

Nigeria: Financial Sector Stability Assessment

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NIGERIA

Financial System Stability Assessment

Prepared by the Monetary and Capital Markets and African Departments

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January 22, 2013

This Financial System Stability Assessment (FSSA) is based on the work of the Financial Sector Assessment Program (FSAP) mission that visited Nigeria in September 2012. The FSAP findings were discussed with the authorities during the Article IV Consultation mission in November 2012. The team comprised Charles Enoch (head of mission, IMF), Michael J. Fuchs (head of mission, World Bank), Eija Holttinen, Moses Kitonga, Elena Loukoianova, Carel Oosthuizen, Stephen Swaray, and Rodolfo Wehrhahn (IMF MCM); Dawn Chew (IMF LEG); Mumtaz Hussain (IMF AFR); Gunhild Berg, Clemente Luis Del Valle, Miquel Dijkman, Robin Hofmeister, Lars Jessen, Isfandyar Zaman Khan, Katie Kibuuka, Thilasoni Benjamin Musuku, Evans Makini Osano, Antony Randle, Ilias Skamnelos, Michael D. Wong, and Simon Christopher Walley (World Bank); Carlos Barsallo, Khairul Iswar Ibrahim, and Mimi Ho (experts). The FSAP team is thankful for the excellent cooperation it received from the authorities. Key conclusions:

- The Nigerian economy has experienced domestic and external shocks in recent years, which resulted in a banking crisis in 2009. Large foreign reserves buffers, and low debt, helped mitigate the impact, and the authorities took a comprehensive set of remedial measures. As a result, Nigeria avoided economic collapse, and economic growth resumed. The challenge now is to build on these achievements, so that vulnerabilities can be mitigated, and growth placed on a sustainable and enduring path. The Asset Management Company of Nigeria founded as a response to the crisis can begin to wind down its operations.
- Bank supervision has improved markedly since the financial crisis, through better onsite and offsite practices and higher standards of corporate governance. However, these improvements need to be buttressed in a number of regards, including resolving the problems of at least one weak bank, and making further progress with regards to enhancing cross-border supervisory practices. Meanwhile, non-transparent ownership structures and deficiencies in reporting in the financial sector still need to be fully addressed.

The main authors of this report are Charles Enoch, Elena Loukoianova, and Stephen Swaray, with contributions from the rest of the FSAP team.

FSAP assessments are designed to assess the stability of the financial system as a whole and not that of individual institutions. They have been developed to help countries identify and remedy weaknesses in their financial sector structure, thereby enhancing their resilience to macroeconomic shocks and cross-border contagion. FSAP assessments do not cover risks that are specific to individual institutions such as asset quality, operational or legal risks, or fraud.

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GLOSSARY

ACE	Advisory Committee of Experts
ACGS	Agricultural Credit and Guarantee Scheme Fund
AIM	Alternative Investment Market
AMCON	Asset Management Company of Nigeria
AML/CFT	Anti-Money Laundering and Combating the Financing of Terrorism
BCP	Basel Core Principles
BOFI	Banks & Other Financial Institutions
BOFIA	Banks & Other Financial Institutions Act
BOI	Bank of Industry
CACE	CBN Advisory Council of Experts
CACS	Commercial Agriculture Credit Scheme
CAR	Capital Adequacy Ratio
CAS	Capital Adequacy Standard
CBK	Central Bank of Kenya
CBN	Central Bank of Nigeria
CMU	Crisis Management Unit
CRR	Cash Reserve Ratio
CSCS	Central Securities Clearing and Settlement
CSD	Central Security Depository
DIS	Deposit Insurance Scheme
DFI	Development Finance Institution
DFS	Development Finance Scheme
DMO	Debt Management Office
DTM	Deposit taking Micro Finance Institutions
DvP	Deliver versus Payment
ECA	Excess Crude Account
eFASS	Electronic Financial Analysis and Surveillance System
ELA	Emergency Liquidity Assistance
FATF	Financial Action Task Force
FDIC	Federal Deposit Insurance Corporation
FGN	Federal Government of Nigeria
FIRS	Federal Inland Revenue Service
FMDA	Financial Markets Dealers Association
FMBN	Federal Mortgage Bank of Nigeria
FMoF	Federal Ministry of Finance
FRA	Fiscal Responsibility Act
FRC	Financial Reporting Council
FSA	Financial Services Authority

FSAP	Financial Sector Assessment Program
FSB KA	Financial Stability Board Key Attributes
FSR	Financial Stability Report
FSRCC	Financial Services Regulation Coordinating Committee
GDP	Gross Domestic Product
GIABA	Governmental Action Group against Money Laundering in West Africa
IAIS	Insurance Core Principles
IBRA	Indonesian Bank Restructuring Agency
IFC	International Finance Corporation
IFRS	International Financial Reporting Standards
IFSB	Islamic Financial Services Board
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
IPO	Initial Public Offering
KYC	Know Your Customer
M&A	Mergers and Acquisition
MDF	Micro Finance Development Fund
MFB	Micro Finance Bank
MNO	Mobile Network Operators
MPR	Monetary Policy Rate
MOU	Memoranda of Understanding
MSC	Merchant Service Charge
MSME	Micro Small and Medium Enterprises
₦	Naira
NAICOM	National Insurance Commission
NASB	Nigeria Accounting Standard Board
NBFI	Non Banking Financial Institution
NCC	Nigerian Communications Commission
NDIC	Nigeria Deposit Insurance Corporation
NGN	Nigeria Naira
NHF	National Housing Fund
NIBSS	Nigeria Interbank Settlement Systems
NIRSAL	Nigeria Incentive-Based Risk Sharing System for Agricultural Lending
NPL	Nonperforming Loan
NPV	Net Present Value
NSE	Nigeria Stock Exchange
NSFR	Net Stable Funding Ratio
OBA	Open Bank Assistance

OFISD	Other Financial Institutions Supervision Department
OTC	Over the Counter
P&A	Purchase and Assumption Transaction
P2B	Person to Business
PAIF	Power and Airlines Intervention Fund
PCA	Prompt Corrective Action
PCRG	Partial Credit Risk Guarantee
PD	Primary Dealer
PE	Private Equity
PENCOM	National Pension Commission
PFA	Pension Fund Administrator
PFC	Pension Fund Custodian
PLS	Profit/Loss Sharing
PoS	Point of Sale
PPP	Public-Private Partnership
PSIA	Profit Sharing Investment Accounts
RBS	Risk Based Supervision
RCF	Resolution Cost Fund
ROA	Return on assets
ROE	Return on equity
RRP	Recovery and Resolution Planning
RTGS	Real-Time Gross Settlement System
S&P	Standard and Poor's
SEC	Securities and Exchange Commission
SIF	Supervisory Intervention Framework
SIFI	Systemically Important Financial Institution
SME	Small and Medium Enterprise
SMECGS	Small and Medium Enterprises Credit Guarantee Scheme
SPV	Special Purpose Vehicle
TSA	Treasury Single Account

EXECUTIVE SUMMARY

- 1. The Nigerian economy has experienced domestic and external shocks in recent years, which resulted in the 2009 banking crisis.** However, the economy has continued to grow rapidly, achieving over 7 percent growth each year since 2009. The performance of financial institutions has begun to improve, though some of the emergency anti-crisis measures continue to be in place. The success in maintaining financial stability after the crisis, and in the face of major external threats, reflects the decisive and broad-based policy response by the government and the Central Bank of Nigeria (CBN).
- 2. Following the crisis, the authorities took a comprehensive set of remedial measures.** Substantial liquidity was injected; a blanket guarantee for depositors, as well as for interbank and foreign credit lines of banks, was provided; the Asset Management Company of Nigeria (AMCON) was established to purchase banks' nonperforming loans (NPLs) in exchange for zero coupon bonds and inject funds to bring capital to zero; regulations and supervision were strengthened and corporate governance enhanced; and the universal banking model was abandoned and banks instructed to establish holding companies or divest their nonbank activities.
- 3. As a result, Nigeria avoided economic collapse and economic growth resumed.** The challenge now is to build on these achievements, so that vulnerabilities can be mitigated and growth placed on a sustainable and enduring path.
- 4. Despite a positive macroeconomic outlook, substantial risks remain.** With oil receipts generating 75 percent of government revenue, a significant fall in the oil price could undermine fiscal consolidation, produce faster domestic debt accumulation, increase credit risk, and place a heavier burden on monetary policy. Meanwhile, terrorist activity continues in the north, adversely affecting economic activity (particularly in agriculture and commerce). A further deterioration in security would raise business costs in an already high cost environment and depress confidence, thereby harming growth and further financial system development. Fiscal dominance is a major contributor to the unfavorable trade-off between inflation and growth, whereby monetary policy needs to be kept tight even though private credit growth is sputtering. Nevertheless, stress tests indicate that banks are resilient to a range of shocks.
- 5. The financial system continues to suffer from weak governance, including some non-transparent ownership structures, deficiencies in financial reporting, and endemic perceptions of corruption.** These weaknesses were highlighted by failures and severe undercapitalization of several banks, contributing to banking sector consolidation from 89 banks in 2005 to 20 in 2012. The federal government's fight against corruption has resulted in an improvement in perception of the extent of corruption as indicated, for instance, by Transparency International in 2011. However, corruption continues to be a significant problem, including in the court system and other public authorities.

