Bank Annual Reports

CHAPTER 26

GLOBAL FINANCIAL CRISIS (2007 – 2009)

INTRODUCTION

Financial crisis can be seen as a situation in which financial institutions or assets suddenly lose a large part of their value. The financial crisis of 2007 to 2009 was complex and global in spread, throwing financial markets into turmoil and resulting in unprecedented credit crunch. Indeed, there have been financial crises before this time but the one of 2007 to 2009 was unique in view of its magnitude. Also, it came at a time that globalization had made the world so highly interconnected as improvement in market efficiency through information communication technology has hugely shortened the time for transference of policies and actions from one financial market to another. A development in a foreign country could have immediate and far reaching impact on other countries due to globalization. In this chapter, we examine the major causes of the financial crisis, its effect on the Nigerian financial system as well as the response by the regulatory authorities in Nigeria.

CAUSES OF THE FINANCIAL CRISIS

The primary cause of the global financial crisis which began in 2007 could be traced to the default on sub-prime mortgage loans in the United States of America. Before the year 2007, the US government encouraged financial institutions to lend to individuals that would not have otherwise qualified for housing loans. These

loans were backed by the US federal government which resulted in cheap borrowing and an unprecedented boom in the US housing market. Home loans were granted to people with questionable ability to pay back - people with no income and no assets.

As interest rates on mortgage loans increased, the prices of houses fell. As a result, the houses were valued at less than the mortgage loans, thereby increasing the default rate on the loans. The magnitude of the repossession that followed coupled with the mortgage company's inability to renegotiate loans led to the collapse of the government backed mortgages. Owing to the wide-spread defaults, prices of houses began to fall. Banks and financial institutions repackaged these debts with other high risk debts and sold them to worldwide investors creating financial instruments called Collateralized Debt Obligations (***CDO***). Financial derivatives called Mortgage-Backed Securities (***MBS***), which derive their value from mortgage loans, spread the risk to financial institutions and investors around the world.

With regard to Nigeria, foreign investors who were already facing financial difficulties in their home countries began to sell their investments leading to dumping of stocks and other securities beyond the ability of domestic investors to contain. As a result, supply of equities overwhelmed demand thus leading to price fall. The persistent downward spiral in share prices led to panic selling of stocks among local investors leading to further drop in prices. Also, following the Central Bank of Nigeria's directive in 2005 that all banks should recapitalize to a minimum of N25billion, almost all banks utilized and accessed the Nigerian capital market to raise funds. Within two years, many of the banks besieged the capital market again to raise funds through mega offers in a single tranche. This gave room to unrealistic security prices thus overheating the capital market and creating 'price bubbles' or artificial prices which burst from the contagion effect of the global financial crisis.

In a similar vein, the avalanche of 'Private Placement offers' in the Nigerian capital market contributed to the financial crisis in Nigeria. A lot of companies did private placement of their

shares at lower prices while they sought or intended seeking quotation of their shares at higher values on the Nigerian Stock Exchange, thus making such private placements very attractive. As a result, many investors were lured to dispose their shares in the secondary market, purchase the private placements and sell same quickly after such placements were listed on the Stock Exchange at higher prices. The result was that so much liquidity was taken out from the Nigerian capital market in favour of private placements of private companies contributing to the crash of the Nigerian capital market.

Furthermore, margin loan facility granted by banks to investors and stock broking firms contributed greatly to the financial crisis in the Nigeria. Many banks left their core operation of providing credit to the real sector in favour of 'playing' the capital market for short-term speculative activities that seemed to pay off for a short while before the bubble burst in March 2008. To make matters worse, most of the banks had poorly managed risk exposures that largely concentrated on speculative lending to the downstream petroleum oil sector and stock investments. Consequently the capital market became overheated with so much speculative activities by banks as it was no longer seen as a market for long-term funds but that of a short one which negates the tenet of capital market as medium to long-term market for fundraising.

IMPACT ON THE NIGERIA'S FINANCIAL MARKETS

As earlier pointed out, the initial financial crisis had affected mainly the United States of America and Europe. With the decline in housing prices, major global financial institutions that had borrowed and invested heavily in subprime Mortgage Backed Securities (***MBS***) suffered huge losses. Big financial institutions like Fannie Mae and Freddie Mac, ***AIG***, Bear Sterne, Merrill Lynch, Citigroup, ***HBOS***, Dexia, Wachovia, Bradford & Bringley, Fortis and Hypo Real Estate were in serious financial crises.

By the first quarter of 2008, there was widespread credit contraction as financial institutions in the US and Europe tightened

their credit standards in the light of deteriorating balance sheets. The table below shows huge percentage losses recorded by major capital markets as a result of the global financial crisis:

Table 26.1 Stock markets capitalization losses, as at end-December 2008

Stock Exchange	Loss (%)
London	31.3
New York	33.84
Frankfurt	40.4
Sydney	41.3
Tokyo	42.1
Paris	42.7
Hong Kong	48.3
Singapore	49.2
Mumbai	51.9
Shanghai	65.2

Source: CBN

Initially, the Nigerian financial sector was thought to have been insulated from the global financial crisis. But not too long after the crisis manifested in the United States of America, it became evident that any development in any part of the world affects other parts as well owing to globalization. Consequently, the global financial crisis began to take its toll on the Nigerian financial market by 2008.

