# Nexus between the Central Bank of Nigeria's Regulatory Framework and Global Economic Crisis

**OKWOR, Ferdinard Odey**

Department of Accounting
Bingham University
Karu, Nasarawa State
E – Mail: ferd.okwor@gmail.com, Phone No: +234 802435997

**Abstract**

*This study seeks to consider the relationship between the Central Bank of Nigeria's regulatory framework and global economic crisis*, p*articularly, the extent to which the Central bank of Nigeria's policies, guidelines, procedures and directives reduced the impact of the 2007/2008 global financial crisis on the Nigerian economy was the main stay on this work. Central Bank of Nigeria's circulars and guidelines as well as the fundamental laws establishing and empowering the Central Bank of Nigeria was the main sources of information for the study. The literature review examines the twin peaks and "combined" regulatory approaches; parallels were drawn between the two. The study concludes that a regulatory framework for the financial system and the economy, as a whole, is necessitated by the plethora of factors buffeting the economy. The study recommends the full autonomy of the Central Bank of Nigeria, the formulation of a strong regulatory framework for Fintech and Cryptocurrency operations as well as the harmonization of regulatory efforts by co-regulators of the financial system in Nigeria.*

Keywords: Economic Crisis, Regulatory Framework, Financial System, Central Bank of Nigeria

## 1. INTRODUCTION

Apart from its principal objectives as encapsulated in Section 2(a-e) of the Central Bank of Nigeria Act, 2007, the Central bank of Nigeria (CBN) plays a leading role in the management of the Nigeria's economy. This is aptly encapsulated in Section 1(3) of the CBN Act. To further underscore the CBN's role in the management of the Country's economy, the Explanatory Memorandum of the CBN Act of 2007 clearly stipulates that "THIS ACT repeals the Central Bank of Nigeria Act, 1991, re-enacts a new Central Bank of Nigeria Act, 2007 and established the Central Bank of Nigeria for the promotion of sound financial system in Nigeria and to act as banks and provide economic and financial advice to the Federal Government." (Federal Republic of Nigeria Official Gazette (2007).By offering advisory services to the Federal Government of Nigeria, the Central Bank of Nigeria, is therefore one of the 'managers' of the Nigerian economy. Established by the Act of Parliament of 1958 (Central Bank of Nigeria, 2020) and subsequent amendments to the Act in 1991, 1993,1997,1998,1999 and 2007, the Central Bank of Nigeria carries out her core mandates (which includes providing financial and economic advice to the Federal Government) through various regulations, circulars, and guidelines. From its inception to date, it is safe to state that the bank contributed to guiding the Country's economy through, at least, four global economic crises (in 1975, 1982, 1991 and 2009). This paper therefore examineshow the central bank's regulatory framework slows down or minimizes the impact of global economic crises on the Nigerian economy.

## 2. LITERATURE REVIEW

### 2.1 Conceptual Framework

#### 2.1.1 Concept of Regulatory Framework

Regulatory framework generally refers to laws, regulations, decisions, directives, policies, guidelines, recommendations and procedures formulated (including any revisions or amendments made to them) and approved by an agency or a regulating body. The regulatory framework in the financial system of the economy in Nigeria is anchored on various legal instruments as well as subsidiary legislations.These laws which have metamorphosed over time include (but not limited to) the Central Bank of Nigeria (CBN) Act, 2007, the Banks and Other Financial Institutions Act (BOFIA) 1999 (as amended), the Nigeria Deposit Insurance Corporation Act, 2006, the Securities and Investment Act, 2007, the Financial Reporting Council Act 2011, the Insurance

Commission Act 2003, the National Insurance Commission Act 1997, the Pension Reform Act 2014 and the Companies and Allied Matters Act 1990. These laws confer some degree of regulatory authority on the Central Bank of Nigeria (CBN), the Nigeria Deposit Insurance Commission (NDIC), the Securities and Exchange Commission (SEC), the Financial Reporting Council (FRC), the National Insurance Commission (NAICOM), the National Pension Commission (Pencom) and the Corporate Affairs Commission (CAC). Recognizing the challenge posed by the multiplicity of regulators in the Nigerian financial system of the economy, Section 43 of the CBN Act 2007 established the Financial Services Regulation Coordination Committee (FSRCC) "*To proactively promote a sound financial system in Nigeria through effective inter-agency collaboration*" (FRSCC). Members of the Committee include the CBN, NDIC, SEC, NAICOM, Pencom, CAC and the Federal Ministry of Finance with the Abuja Stock and Commodity Exchange and the Nigerian Stock Exchange being members in observing capacity (FRSCC).