6. **Despite significant progress in recent years, the regulatory and supervisory framework has gaps and weaknesses:** (i) Nigerian financial institutions operate under a framework of laws, regulations, circulars, and guidelines that are not all well-understood, and do not seem to provide a coherent overall framework; (ii) further enhancements are still needed in bank supervision and resolution, particularly with regards to at least one weak bank, and to cross-border supervisory practices; and (iii) the extensive agenda ahead for supervisors and regulators will pose serious capacity challenges.

7. **The development and regulation of non-bank financial institutions require further reforms.** The insurance sector needs better enforcement of compulsory insurance; improvements in product disclosure standards; and resolution of small unprofitable companies. The 2004 pension sector reform was helpful, but coverage remains low. Legacy funds' assets are yet to be transferred to Pension Fund Administrators. Although the Nigerian Securities and Exchange Commission (SEC) has made progress, more reforms are needed to further enhance oversight of the capital markets. The SEC has been without a Board since June 2012, jeopardizing its proper governance and functioning.

8. **With the financial system now stabilized, the process of unwinding crisis measures and strengthening the crisis prevention and resolution framework should continue.** The CBN's emergency liquidity assistance (ELA), while well-designed for the short-term, needs to be replaced with a framework that will endure for the longer term. AMCON has been a central element in the authorities' response to the banking crisis; this agency has only a temporary purpose and should be wound down as normal banking business is restored. The blanket guarantee should be officially unwound. The authorities should instead rely on the conventional Deposit Insurance Scheme (DIS) that is in place and operates well.

9. **Access to finance is an important constraint to Nigeria's development.** There is negligible intermediation to small and medium-sized enterprises (SMEs) by the formal financial sector. While the microfinance sector has undergone significant changes, it remains characterized by numerous small, financially weak and ineffective institutions.

10. **In sum, the Nigerian economy has emerged from the banking crisis, and has the potential to enjoy an extended period of strong economic growth.** This will be facilitated by a comprehensive strategy to exit from the crisis management period; to enhance protection against existing and emerging vulnerabilities; and foster financial deepening that can underpin sustainable growth for the periods ahead.

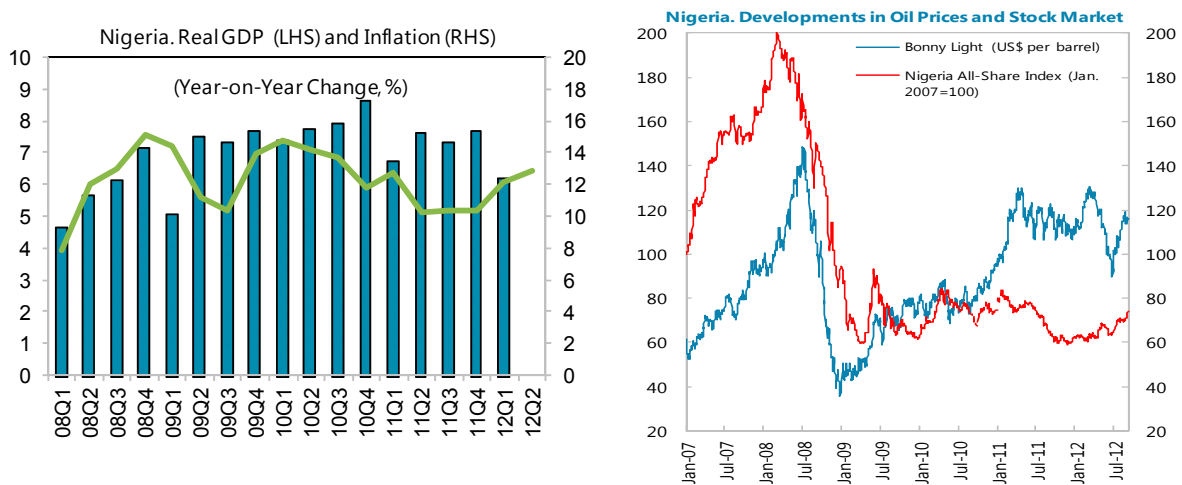
Table 1. Nigeria: Key FSAP Recommendations

Recommendations	Authority Responsible for Implementation	Timeframe
<i>Cross Sector Issues</i>		
Further enhance supervisory oversight over banks with international presence.	CBN	Short-term
Strengthen macroprudential oversight and crisis preparedness by enhancing the functioning of the FSRCC.	Government	Short-term
Strengthen capacity of supervisors and establish clarity regarding their regulatory authority; and improve availability and quality of data for macroprudential analysis.	FSRCC	Short-term
<i>Banking Sector</i>		
Review and update the BOFIA.	CBN	Short-term
Implement HRD plan for a new category of BSD specialists with a separate career path.	CBN	Short-term
Withdraw the CBN circular restricting recapitalization of foreign subsidiaries by Nigerian parent banks.	CBN	Short-term
<i>Insurance</i>		
Upgrade the solvency regime, as well as valuation and the reserve requirements, to better capture risk.	NAICOM	Medium-term
Put high priority on enforcement of mandatory insurance.	NAICOM	Short-term
<i>Pensions</i>		
Establish a database of employers required to comply with the Pension Reform Act, 2004.	PENCOM	Medium-term
Develop Nigerian specific mortality tables for pricing annuities and programmed withdrawals.	PENCOM	Medium-term
<i>Securities Markets</i>		
Expediently nominate the new Board members of the SEC.	Government	Short-term
Ensure that broker-dealers are subject to higher risk-based capital requirements and other prudential requirements as well as sufficient entity-level supervision, including regular on-site inspections.	SEC	Short-term
<i>Safety Nets and Crisis Management</i>		
Unwind crisis response measures and revert to the conventional financial safety nets that are already in place, including the DIS.	FMoF, CBN, AMCON	Short-term
Establish end-2017 as the sunset for AMCON, disallow further acquisition of assets, and use surplus funds to buy back bonds.	FMoF, AMCON	Short/ Medium-term
<i>Access to Finance</i>		
Review the licensing of the microfinance banks, to offer two types of license.	CBN	Medium-term
<i>Development Finance</i>		
Divest CBN's interest in DFIs to the FMoF and/or the private sector as appropriate.	FMoF/CBN	Short-term
Review the design and performance of the Development Finance Schemes.	CBN	Medium term
<i>Asset-Liability Management</i>		
Create central unit to monitor contingent fiscal commitments and develop a strategy as regards further commitments.	FMoF	Short-term
<i>Payment Systems</i>		
Revise the 2009 Regulatory Framework for Mobile Payment Services to level the playing field and intensify competition.	CBN	Short-term

I. MACROECONOMIC PERFORMANCE AND STRUCTURE OF THE FINANCIAL SYSTEM

11. **The Nigerian economy experienced domestic and external shocks in recent years, but the economic outlook remains positive.** Large buffers, built before the crisis, and low public debt, helped mitigate the impact of the 2008-09 shocks by providing room for expansionary fiscal policy. Only moderate deceleration in growth, to around 6.3 percent, is expected in 2012. High oil prices in 2012, and efforts to dampen abuses of the fuel subsidies, contributed to a strengthening of the external current account surplus and, together with a tighter monetary policy stance and strong portfolio inflows, increased international reserves to five and a half months of import cover by end–November 2012.

Figure 1. Recent Macroeconomic and Stock Market Price Developments



12. **The continued economic stabilization helped improve market sentiment.** In response to stronger fiscal and external buffers, as well as ongoing economic reforms, Standard and Poor’s (S&P) raised its long-term foreign and local currency sovereign credit ratings on Nigeria from B+ to BB-, putting them in line with those of Fitch and Moody’s.¹ Barclays announced the addition of Nigeria to its emerging market local currency bond index from end-March 2013. JPMorgan added Nigeria’s local currency bonds to its GBI-EM indices in October 2012.

13. **However, failure to implement Nigeria’s fiscal consolidation strategy could pose risks to financial stability.** In particular, overly ambitious infrastructure spending, continued fuel subsidies and directed credit schemes, and large contingent liabilities in the form of

¹ Moody’s assigned an equivalent rating of Ba3 to Nigeria on the same day as S&P raised its ratings.

AMCON bonds, could require sustained high interest rates to contain inflation and fight pressures on the currency.²

14. **The Nigerian financial system is growing fast and becoming increasingly integrated into the regional and global financial systems (Table 2).** As of end-2011, gross financial system assets accounted for 61 percent of GDP. At the core of the system are banks, followed by pension funds. Banks are the main players in the money markets; act as settlement banks in capital markets, and account for 36 percent of total equity market capitalization.³ Non-banking financial institutions (NBFIs), other than pension funds, stand at 7 percent of total financial market assets. The insurance sector has the equivalent of less than 2 percent of GDP in assets. Life business is underdeveloped, with assets constituting only about half of non-life sector assets.