Before the crisis, stock prices had appreciated (although without correlation with market fundamentals) such that the Nigerian stock market capitalization rose to peak at N12.6 trillion in March, 2008. The boom led to an investment rush by all classes of society. Bank customers took loans to invest in stocks of their banks! The withdrawal of funds by the foreign investors led to the huge decline of most stock prices as supply exceeded demand. As a result of the crisis, the stock market capitalization nose-dived to less than N4.6 trillion by December 2008 while the All-Share Index (a measure of the magnitude and direction of general price

movement) declined from about 66,000 basis points to less than 22,000 points within the same period. The result was severe illiquidity in the market as many investors in quoted stocks could not convert them to cash to meet their various needs. At the same time, new investors were reluctant to embrace the market as they watched helplessly the pains of other investors.

The banking sub-sector was affected by a credit contraction as most foreign banks reduced their credit lines. So, many banks had to grapple with liquidity squeeze as well as limited foreign trade finances. The result was tightness in the balance sheet of banks and counter-party risks vis-à-vis external reserves, higher provision for loss by banks leading to reduced profitability and lending. As funds dried up, interest rate spread increased. By early February 2009, prime lending rate had risen to 18.95% from 16.08% in December 2008.

The Foreign Exchange Market (***FEM***) was not left out. According to the Central Bank of Nigeria, the ***FEM*** witnessed high outflows and low inflows of foreign exchange into the economy as a result of increased demand pressure in the foreign exchange market. This led to depreciation of the exchange rate as the naira depreciated from N117 to N135 per US dollar as at end of December 2008.

NIGERIA's RESPONSE TO STABILIZE THE FINANCIAL SECTOR

The Federal Government and other stakeholders in the financial market put in place a number of reforms to facilitate the quick recovery of the financial market following the aftermath of the financial crisis. In the banking sector, the Central Bank of Nigeria in a bid to mitigate the effects of the global financial crisis and stabilize the Nigerian banking system, introduced a reform programme anchored on four pillars: (1) enhancing the quality of Banks; (2) establishing financial stability; (3) enabling a healthy financial sector evolution; and (4) ensuring the financial sector contribution to the real Economy

In pursuit of the above targets, the Central Bank of Nigeria took the following measures:

1. Reduced the Monetary Policy Rate (***MPR***) by 50.0 basis points from 10.25 to 9.75 per cent and later to 8.0 per cent.

2. Reduced the Cash Reserve Ratio (***CRR***) from 4.0 to 2.0 per cent and Liquidity ratio from 40.0 to 30.0 per cent.

3. Expanded the discount window facility from overnight to 360 days, interest rate not exceeding 500 basis point above the ***MPR.***

4. Suspended its aggressive liquidity mop up as the monetary authority embraced relaxed monetary policy.

5. Adopted a + or -3 per cent band for exchange rate movement.

6. Suspended daily inter-bank foreign exchange market to ward off speculative attacks on the domestic currency.

In May 2009, a joint special examination by the ***CBN*** and ***NDIC*** was conducted in a bid to stabilize the financial system. The results showed that of the 24 banks in operation, 10 had substantial non-performing loans; poor corporate governance; weaknesses in capital adequacy; and illiquidity. The ***CBN*** had to inject N620 billion into the banks but not before replacing the Chief Executives/Executive Directors of the affected banks. As part of the broad resolution strategy aimed at addressing the problems of non-performing loans in the Nigerian banking industry, the Asset Management Corporation of Nigeria (AMCON) was established by an Act of the Nigerian parliament in 2010. It was created to be a key tool to revive the financial system especially the banking sector and the stock market.

In August 2011, the Nigeria Deposit Insurance Corporation (***NDIC***) in line with its powers under its enabling law, established

Enterprise Bank, Keystone Bank, and Mainstreet Bank as Bridge Banks to take over the deposit liabilities and assets of the three banks namely Bank *PHB*, Afribank and Spring Bank. The Securities and Exchange Commission and the Nigerian Stock Exchange equally took some measures to stabilize the capital market amongst which were:

1. Reduced market transaction costs by 50 percent.

2. Registered market makers to provide continuous liquidity and stabilize stock prices.

3. Introduced a Code of Conduct for Shareholders Association and market operators

4. Reviewed the 2003 Corporate Governance Code to a standard comparable to international codes to overcome observed weaknesses in corporate governance and ensure full disclosure by regulated entities.

5. Introduced annual conference for Directors of Public companies to continually update them on their responsibilities and liabilities.

6. Adopted strict enforcement of listing requirements with zero tolerance for infractions

7. Pegged the downward movement of share prices at 1 percent while upward movement remained at 5 percent.

8. De-listed moribund companies and released rules on share buy-back with limit of 15 percent.

In view of the fact that the crisis in the capital market was fueled to some extent by the absence or inadequacy of rules, the Securities and Exchange Commission made a number of new rules and

amended existing ones with a view to strengthening the protection of customers' assets in the market and improving financial reporting and governance of public companies. In addition, the government granted tax waivers on corporate and municipal bonds in a bid to increase the demand for bonds and deepen the bond market.

SUMMARY

The 2007-2009 financial crisis that began with the United States subprime mortgage crisis was truly global in the sense that it affected not only the United States of America and Europe but also many other countries including Nigeria. Although various factors have been advanced as being responsible for the crisis, the major cause was the collapse of the US sub-prime mortgage market brought about by lending to borrowers who could not afford the mortgages on the properties funded by the banks. In Nigeria, the price collapse within the market resulted in massive wealth destruction, credit contraction, impairment of banks' assets, liquidation and loss of confidence in the financial markets such that many years after, the country is yet to fully recover from the effect of the global financial crisis.

REVIEW QUESTIONS

1. What were the major causes of the global financial crisis of 2007 to 2009?

2. Discuss the factors that led to the crisis in the Nigeria's financial markets.

3. Examine the effects of the global financial crisis on the country's financial system.

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