Although each of the aforementioned agencies of government performs some form of regulatory and supervisory functions with respect to the financial system in particular and the economy as a whole, the Central Bank of Nigeria (CBN) is saddled with the primary function of regulating the financial system through the CBN Act 2007 and BOFIA 2007 (NDIC, 2007 and CBN, 2007). The CBN which was established by the 1958 Act of Parliament is charged "with the overall control and administration of the monetary and financial sector policies of the Federal Government" through the CBN Act 2007 and with "the responsibility of administering banks and other financial Institutions with the sole aim of ensuring high standards of banking practice and financial stability through surveillance activities, as well as promotion of an efficient payment system (CBN, 2007). To be able to dutifully and thoroughly discharge her statutory responsibilities (under the CBN Act), which include inter alia ensuring monetary and price stability; issuing legal tender currency in Nigeria; maintaining external reserves to safeguard the international value of the legal tender currency; promoting a sound financial system in Nigeria and acting as banker and provide economic and financial advice to the Federal Government as well as those in the Banks and Other Financial Institutions Acts, 2007 as amended, the CBN, from time to time develops various regulatory frameworks.

### 2.1.2 Concept of Economic Crisis

Economic crisis refers to a sharp decline in the economic state of a country or countries, manifested in a significant decrease in production; disruption of existing production relations; bankruptcy of enterprises; and rising unemployment. The result of economic crisis is a decline in the living standards of the population and a decrease in the real gross national product (Erokhin & Gao, 2019). It is a phase characterized by marked deficiency in production, marketing and consumption of goods and services and because the sudden downturn in the economic fortunes at such a period is brought on by a financial crisis, economic crisis is variously referred to as economic recession or even financial crisis. Essentially, economic crisis manifests in wild fluctuations, beyond the tolerable curbs of change, in the prices or supplies in any markets of commodity or services, or factors of production.

### 2.1.3 Concept of Financial System

Financial system comprises all financial agents that function in the financial sector in an economy. The system is hinged on the principle that economic actors are classified into surplus and deficit spending units. The surplus spending units are persons or organizations with surplus funds above their current requirements. On the other hand, the deficit spending units are those that have shortage of funds and so need to borrow to fund their activities. The financial system provides an enabling ecosystem for economic growth and development, productive activity, financial intermediation, capital formation and management of the payments system. With intermediation, savers lend to intermediaries, who in turn lend firms and other fund using units. 'The saver holds claim against the intermediaries, in form of deposits rather than against the firm. These institutions provide a useful service by reducing the cost to individuals, of negotiating transactions, providing information, achieving diversification and attaining liquidity' (Central Bank of Nigeria, 2017). The Central bank of Nigeria (2017) opines that the Nigerian financial system consists of the formal sector (bank and non-bank financial institutions) and the informal sector (savings and loan association, local money lenders, etc.).