Table 2. Nigeria: Structure of the Financial System, 2011
(₦billion, unless specified otherwise)

	2006			2010			2011		
	Number	Assets	In percent of total assets	Number	Assets	In percent of total assets	Number	Assets	In percent of total assets
Commercial banks	25	6,738	90.5	24	15,544	94.8	20	18,477	78.7
Private	25	6,738	90.5	24	15,544	94.8	17	17,548	74.7
Domestic	21	6,456	86.7	20	14,217	86.7	13	14,704	62.6
Foreign	4	282	3.8	4	1,327	8.1	4	2,844	12.1
State-owned	0		0.0	0	0	0.0	3	928	4.0
Institutional investors	124	300	4.0	100	565	3.4	91	3,457	14.7
Insurance Companies	107	n.a.		61	565	3.4	61	622	2.6
Pension Funds	13	300	4.0	30	n.a.		21	2,835	12.1
Unit Trusts	8	n.a.		8	n.a.		8	n.a.	
Other Non-Banks Financial Institutions	1,683	409	5.5	1,619	280	1.7	1,403	1,543	6.6
Finance Companies	112	54	0.7	108	31	0.2	n.a.		
Specialized development institutions	6	n.a.	n.a.	6	250	1.5	6	267	1.1
Securities Firms	581	n.a.		580	n.a.		254	n.a.	
Fund Managers							136	1,085	4.6
Mortgage Institutions	90	114	1.5			0.0			
Microfinance Banks	757	55	0.7	800	n.a.		876	191	0.8
Discount Houses	5	186	2.5			0.0	5	n.a.	
Bureaux de Change	126	n.a.		125	n.a.		125	n.a.	
Asset management Companies (AMC)							1	n.a.	
Other	6	n.a.							
Total financial system	1,826	7,447	100.0	16,389	100.0		23,477	100.0	

Source: CBN.

15. **Capital markets remain relatively small, with low investor confidence since the crisis, and large sectors of the economy underrepresented.** The only securities exchange operating in Nigeria is the Nigerian Stock Exchange (NSE). Its market capitalization dropped from US\$80.6 billion (30 percent of GDP) at end-2008 to a low point of US\$27.7 billion, before recovering to US\$52 billion (12 percent of GDP) at the end of September 2012. At

² See Risk Assessment Matrix (RAM) in Appendix 1 for more detailed discussion of risks.

³ This is after a 37 percent decline in the bank index of the exchange.

end September 2012, there were 202 listed companies, of which only six new companies have listed since end-2009. The top five companies account for about 60 percent and the largest company over 25 percent, of market capitalization. Equity trading is dominated by foreign investors.

16. **Despite a large number of broker-dealers in the Nigerian securities market, the sector is concentrated.** The 10 largest dealing members had over 75 percent market share during the first half of 2012. The collective investment scheme sector remains small. As at September 7, 2012, the Net Asset Value of the funds under management remained at approximately US\$600 million, managed in only 43 collective investment schemes that were primarily open-ended unit trusts.

Table 3. Nigeria: Comparative Size of Capital Markets

	Nigeria		South Africa	Malaysia	Kenya
	(US\$ bln)		(In percent of GDP)		
Government Bonds	26.1	11.1	30.6	54.1	23.0
Non-government Bonds	4.0	1.4	27.0	54.9	2.8
Equities	44.0	16.7	2.1	141.8	30.3

17. **The insurance sector is underdeveloped.** Penetration of insurance is less than 1 percent of GDP; there has been minimal growth in written premium over the last decade in real terms, and more than 90 percent of premium written is for commercial risks. There is potential for micro-insurance and takaful insurance (Appendix 3).

II. FINANCIAL SECTOR RISKS AND RESILIENCE

A. Banking System Structure and Performance

18. **The Nigerian banking system has undergone significant reforms.** After the 2005 bank consolidation and capitalization, Nigeria experienced rapid credit expansion, as banks broadened their activities and moved to the untapped retail sector, and borrowers speculated in the equity market (margin lending collateralized by shares). The oil price drop and currency devaluation in 2008 stressed particularly those banks with heavy concentration in the energy sector, while the stock exchange downturn affected banks exposed to margin lending. By 2009, the banking sector was in crisis. Widespread insider abuse and inappropriate related-party lending were identified. In response, the CBN undertook a comprehensive set of measures (Box 1). Further reforms are under way: the full adoption of IFRS; the end of universal banking; and differentiating bank licenses by activity profile.

19. **The banking system is dominated by six banks out of 20 in total.** At end-2011, the six dominant banks (one pan-African and five domestic banks) accounted for about

60 percent of total banking sector assets. Unlike in many other sub-Saharan African countries, European banks in Nigeria held only 4 percent of total assets.

20. **The Nigerian banking system appears well capitalized, liquid, and profitable (Appendix Table 6.2 and Figure 2).** The capital adequacy ratio (CAR) grew from under 2 percent in 2010 to an average of 18 percent in June 2012.⁴ Tier 1 is almost 100 percent of total qualifying capital, while the leverage ratio is about 11 percent of net assets. The NPL ratio fell to about 5 percent of gross loans by end-June 2012, mainly due to the transfer of bad assets to the Asset Management Company of Nigeria (AMCON).

21. **Banks' true positions may be less positive because current classification rules delay the recognition of problem loans.**⁵ Eight banks had negative profitability in 2011, but most of these were profitable in the first half of 2012. By end-June 2012, return on assets (ROA) for the industry had risen to 1.2 percent, and return on equity (ROE) to 8.9 percent. Longer prospects are unclear, given that the improvement in 2012 derived at least in part from the one-off effect of the disposal of assets to AMCON.

22. **Three small banks demonstrated even more severe weakness.** One bank (under 2 percent of banking assets) has been insolvent since at least June 2012. The CBN intends to resolve it by end-2012 through merger. Two others are former bridge banks, with AMCON being the main owner (Figure 3).⁶ All three weak banks reported negative profitability as of end-August 2012.

⁴ The regulatory threshold for the CAR is 10 percent; 15 percent for internationally active banks.

⁵ Classification of NPLs is the following: Substandard (91–180 days), doubtful (181–360); loss (over 360 days).

⁶ Consultants are working on proposals on how to deal with the former bridge banks. A bridge bank is defined as a temporary bank organized by the regulators (CBN and NDIC) to administer the deposits and liabilities of a failed bank. Under the arrangement, the NDIC is authorized to operate a failed bank for a period until a buyer can be found for its operations.

Box 1. Measures Adopted in Response to the 2008 Banking Crisis

Below are some of the measures taken by the CBN:

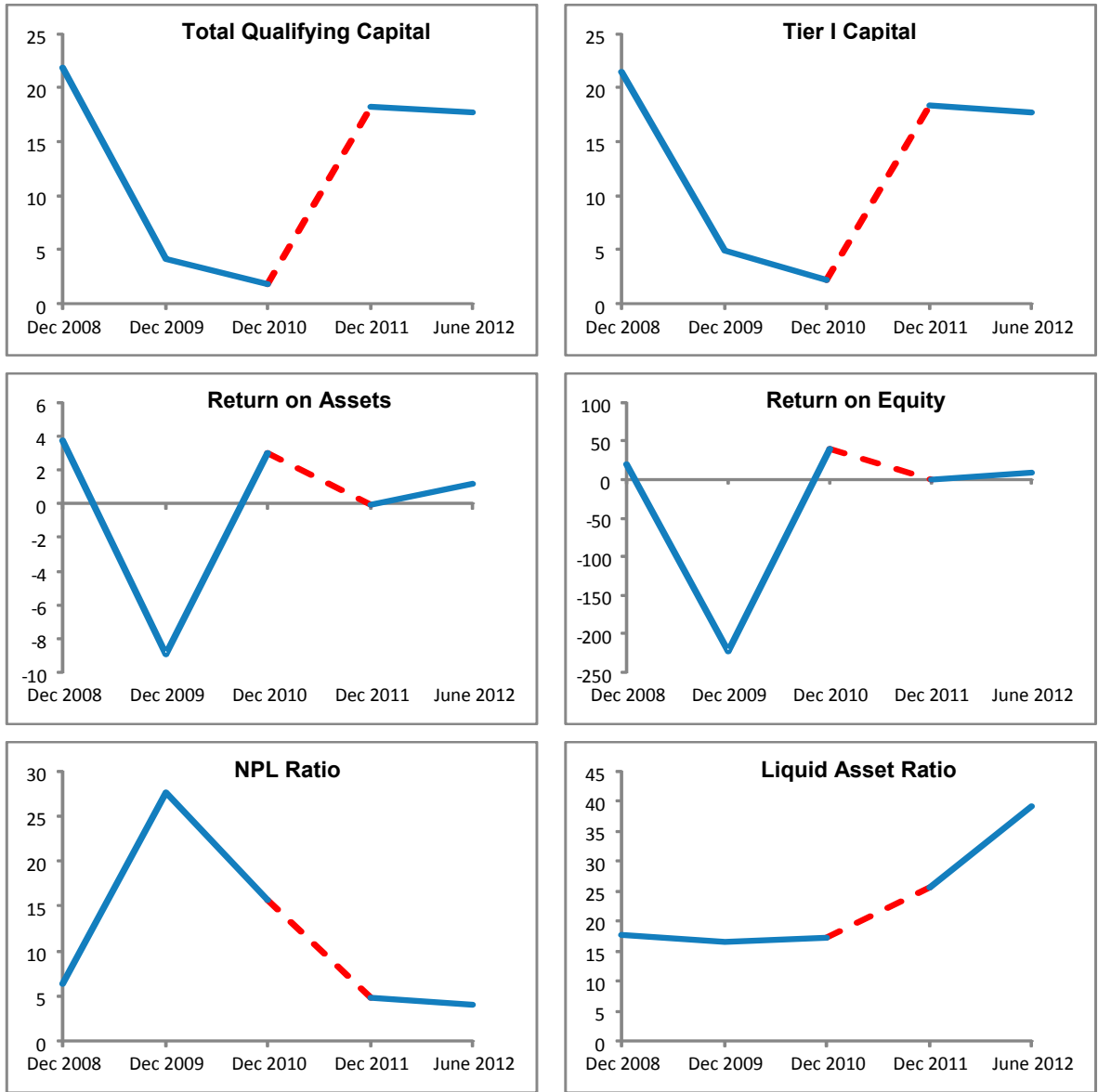
- Ten banks were intervened and eight had their management replaced.
- The CBN provided liquidity and capital support of ₦620 billion (US\$4.1 billion) in the form of unsecured, unsubordinated debt.
- A guarantee of interbank and foreign credit lines of banks was introduced, and extended for six-monthly periods until end-2011.
- The CBN publicly committed to protect all depositors and foreign creditors against loss.
- The authorities established the AMCON to support the troubled bank resolutions and the banking industry more broadly.
- The universal banking model was abolished in favor of a “back-to-basics” model, and a new bank license regime was introduced.
- A new supervisory framework was adopted combining risk based and consolidated supervision.
- A number of regulatory guidelines were issued, including capital adequacy, related parties and large exposures, risk and risk management, and internal control and auditing.
- The CBN issued a Corporate Governance Code to the banks.
- The CBN issued a directive on accounting and disclosure practices.
- The placing of resident examiners in banks was instituted.
- The CBN signed Memoranda of Understanding (MOU) with foreign supervisors geared toward receiving information on the financial condition, and adequacy of risk management and controls, of the various entities of the banking groups that have foreign operations.
- Cooperation and coordination between the two agencies involved in banking supervision, the CBN and the Nigeria Deposit Insurance Corporation (NDIC), were strengthened.
- Coordination was also enhanced through bi-monthly meetings of the Financial Services Regulation Coordinating Committee (FSRCC), on which the CBN, SEC, NAICOM, and NDIC participate.

23. **In 2011, 20 percent of banks’ assets were held in short-term investments (treasury bills and the stabilization securities).**⁷ However, weaker banks had a higher stock of AMCON zero-coupon bonds, while the rest had a higher proportion of treasury bills. In the first half of 2012, weaker banks started increasing their stock of T-bills, to about 10 percent of assets, although there seems to have been some reversal since.⁸

⁷ Stabilization securities are AMCON bonds (see later sections).

⁸ It seems that some bank recapitalization was effected through the sale of T-bills in exchange for AMCON bonds, suggesting that the inclusion of the bonds within capital may sometimes be more important than earning income from T-bills.

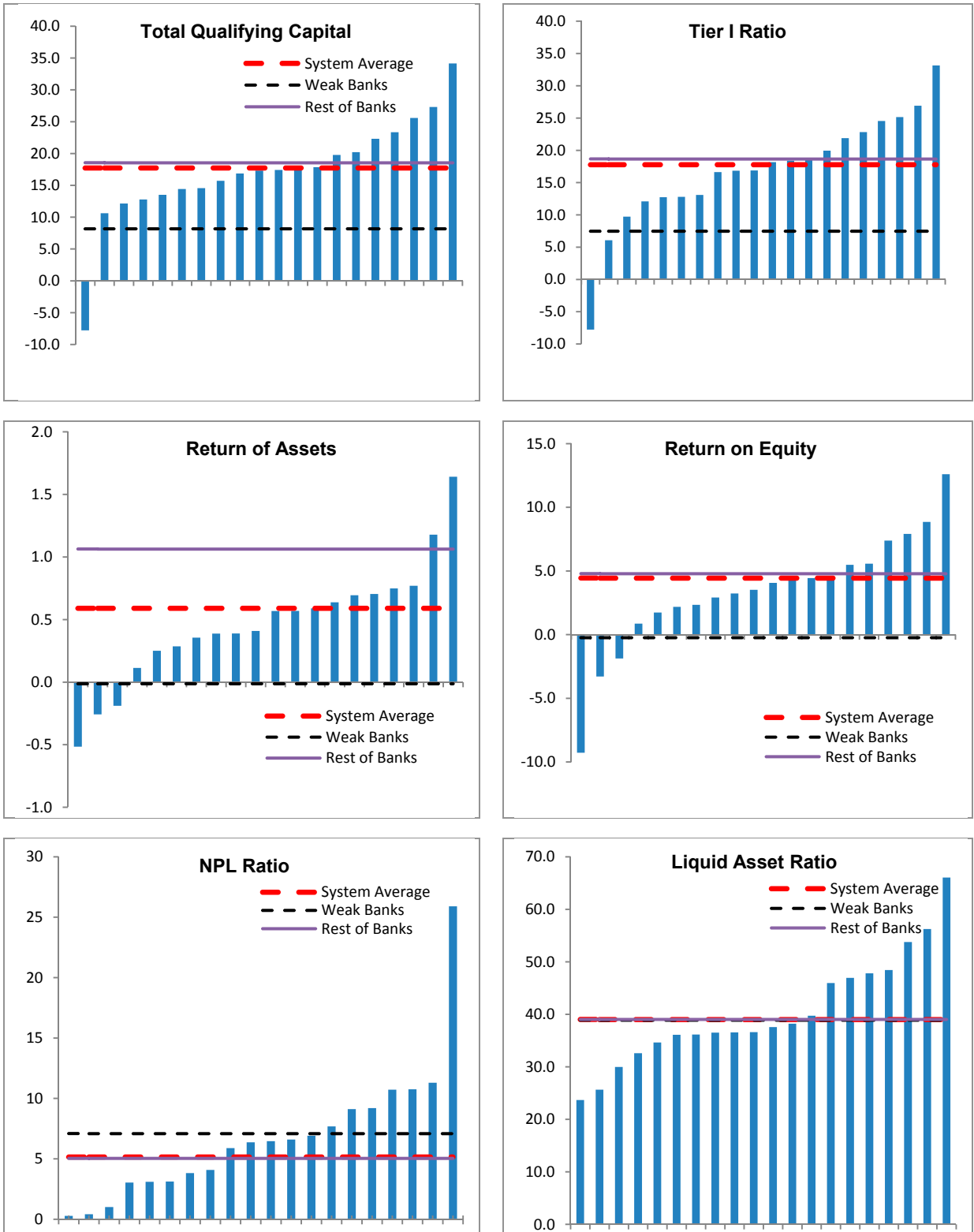
Figure 2. Nigeria: Selected Financial Soundness Indicators, 2008–12⁹



Source: CBN.

⁹ The red dotted line represents the structural break, as the NPLs were lifted from the banks in exchange for AMCON bonds.

Figure 3. Nigeria: Bank-Wide Financial Soundness Indicators, June 2012



Source: CBN.

B. Risks to Banking Sector Stability

24. **Although the financial system has recovered since the peak of the recent crisis, it is still vulnerable to global and domestic shocks.** The likelihood and potential impact of key risks is assessed below and summarized in the Risk Assessment Matrix (Appendix I). While oil prices have recovered recently, a further deterioration in the global environment could result in a sharp drop in oil prices. Such a shock, or disruptions in oil supplies (including from theft), would impact Nigeria's current account and fiscal positions, thereby limiting the buildup of international reserves and increasing public debt. A more immediate risk stems from the recent upswing in terrorist activity in northern Nigeria, that is harming the non-oil sector (particularly agriculture and commerce) there. A further deterioration in the security situation would raise business costs in an already high-cost environment, and dampen activity.

C. Stress Tests

25. **Stress tests suggest that most Nigerian banks could withstand extreme shocks.** The tests, which were carried out in close cooperation with the CBN (Box 2), included three macroeconomic scenarios, which were translated into single and multi-factor shocks: i) a slowdown in the global economy and a sharp drop in oil prices; ii) continuing terrorist attacks in the North; iii) economic deterioration elsewhere in Africa; and (iv) a decline in value of the AMCON bonds and increased contingent fiscal liabilities of the government. These tests suggest that a severe increase in overall NPLs would result in undercapitalization of just a few banks. The general resilience reflects banks' high capitalization and currently low NPLs,¹⁰ which in turn reflects the banking system restructuring and recapitalization after the 2009 banking crisis. However, some individual banking institutions appear vulnerable, and one is insolvent even before any stress test. The credit risks analysis suggests that the highest risk comes from credit concentration to single names and group borrowers.