### 2.2 Empirical Clarifications

Economic crises are not new to man. Writing in the Business Insider in 2016, Bryan Taylor dug up factors leading to the financial panic and eventual economic crisis in the first century under the reign of Emperor Tiberius in the Roman Empire in AD 33. Skrabec (2016) listed piles of economic crises ranging from the crisis of the 3rd century (AD 235–284), the 14th century banking crisis in 1345, the general crises of 1640 up to the 2007/2009 financial crisis. In terms of their global impacts, Bondarenko (2015) highlighted the five economic crises that rocked the globe. First among these five is the Credit Crisis of 1772 which originated in London and quickly spread to the rest of Europe. The British Empire had accumulated an enormous amount of wealth through its colonial possessions and trade thus creating an aura of over-optimism and a period of rapid credit expansion by many British banks. The ensuing hype ending in bank run and eventual credit crises that spiraled across the globe, at the time. It is claimed that the economic consequences of this crisis were one of the major contributing factors to the Boston Tea Party protests and the American Revolution (Bondarenko, 2015).Next was the Great Depression of 1929–39 which is reputed to be the worst financial and economic catastrophe of the 20th century. This is understood to have been sparked by the Wall Street crash of 1929 and worsened by the poor policy decisions of the U.S. government. The crisis lasted almost ten years and resulted in massive loss of income, output and jobs in the industrialized world. At the peak of the crisis in 1933, the unemployment rate in the United States was at a record 25 per cent. Also, in retaliation to the United States supplies of arms and ammunition to Israel during the Fourth Arab–Israeli War, member countries of the Organisation of Petroleum Exporting Countries (OPEC) boycotted oil supplies to the United States and her allies leading to acute energy and inflation crises in 1973.There was also the Asian Crisis of 1997 which started in Thailand and snowballed into a toxic menace among the Asian tigers. The last of the five economic crises is the 2007/2008 which started in the United States of America.

### 2.3 Theoretical Framework

#### 2.3.1 Regulatory Framework Theory

There are basically three main objectives of central bank's regulatory framework namely; to maintain confidence in the financial system; to contribute to the protection and enhancement of stability of the financial system and; to secure the appropriate degree of protection for consumers (Llewellyn, 2006). Although a number of regulators are involved in the financial space in Nigeria, the Central Bank of Nigeria is the principal regulator of the system working to ensure both the stability of the financial system and the protection and promotion of consumers' interest and confidence in the system, respectively. What obtains in the United Kingdom and other climes is however different. The regulatory model in the UK is the 'Twin Peaks' model where the role of prudential regulation is handled by one regulator and that of conduct of business is handled by another (Financial Times, 2013). The twin peak model which was pioneered in Australia in 1998 is also practiced in the Netherlands and in our neighboring South Africa. While the prudential regulation is located outside the Central Bank in Australia, it is located in the Central Bank in the Netherland. This is similar to the Bank of England's (BoE) approach. To enhance the absorbency capacity of the financial system in the event of any shock, the United Kingdomabandoned the tripartite model of regulation which involved the Bank of England, the Treasury and the Financial Services Authority in 2013 (BoE, 2016) and instead, adopted the twin peak model. Essentially, the model segregates the prudential regulation responsibility from the conduct of business responsibility and placed the former under the BoE's Prudential Authority and the later under the Financial Conduct Authority.

The Nigerian approach basically houses both the prudential regulation and conduct of business in the CBN.This approach ensures consistency in regulation as there is no confusion between the old regulation regime and the new. Secondly, it is less costly because there is no duplication of operating and administrative costs. Another advantage with the Nigerian approach is that there is no confusion as to who does what, when and how? Since the CBN is saddled with both the prudential and conduct of business regulation and supervision. A major disadvantage of this approach is that the CBN could be over-worked thereby causing ineffectiveness and efficiency. In conclusion, there is no single approach that fits all situations and so each country must identify that which suits her circumstance and environment. Dr. Michael Taylor, one of the earliest proponents of the twin peaks approach for the United Kingdom (UK) captures this more succinctly when he said that the approach suits the UK because the UK's financial sector is not dominated by banks alone and that in the UK, there is "highly developed consumer protection framework" (Michael, 2014). Essentially, the primary regulatory framework on which the fulcrum of the CBN revolves are the CBN Act, 2007 (as amended) as well as the Banks and other Financial Institutions Acts, 1999 (as amended). Both legal instruments empower the CBN to roll-out subsidiary legislations (as it deems suitable) for the regulation of the financial system (CBN Act, Section 33). The CBN therefore latches on these statutory provisions to issue guidelines, regulations, decisions, directives, policies, recommendations and procedures for the smooth operation of the financial and economic systems. These subsidiary legislations and the laws (CBN Act and BOFIA) are considered to be the crux of the CBN's regulatory framework in this study. The primary targets of the CBN regulatory framework are the Deposit Money Banks, Development Banks (Bank of Industry, Nexim Bank, Bank of Agriculture, Microfinance banks, Development Bank of Nigeria), Designated Non-Financial Institutions (lenders such as cooperatives, etcetera) and Bureau De Change.