26. **Stress tests were not derived from econometric time series analysis (so called macro stress tests) because of lack of structural breaks.** The banking sector time series (including that for the NPLs) have recent and fundamental structural breaks due to the major consolidation since 2005–06, and the significant changes in the structures of the banks' balance sheets following their surrender of bad assets. Among these effects was the reduction of NPLs from about 35 to about 5 percent in 2011.

¹⁰ The CBN's 2011 introduction of a 5 percent regulatory limit on banks' NPL ratio may cause moral hazard, and should be replaced by supervisory oversight.

Box 2. Stress Test Scenarios and Shock

To approximate the impact of several macroeconomic shocks materializing at the same time, the stress tests translated a set of macroeconomic scenarios into a series of single and multi-factor shocks.¹¹ Due to data constraints, the scenarios are based on expert judgment and historical qualitative and quantitative information where applicable. The following scenarios have been analyzed:¹²

- *A slowdown in the global economy is expected to result in a sharp oil price drop (about US\$50 per barrel).* This scenario would result in (i) aggregate NPLs increasing by 200 percent; and (ii) a further increase of NPLs of the same magnitude in the major sectors financed by the banks: oil and gas, general commerce, real estate and construction, and general loans.¹³ In addition, the rate of the Naira vis-à-vis the U.S. dollar would depreciate by 30 percent and the stock market index decline by 30 percent.
- *Continuing terrorist attacks would result in an overall shock to the economy (by at least three standard deviations of GDP).* This scenario is expected to increase aggregate NPLs by 100 percent, depreciate the Naira vis-à-vis the U.S. dollar (and other major foreign currencies) by 30 percent; and depress the stock market index by 50 percent.
- *Economic deterioration in other African countries with Nigerian banks' subsidiaries and branches would result in a structural deterioration of the Nigerian banking sector.* This scenario is put as resulting in an increase of NPLs by 200 percent and a sharp decline of the local stock market index by 30 percent.
- *Decline in value of the AMCON bonds and increased contingent fiscal liabilities of the government.* This scenario would result in the decline of bank capital, and in banks' liquid assets, and thus in their liquidity ratios.

27. **Single factor market risk tests confirm that most risks appear manageable.**

Banks are resilient to severe interest rate shocks, and the impact of the exchange rate risk is minimal, given the stringent net open position limits¹⁴ and the limited foreign currency lending to unhedged borrowers. Severe combined shocks would however cause at least two banks to become insolvent (see also Appendix II).

28. **Liquidity stress tests suggest that the system could withstand liquidity pressure and absorb moderate potential losses, although some banks appear more vulnerable.**¹⁵

All large banks pass the liquidity stress test, though some only by a narrow margin. However,

¹¹ In general, macroeconomic shocks (in terms of GDP decline in standard deviation terms) cannot be easily translated econometrically into shocks in the sensitivity analysis. Thus, expert judgment is used here to create single and multifactor shocks based on the broader macroeconomic shocks under consideration.

¹² See Risk Assessment Matrix for more details.

¹³ Definitions of some of the sectoral classifications are: (i) general commerce—domestic trade, automotive loans, and food processing; and (ii) general—personal loans and retail loans.

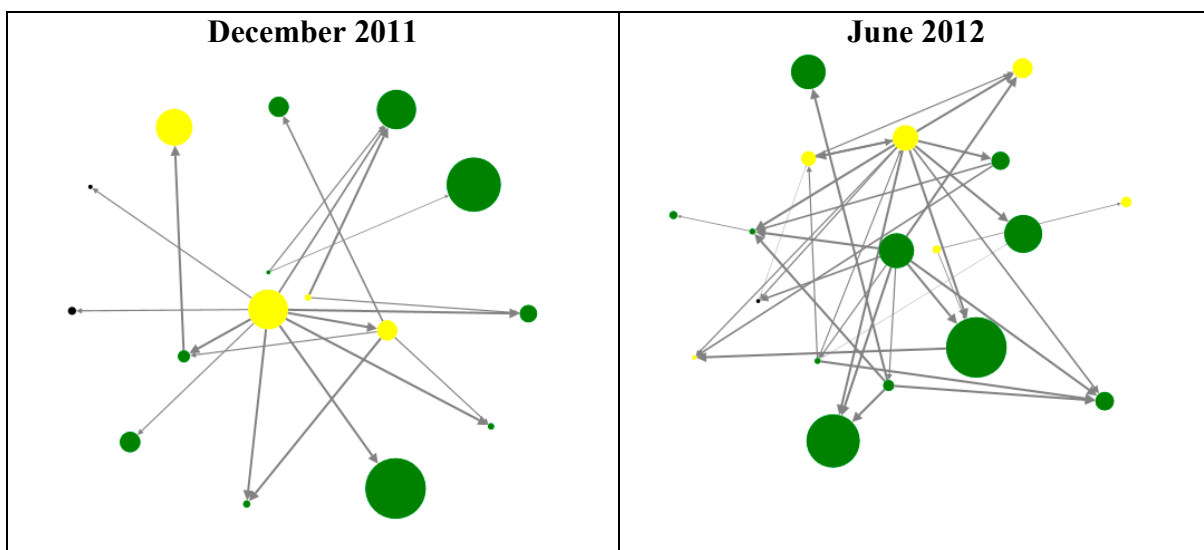
¹⁴ 1 percent of unimpaired shareholders funds.

¹⁵ Rather severe liquidity pressures can be withstood due to the high level of liquidity in the banking system.

some smaller banks appear vulnerable. Overall, the banking system could withstand relatively large liquidity pressures from the funding and market side, mainly as a result of current excess liquidity. A complete transfer of federal government deposits within 30-day period would result in an illiquid banking system.

29. **The analysis demonstrates that in the event of a default of one bank, there would be only one small systemically unimportant bank defaulting through interbank linkages.** The interbank market appears clustered with most banks being either lenders or borrowers, and contagion risk through interbank exposures is generally small (Figure 4). In general, the interbank market is capable of withstanding significant adverse liquidity and funding shocks.

Figure 4. Nigeria: Tiered Structure of the Banking System



Note: The green nodes represent banks with CARs above 15 percent; yellow – banks with CARs between 10 and 15 percent; and black – banks with CARs under 10 percent. The thickness of the edges represents approximate amount of the obligations between the banks connected by these edges. The size of the nodes (vertices) approximately reflects the share of the bank’s assets in the total assets of the banking system.

Source: CBN data and IMF staff calculations.

D. Systemic Liquidity Management

30. **The CBN has struggled to contain the upsurge in systemic liquidity created largely by government spending of oil receipts.** Over the past few years, the CBN has undertaken a number of reforms toward meeting its monetary policy operating target, including implementing an interest rate corridor, resolving problems with accounting and payment systems, and enhancing the effectiveness of its monetary policy instruments. Nonetheless, it still faces challenges:

- Structural liquidity in the financial system continues to fluctuate, because oil revenues accumulate in banks for a month and are then disbursed to all tiers of government simultaneously. Combined with volatile oil prices, this makes monitoring and sterilization of liquidity difficult. Monetary policy implementation has been further challenged by the weakening of the oil price fiscal rule and the ECA.
- At times, the CBN's pursuit of multiple objectives has confused the markets, particularly after the 2009 crisis.¹⁶
- Short-term markets are segmented. Some banks seem not to be able to participate.
- Frequent changes to the operating procedures of monetary policy have undermined credibility. Over the past two years, the monetary policy rate (MPR) corridor has varied between 400 and 700 bps. The use of the cash reserve ratio (CRR), which was progressively raised from 1 percent in 2010 to 12 percent in 2012, drives an increasing wedge between banks' costs and their revenues, and contributes to high interest rate spreads.

III. MACROPRUDENTIAL AND CROSS SECTORAL ISSUES

A. Macprudential Policy

31. **Nigeria has taken important steps toward the identification and adoption of a framework for macroprudential policies.** Nigeria has placed responsibility for macroprudential responsibility with a dedicated sub-committee of the inter-agency Financial Services Regulation Coordinating Committee (FSRCC).¹⁷

32. **The FSRCC coordinates the supervision of financial institutions** (Box 3). It does not however have an explicit mandate for financial stability, nor for financial crisis management. Nevertheless, it could be the natural forum for coordinating financial stability issues. So far, however, it is not evident how much impact the FSRCC has had. It should meet regularly on a more frequent basis, have a permanent secretariat, prepare detailed work programs, and ensure that it is fully abreast of cutting edge work on macroprudential policies and instruments.

¹⁶ The desire not to raise interest rates when a number of banks were facing serious solvency pressures was in conflict with the need to take action to counter pressures on the current account and prices. To maintain exchange rate stability in this period the CBN made extensive use of Nigeria's international reserves.

¹⁷ In some countries the central bank has been allocated responsibility for macroprudential policies; other countries have established inter-agency committees that bring together the supervisory agencies covering the various parts of the financial system.

B. Cross-Border Issues

33. **Nigeria’s financial system is dominated by domestic institutions, but international linkages are increasing.** The consolidation of the banking sector in 2005–06 generated capacity for several Nigerian banks to expand internationally, establishing subsidiaries particularly in Africa. A major regional bank headquartered outside Nigeria, and active in 32 African countries, has its largest subsidiary in Nigeria. One of the largest re-insurance companies is a regional entity, with headquarters in Nigeria and offices in much of Africa.¹⁸

34. **The CBN has been gradually implementing initiatives to enhance its cross-border oversight.** It has established a unit for cross-border supervision and put in place a Framework for the Supervision of Cross-Border Institutions, and has initiated and executed bilateral MoUs on cross-border supervision and cooperation,¹⁹ with three in 2012.²⁰ Recently, the establishment of MoUs with host regulatory authorities has become a prerequisite for the initiation of Nigerian banking operations in foreign jurisdictions. The CBN has commenced joint examinations of Nigerian banks with host central banks in West African countries,²¹ and initiated a process for establishing specific Colleges of Supervisors for foreign subsidiaries of Nigerian banks. The CBN also participates in the core college established by the Financial Services Authority (FSA) for Standard Chartered Bank.

35. **While its steps in this regard are welcome, the CBN faces challenges in further strengthening cross-border supervision.** Among the obstacles are language barriers, differences in quality of supervision, reporting requirements, data reliability in some weaker jurisdictions, and off-site monitoring systems. The CBN has opened its supervisory training

¹⁸ The African Reinsurance Corporation (Africa Re) was established in 1976 by Organization of African Unity (OAU) member states and the AfDB to reduce the outflow of foreign exchange from the continent by retaining a substantial proportion of the reinsurance premium. A mandatory reinsurance cession of 5 percent in the different member countries is in place. Africa Re now has 41 member States representing 38.75 percent of the capital in addition to the AfDB, which has 8 percent of the capital and is among the single largest shareholders. Africa Re enjoys mandatory cessions, preferential tax treatment, and supervisory exemption. This creates a tilted playing field and hinders competition. Its preferences no longer appear necessary; as a first stage it is recommended that proper group supervision and taxation be introduced.

¹⁹ The CBN has entered into bilateral MoUs with Bank of Ghana, COBAC, China Banking and Regulatory Commission, Bank of Uganda, FSA, South Africa Reserve Bank, National Bank of Rwanda, Bank of Zambia, Central Bank of Kenya, BCEAO, Central Bank of the Gambia, Bank of Sierra Leone, WAMZ (Gambia, Ghana, Guinea & Sierra Leone), Bank Negara Malaysia, Central Bank of Liberia and Central Bank of Guinea. The MoUs do not cover specific aspects of crisis management and resolution.

²⁰ These include Banque Centrale des Etats de l’Afrique (BCEAO) for Ecobank.

²¹ The CBN is a member of the “College of Supervisors” of the West African Monetary Zone (WAMZ). The WAMZ College aims at enhancing coordination, cooperation, and information exchange among supervisors in the WAMZ area, rather than a college aimed at strengthening supervision of a specific banking group.

program to foreign inspectors to strengthen capacity in other jurisdictions. It is also actively promoting the harmonization of reporting requirements and off-site monitoring tools through the adoption of Electronic Financial Analysis and Surveillance System (eFASS).

Box 3. The Financial Services Regulation Coordinating Committee

Membership: The FSRCC is chaired by the Governor of the CBN and comprises the Managing Director of the NIDC, the Director-General of the SEC, the Commissioner for Insurance, the Registrar-General of the Corporate Affairs Commission (the body that administers the provisions of the Companies and Allied Matters Act) (CAC); and a representative of the FMoF. The Director-General of PENCOM has also been admitted as a member, but the CBN Act needs to be amended to formalize this. The NSE, Abuja Securities and Commodities Exchange, and Federal Inland Revenue Service send observers to the FSRCC, and the CBN serves as the Secretariat.

Objectives: Its objectives include: (i) to coordinate the supervision of financial institutions especially conglomerates; (ii) to reduce arbitrage opportunities; (iii) to deliberate on problems experienced by members with any financial institution; (iv) to eliminate any information gaps; and (v) to articulate strategies for the promotion of safe, sound and efficient practices by financial intermediaries.²² Under Article 4 of the Charter of the FSRCC, the functions include:

- a. Identify the causes of distress in the financial system, examine resolution options adopted so far and recommend any other solutions and measures to avert future distress.
- b. Examine the regulatory and supervisory standards of each member and recommend areas that require joint supervision and enforcement.

Sub-Committees: The FSRCC has five standing sub-committees:

- a. Financial Sector Soundness (Chair: CBN) that conducts surveillance over potential risks and recommends measures to avoid systemic crisis.
- b. Harmonization and Coordinating (Chair: NDIC) that examines regulatory and supervisory standards, recommends joint supervision and enforcement and capacity building.
- c. Information sharing (Chair: SEC) that identifies processes for information sharing.
- d. Legal and enforcement (Chair: CAC) that identifies overlaps, gaps, conflicts, inconsistencies and enforcement cooperation.
- e. Financial Market Development (Chair: NAICOM) that identifies and recommends areas to improve the financial system.

Information sharing: There is a multilateral MOU for information sharing between members of FSRCC and a website through which information is shared among member agencies.

Decision making: FSRCC decisions are taken on a consensual basis.

²² Section 44 of the CBN Act.

36. **Ecobank,²³ a pan-African financial conglomerate, presents particular cross-border supervisory challenges.** Headquartered in Lomé, Togo, the Banking Commission of the West Africa Economic and Monetary Union (WAEMU) in Abidjan is responsible for exercising consolidated supervision, despite the limited presence of the group in the home country.²⁴ In light of the supervisory weaknesses observed in some of its countries, this is challenging. The CBN supervises the Nigerian operations on a stand-alone basis, but may not observe losses elsewhere in the group, or for instance the build-up of intra-group exposures or double gearing of capital. Discussions with CBN staff suggested that there was little awareness of the bank's overall condition.²⁵ The CBN should ascertain that the home country exercises adequate consolidated supervision with respect to Ecobank.

37. **The CBN should enhance its supervisory oversight over banks with a regional or international presence.** Joint inspections should enhance international supervisory cooperation, both where Nigeria is host and where it is the home authority. Ex ante arrangements on what to do in the event of difficulties would be helpful. Crisis Management Groups can be set up to ensure that relevant information is shared and recovery and resolution plans prepared on a group wide basis. Infusions of capital from overseas should be subject to precise verification as to their sources to prevent recurrence governance issues that arose before the 2009 banking crisis. Finally, the headquartering of a bank in a country where domestic supervision may not be the strongest should lead the CBN to be particularly careful that it knows the bank's full condition.

38. **A recent CBN circular issued in May, restricting Nigerian banks' capacity to capitalize their foreign subsidiaries, is not in the spirit of enhancing cross-border cooperation.** Although the CBN claims that it would allow for exemptions for well-capitalized parent banks, the Circular does not seem to provide for any exemptions. Such measures risk undermining the goodwill and trust of host authorities necessary to strengthen home-host cooperation and coordination. Existing prudential requirements already grant the CBN discretion to refuse outflows of capital. It is recommended therefore that the circular be withdrawn.

²³ As of August 2012, Ecobank was the fourth largest bank in Nigeria both in terms of total assets and total deposits, with its total assets and total deposits constituting 8 and 8.9 percent of the system's total respectively.

²⁴ The International Finance Corporation (IFC) is a major investor in Ecobank and imposes its own liquidity and capital requirements through various financial covenants.

²⁵ Note that operations in Togo, which is the home supervisor responsible for exercising group-wide supervision, account only for a small share of the group's asset and deposit base.

C. Other Cross-Sectoral Issues

39. **While, as indicated in the following chapter, each supervisory agency is confronted with distinct legal, regulatory and operational issues, there are a number of challenges that cut across them.** These may be divided into macroprudential policy development and implementation; cross-border supervision; legal certainty; data issues; and capacity constraints.

40. **All supervisory agencies seem to suffer from a lack of capacity.** Maintaining financial soundness is challenging in any case, but all agencies are faced with major enhancements in their work in the coming period, for instance implementation of IFRS and relevant aspects of Basel III. There will be dangers to financial stability if sufficient staff with the necessary skills cannot be recruited.

41. **Data deficiencies are also an issue.** Data requirements for effective supervision have been rising recently, but infrastructure and capacity constraints have led to difficulties.

42. **Legal certainty is a prerequisite for effective action in any area.** During the crisis, policy was necessarily on occasion ad hoc, with measures implemented on the basis of narrowly-focused laws, regulations or guidelines, or even just official statements. As the crisis period recedes, there is uncertainty in a number of areas as to what the actual situation now is, for instance as regards the status of the blanket guarantee on deposits.

IV. FINANCIAL SYSTEM OVERSIGHT

A. Banking Sector

43. **In light of the potential risks and vulnerabilities to the banking sector, the CBN has taken decisive action over the last few years to strengthen its oversight.** Though the banking crisis inflicted extreme and severe damage, there may be a silver lining. A sense of urgency was engendered, minds became focused and prompt action was taken.

44. **Although these reforms are highly commendable, much still needs to be done, including:**

- Bank supervisors need the capacity to challenge banks effectively. They need to apply zero tolerance to non-compliance and corporate governance violations.
- The HR proposal for separate career paths for employees in areas such as risk management, information technology, accounting and auditing, and project management, should be implemented expeditiously.