## 3. METHODOLOGY

This study adopted the exploratory assessment approach by examining previous works done on the subject-matter. The method attempted to x-ray the role of the CBN as enshrined in its establishment Act, Impact of global economic crises on the Nigerian economy, CBN's response to the 2007/2008 global financial crises, and how the CBN's regulatory framework shields the Nigerian economy from the pans of global economic crises.

## 4. RESULT AND DISCUSSION

While comparing the 2007/08 global financial crises with previous ones, Stephanou (2009) described it as "… deeper and wider, reflecting the growth in financial penetration and globalization in recent decades". This underscores the urgency with which the Central bank of Nigeria responded to the crisis. According to Sulodo (2009), commodity prices collapse, revenue contraction, diminishing capital inflows into the Nigerian economy, pressure on the exchange rate because of de-accumulation of foreign reserves and capital market downturn were the impact by the financial crises. Adeniran & Sidiq (2018) listed the following as the effects of the global economic crisis on the Nigerian economy

i. High interest rates: This reduces the liquidity or theamount of money available to invest.
ii. Increased inflation: The crisis also led to persistent rise in prices of goods andservices in the country leading to decrease in the worth of goods and servicesthat could be purchased with same amount of money.
iii. Reduced consumer confidence: Believing that the economy is bad, the consuming public held back and mimimized spending thus complicated the economic situation (Adeniran & Sidiq; 2018).

Globalization and modern information and communication technology mean that no country is self-sufficient on its own. The import of this is that when one country sneezes, another, if not many others, catch cold. In the height of the 2007/2008 crisis, the Federal Government set up the Presidential Committee on Global Economic Crisis in January 2009 and the Presidential Advisory Team on Capital Market Set-up in August 2008 to advise on the way out of the crisis. Also, the Securities and Exchange Commission released various guidelines bordering on the capital market operations and the Nigeria Stock Exchange de-listed 19 moribund companies (Soludo, 2009 and Kama, 2010). The CBN's immediate reaction was to reduce the Monetary Policy Ratio (MPR) by 5%, reduced Cash Reserve Requirement (CRR) by 2%, reduced liquidity ratio by 10%, directed all banks to restructure margin loans (optional directive), expanded lending facilities to banks up to 360 days, introduced expanded discount window facility and stopped liquidity mopping-up (Soludo, 2009 and Kama, 2010).

To further determine the extent of the shock on the economy (financial system, specifically), the CBN and the National Deposit Insurance Corporation undertook a joint examination of 24 commercial banks in May 2009. The joint exercise revealed that 10 of the banks exhibited the following signs: substantial non-performing loans, capital inadequacy, illiquidity and weak corporate governance (Kama, 2010). The CBN thus took the following drastic steps to restore public trust and strengthen the financial system:

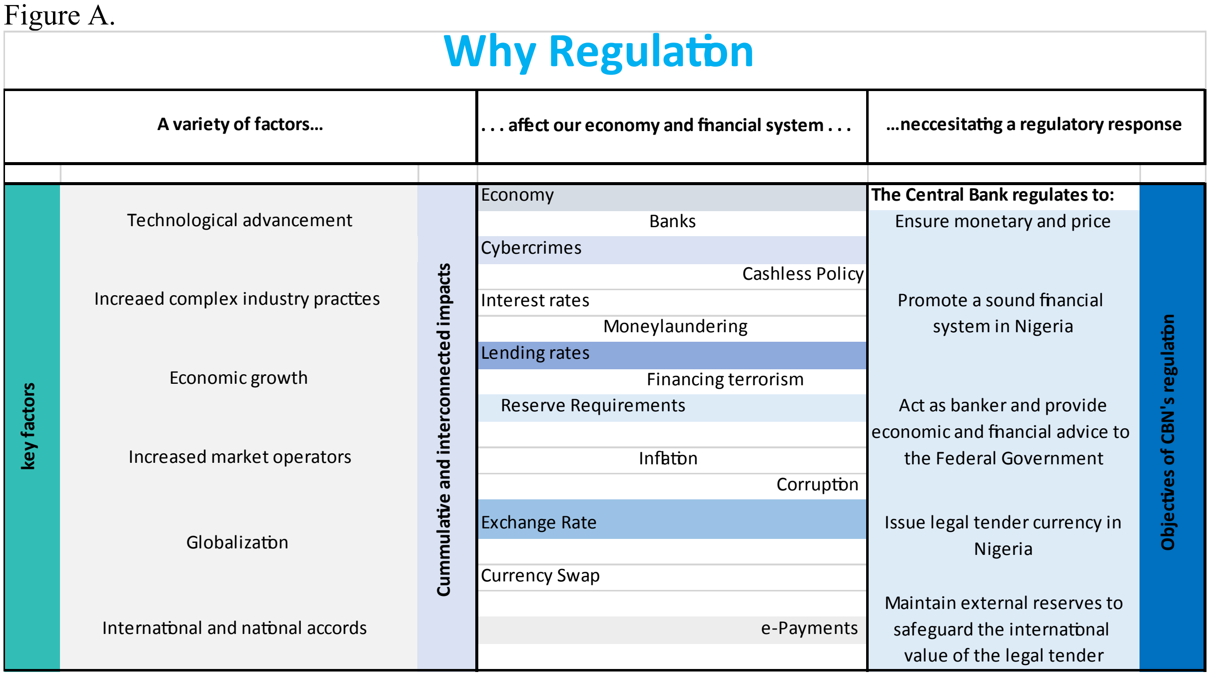
- The CEO and Executive Directors of the 10 banks were immediately replaced
- Injection of 620 billion naira into the banking system to avoid systemic crisis
- Creation of Assets Management Corporation of Nigeria (AMCON) to soak up toxic assets of the 10 banks
- Provision of 200 billion naira for SME financing
- Strengthening the Financial Services Regulation Coordination Committee (FSRCC) and
- Established the Consumer and Financial Protection division to address consumers' complaints (Kama, 2010).

On the whole, the CBN's response to the 2007/2008 global financial crises was applauded as laudable and far-reaching as it averted the impact of the contagion that drove many developed economies under (Soludo, 2009). As dutiful as the CBN appears to be, there are noticeable lacunas in her regulatory framework with dire impacts on the Nigerian economy. Firstly, although Section 1(3) of the establishing Act underlines its independence, the bank still operates under the firm grip of the President as well as that of the Minister of Finance. Specifically, Section 11(f) of the CBN Act empowers the President to sack the CBN Governor without cause. This is a clear invitation for undue political interference. Secondly, the bank (CBN) does not seem to be capable of reacting well on time to the ever-evolving economic and financial landscape in which it operates. For instance, the bank has not been able to bring out a tangible regulatory framework for the fintech companies. FinancialTechnology simply refers to as Fintech denotes new innovation that disrupts traditional ways of conducting financial transactions. According to PWC (2017), at least 62% of bank customers will take advantage of fintech platforms within the next five years. Although the bank developed guidelines for mobile payments and payment services banks (PSB), a tangible and streamlining regulatory framework is required in order not to allow 62% of the financial system drudge on aimlessly.

### 4.1. Discussion of Findings

From the deluge of literature synthesized in the course of this study, regulatory framework of the CBN is essential because of the multiplicity of factors inundating the economy and the financial system. Figure A developed in the course of this study attempts to rationalize the essence of CBN's regulatory framework.

Figure A.



## 5. CONCLUSION AND RECOMMENDATION

The study focused on the interrelationship between the Central Bank of Nigeria's regulatory framework and the global economic crises. The study concludes that a regulatory framework for the financial system and the economy as a whole is necessitated by the plethora of factors buffeting the economy. As A Result, the following recommendations are proffered:

i. Considering the size and impacts of Fintech operators on the economy, it is recommended that a strong, coordinated and deliberate regulatory framework should be formulated to streamline and guide its operation.

ii. The study also recommends, very strongly, the amendment of Section 11(f) of the CBN Act of 2007 to ensure consummate autonomy of the bank. It is expected that this will attenuate political interference and promote the culture of objectivity, merit and excellence in the management of the nation's economy.

iii. This study further recommends that, to eliminate entropy in the regulation of the financial system, the Financial Services Regulation Coordination Committee (FRSCC) be strengthened to harmonize duplicated and conflicting regulatory frameworks in the system.

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