- The BOFIA needs to be reviewed and updated. It was last amended in 1999, but since then there have been many changes to the internationally generally accepted framework for bank regulation and supervision.
- The draft consolidated supervision framework, the draft code of corporate governance, and the framework for financial and bank holding company structures need to be finalized, issued, and implemented.
- Blockages in the legislative process need to be addressed so that the legal and regulatory frameworks can remain current.
- Gaps in the regulatory framework need to be addressed, for instance in relation to market, operational, and interest rate risk.
- The authorities need to enhance communication, cooperation, and information exchange, including through the FSRCC.
- The authorities need to pursue contingency planning for crisis management, that simulation exercises are undertaken periodically with clarity of roles for each agency, stress testing is performed regularly, and (financial) buffers are built and maintained. The FSRCC should be given an explicit financial stability mandate.
- A robust insider trading framework and regime needs to be developed and implemented.
- More regular disclosure of aggregate data on the banking system would improve market discipline and facilitate public understanding.

B. Securities Markets

45. **The Nigerian Securities and Exchange Commission (SEC) has made marked progress since the 2002 FSAP, and has a number of significant achievements.** Under the Investment and Securities Act 2007 (ISA), the SEC is the sole regulator of the securities markets. Since the adoption of the ISA, it has continued to strengthen and expand its rules and regulations. There are comprehensive legal provisions to ensure its robust governance structure. However, the SEC has been without a Board since June 2012. The authorities need to expeditiously finalize Board appointments. Further, corruption continues to be a significant problem in the Nigerian court system, although the government's efforts to combat it are gaining international recognition. SEC management is pursuing a zero tolerance policy against corruption, although internal and external reports suggest that the issue is not yet fully resolved.

46. **Additional reforms are needed.** The SEC's independence needs to be further enhanced. Its mandate to issue rules and regulations is subject to the final approval of the

minister of finance, who can also exempt a person from the application of the ISA. Even though the Senate does not have any formal role vis-à-vis the day-to-day operations of the SEC, in practice its views seem to have an impact on the SEC's decisions. This compromises the SEC's independence. The SEC should formalize its procedures. The regulatory framework is weak in prudential and organizational requirements, including internal control, risk management, and capital requirements. Broker-dealers have been rarely inspected, and the few inspections conducted have been reactive, triggered by major deficiencies in capital. The limited supervision of broker-dealers can potentially introduce systemic risk through the securities settlement system. In addition, the SEC should exercise its comprehensive enforcement powers in a timely, effective, and consistent manner.

C. Insurance and Pension Sectors

47. **NAICOM has worked hard to improve the regulatory environment.** Following the recapitalization of insurers and reinsurers in 2007, the National Insurance Commission (NAICOM) issued a voluntary code on corporate governance; issued operational guidelines; upgraded regulatory requirements including the risk management framework, KYC and anti-money laundering and combating the financing of terrorism (AML/CFT) requirements; and prepared for the adoption of IFRS. It has begun work on the transition to risk based supervision, although it needs significant capacity enhancement.

48. **With the rapid expansion of insurance sector, more reforms are needed.** NAICOM should collaborate with the FRC to improve the timeliness and reliability of audited financial statements, and be able to sanction non-complying insurers more effectively. NAICOM should improve disclosure standards for the industry. Intermediaries should be required to disclose their capacity to act (whether as agent or broker), their financial interest in the policy, and any conflict of interest that might affect their recommendation of products. NAICOM should promulgate standards for micro-insurance and takaful insurance. The enforcement of compulsory insurance must be enhanced. The authorities should focus on the development of long-term financial instruments in anticipation of growth in the life and annuities markets, and establish a level playing field in agricultural insurance. Finally, the government should reconsider its position on mandatory reinsurance cessions to local insurers.

49. **Despite the reforms of the Pension Reform Act of 2004, challenges remain.** Redemption bonds' funding needs should be actuarially determined and the formula for funding reviewed. The six legacy civil service schemes should be aggregated under the minister of finance and supervised by the National Pension Commission (PENCOM). To ensure compliance, a database of employers needs to be developed. PENCOM should reconsider the timing of the introduction of multi-funds (investment alternatives). PENCOM and NAICOM need to jointly develop and enforce disclosure standards for annuity products and programmed withdrawals. Country specific mortality tables are needed to calculate final benefits to retirees.

V. FINANCIAL SAFETY NETS AND CRISIS MANAGEMENT

50. **The CBN took decisive measures to avert a systemic banking crisis (Box 1), but should now more fully develop its crisis management and safety net arrangements.** The authorities have introduced a framework that sets out general and specific triggers for a range of corrective actions as well as a prompt corrective action (PCA) regime. However, the post-crisis Supervisory Intervention Framework (SIF) needs to be aligned with the early intervention powers in the BOFIA, to ensure that the powers have a sound statutory footing. Proposed amendments to the BOFIA that provide for the CBN to acquire shares in a failing bank should be deleted. The CBN should also implement recovery and resolution planning for banks that are systemically important financial institutions (SIFIs) in Nigeria.

A. Crisis Management Tools

Official financial support

Emergency liquidity assistance (ELA)

51. **The CBN should develop a comprehensive framework for a longer term liquidity facility.**²⁶ An expanded discount window facility was provided during the crisis, from September 2008 to August 2009. Under this facility, the CBN provided loans up to 360 days, and the range of eligible collateral was increased to include non-federal government securities, such as commercial paper and bank acceptances. To enhance systemic liquidity, the CBN granted a blanket guarantee on interbank claims²⁷ and provided ₦620 billion in liquidity. It should develop a longer term ELA facility and include clear policies, guidelines, and procedures, including a solvency test, eligibility requirements, applicable interest rates (typically penal) and acceptable collateral. Banks that access such a facility should be subject to enhanced supervision.

52. **The NDIC's statutory role in providing ELA and guarantees should be removed.** Although this facility has not been used in the last two decades and an operational framework is lacking, such a role potentially exposes the NDIC to losses and would reduce funds available for a payout. Financial support from the NDIC to banks should be limited to assisting resolution measures, and should be capped at the amount of insured depositors' funds that would have been paid out by the NDIC if the bank had instead been liquidated.

²⁶ The CBN currently has an overnight standing lending facility, a repurchase facility (up to 90 days, with an option to roll over) and a rediscount facility.

²⁷ The inter-bank guarantee was lifted as of end-2011.

Solvency support

53. **During the banking crisis, the CBN's support extended well beyond the provision of liquidity to solvent banks.** The CBN provided solvency support to the banking sector through AMCON, guaranteed inter-bank claims, and provided a blanket guarantee on deposits. It also contributed capital for AMCON and will from 2011 to 2020 contribute ₦50 billion annually to the Banking Sector Resolution Cost Fund (established for the purposes of paying the AMCON bonds). The FMoF contributed by providing part of the initial capital for AMCON and guaranteeing its bonds.

54. **With the financial system stabilized after the crisis, the CBN should move toward unwinding crisis measures for solvency support:**

- The provision of support beyond liquidity assistance for illiquid but solvent banks is the role of the FMoF, which should take all necessary steps (e.g., standing approvals or standing legislation) to ensure that such support can be made available on an expedient basis. If the CBN were to provide such support, it should be indemnified by the FMoF.
- There should be proper public communication that the deposit blanket guarantee announced by the CBN during the 2008–09 crisis is no longer in place and that reliance would henceforth be placed on the existing conventional DIS operated by the NDIC.

55. **Proposed amendments to BOFIA to provide a statutory blanket guarantee should be deleted.** These amendments envisage that the CBN shall, upon revocation of license, pay all private deposits liabilities not covered by deposit insurance and thereafter seek to recover in liquidation. Instead, payment of private deposit liabilities should be limited to the criteria and levels stipulated under the NDIC Act.

Orderly and effective resolution

Going concern resolution

56. **The CBN and NDIC have a broad resolution toolkit which was put to use during the crisis to resolve the intervened banks.** The authorities arranged mergers and acquisitions, set-up bridge banks to take over assets and liabilities of problem banks, and established an asset management company to deal with NPLs and recapitalization of banks. However, these powers were not invoked without challenges, both legal and procedural.

57. **The resolution authorities should have express statutory power to override shareholders' rights.** The measures taken during the crisis had to abide by company law requirements relating to shareholders' rights to vote and a requirement for court sanction,

which added to the duration of the resolution proceedings. Such shareholder rights requirements and court approval should be disappplied.

58. **Steps should be taken to minimize the disruption to the resolution process caused by legal challenges.** The authorities faced numerous challenges to the exercise of their resolution powers. The law should be amended to provide that (i) in the event that there is any challenge to resolution actions, there should be no suspension of resolution proceedings; and (ii) redress for wrongful measures should take the form of monetary compensation.

59. **The resolution toolkit could be expanded.** It could include mandatory recapitalization of banks without the pre-emptive rights of existing shareholders; the power to write-down capital without shareholders' approval;²⁸ and the power to carry out a bail-in.²⁹

60. **The statutory triggers for invoking resolution measures could be expanded and harmonized.** The triggers should be harmonized under the BOFIA and the NDIC Act to include both quantitative triggers (tied to CAR, liquidity ratios, etc) and qualitative triggers (e.g., breaches of laws and regulations, carrying on business detrimental to depositors).

Gone concern resolution - orderly liquidation

61. **The NDIC carries out, and the CBN monitors liquidation proceedings.**³⁰ The NDIC as a liquidator also facilitates the implementation of the Failed Banks Act, which provides for the recovery of debts owed to failed banks and for the trial of offences relating to financial malpractices in banks and other financial institutions.

62. **The bank liquidation regime needs to be amended to address legal challenges and protracted delays.** Past experience with bank liquidation has been fraught with delays and uncertainty for bank depositors and creditors, eroding confidence in the banking system and raising the costs of bank failures. The law should be amended to prevent suspension or reversal of resolution proceedings (subject to payment of monetary compensation for wrongful revocations or liquidations). To speed up liquidation, the CBN should regain legal authority to appoint the NDIC as liquidator immediately upon revocation of the license and requirements for advertisement of the petition before appointment dispensed with.

²⁸ The proposed amendments to the BOFIA to reduce the share capital of a bank with the approval of the court should be amended to allow for an administrative procedure.

²⁹ In other words, the power to write down equity and unsecured and uninsured creditor claims to absorb losses, convert unsecured and uninsured creditor claims into equity, and convert or write-down any outstanding contingent capital instruments that have not already been triggered according to their terms.

³⁰ Until 1998, liquidation proceedings were administratively based with the CBN appointing the liquidator.

B. AMCON

63. **The creation of AMCON in 2010 has been pivotal in restoring the financial health of Nigeria’s banking sector.** AMCON injected capital into five banks to bring them to zero net asset value, leaving the remainder of the recapitalization to private investors. AMCON also purchased equity and topped up the capital of the three former bridge banks, it has acquired more than 12,000 problem bank loans, generally on the basis of valuation that follows best available market prices,³¹ which for some distressed assets presents challenges.³² While the initial round of acquisitions focused on the absorption of margin loans backed by shares, subsequent rounds focused on a broader set of assets. In return for the transferred assets, banks receive AMCON bonds, guaranteed by the federal government.³³

64. **AMCON has concentrated on the largest corporate loans and provided generous debt relief, yet delinquencies are high.** Restructuring arrangements with some large corporations (460 loans represent 80 percent of the portfolio) frequently involved partial conversion of debt into equity and an initial down payment of 10–20 percent of the outstanding debt. Despite generous debt relief in NPV terms and that the restructurings were conducted only recently, delinquencies on the newly restructured loans are, according to AMCON, already in the order of 10 percent.

65. **The authorities should ensure that AMCON follows the legal framework and is treated as a temporary arrangement created as a response to the crisis:**

- AMCON has yet to produce its first audited financial statements.³⁴ The first deadline was missed, and the CBN has provided a waiver; AMCON expects to release its final statements soon.
- The increasing use of debt-for-equity swaps can create misalignment of incentives. In its capacity as a (co-)owner of distressed companies, a bank is unlikely to enforce its creditor rights aimed at maximizing repayment on its claims. Ensuring a successful company restructuring is also challenging, including because political pressures can

³¹ Margin shares are an important exception. These are valued at the greater than (i) 5 percent of the principal sum, or (ii) the 60 day moving average price plus a 60 percent premium. Unsecured loans are valued at 5 percent of the premium sum. Additional detail is provided in the accompanying technical note.

³² According to AMCON, it has on average acquired loans at around 45 percent of the original book value.

³³ As per the Section 26 of AMCON Act, all issued bonds are underwritten by the government. AMCON has issued ₦4.5 trillion in three-year zero coupon bonds.

³⁴ The AMCON Act requires dissemination of the audited financial statements within six months upon conclusion of the book year.

stand in the way of a drastic restructuring and liquidation may not be a credible threat.³⁵

- AMCON's cash flows should be earmarked for buying back bonds. It may be politically expedient to use AMCON as a vehicle for keeping ailing industries and financially challenged public utilities afloat, but such bailouts are the subject of industrial policy and clearly outside AMCON's mandate.
- A credible exit strategy for AMCON needs to be devised, in line with the one-off character of its operations. It should be considered a temporary arrangement, to be dismantled as soon as circumstances permit. This calls for the setting of a firm and ambitious closing date for AMCON's operations, recommended as 2017, and embedded in the law.³⁶
- A sunset clause should be established, disposal targets set (with an emphasis on frontloading) and the regulation capping the proportion of NPLs in banks withdrawn. The most recent purchases were made in June 2012, enabling banks to comply with the 5 percent prudential cap on NPLs. The acquisition of problem loans should be discontinued, relevant prudential requirements withdrawn and responsibility for maintaining a sound loan portfolio shifted back to the banks. The moral hazard associated with encouraging banks to pass NPLs on to AMCON damages banks' incentives.

66. Steep redemptions in 2014 will likely exceed the funds accumulated.³⁷

Consequently, a detailed plan for handling the bond roll over must be developed, including clarifying whether AMCON will access the government guarantee. Contributions to the Resolution Cost Fund (RCF) are projected to be the main income source, accounting for about 60 percent of total cash flows. Recoveries on acquired assets are expected to contribute another 20 percent, with the remainder consisting of disposals. AMCON is currently investigating financing options. It is in the process of setting up an investment policy.

67. The RCF MoUs signed by the banks and the CBN to contribute to the costs to redeem AMCON bonds should be formalized in legislation.³⁸ All banks contribute,

³⁵ Note that labor disputes have occurred at the three AMCON-owned banks, impeding enterprise restructuring.

³⁶ While the general perception is that AMCON has a lifespan of 10 years, this is not specifically mentioned in the AMCON Act.

³⁷ Significant repayment obligations are coming up as the three year zero coupon bonds are falling due in 2013–14.

³⁸ The RCF is financed through annual levies, starting as of end-2011, with the CBN providing an annual contribution of ₦50 billion—essentially a public sector co-payment—and the banks paying a flat premium of

(continued)

regardless of their financial state and use of AMCON. Although draft legislation creating a statutory basis has been prepared, it has not yet been submitted to the National Assembly.

C. Systemic Crisis Management

68. **The CBN has set out its systemic crisis management framework in Part 4 of the SIF.** In the event of a systemic banking distress, the CBN and NDIC would jointly establish a crisis management unit (CMU) to determine the condition of all banks in the system and take immediate remedial actions, ranging from CBN loans, NDIC liquidity support, blanket guarantees, inter-bank guarantees, to the use of AMCON to purchase NPLs. The public nature of the SIF generates expectations that banks will be bailed-out and AMCON always around, raising serious moral hazard issues. Bank liquidation is effectively ruled out in the framework, even for non-viable banks.

69. **Part 4 of the SIF should be withdrawn immediately.** An effective resolution regime should not create an expectation that public solvency support will always be available and that AMCON has an indefinite lifespan. Private sector solutions should be favored and the industry should bear the costs. If public solvency support is needed, there needs to be a stringent systemic risk test³⁹ with a decision to be taken at the highest level of government and the CBN, accompanied by strict conditions imposed on the bank.

D. Deposit Insurance

70. **The NDIC has broad functions extending well beyond the provision of deposit insurance.** It shares supervisory responsibilities with the CBN and is the resolution authority. Depositor preference is provided under the BOFIA, and the NDIC is entitled to such preference by way of subrogation. Coverage seems adequate, but it is suggested to eliminate the practice of netting, and legal clarity needs to be established regarding the status of claims upon liquidation of banks. NDIC membership is mandatory for all deposit-taking institutions.

71. **The NDIC should be exempted from the Fiscal Responsibility Act, and the CBN credit line should be replaced by one from the FMoF.** The FRA impedes the accumulation of funds as it requires 80 percent of the NDIC's operational surplus to be channeled to the government. Supplementary funding should come from the FMoF as it is a fiscal responsibility.

30 basis points of total assets. The total amount of funding is capped at ₦1.5 trillion (₦500 billion for the CBN and ₦1 trillion for the banks).

³⁹ Legislative amendments could provide legal underpinnings for such a test, to allow assistance to be provided only when the institution is considered systemically important or there is a systemic crisis and current tools for emergency liquidity assistance and bank resolution cannot adequately address the situation.

72. **The 90-day payout term for the mainstream banking system should be shortened significantly.** The NDIC plans to reduce the payout term to 30 days, which is still comparatively long as banks worldwide are aiming for 15 days or even less.⁴⁰ Besides the labor intensive process of netting claims, it faces multiple challenges in making rapid payouts.

E. Legal Protection

73. **Legal protection could be enhanced, as numerous challenges are made to regulatory and resolution actions.** The judicial process has been exploited with frivolous cases being filed, and numerous interim and interlocutory injunctions and stays sought to delay proceedings. The burden of proof should be reversed such that it is the party alleging wrongdoing that has to show bad faith. The threshold for commencing legal action could be raised to that of gross negligence or willful misconduct. Legal protection should be extended to all staff of AMCON, and there should be express indemnity provisions for all staff of the agencies.

VI. DEVELOPMENTAL ISSUES IN FINANCE

74. **Access to bank credit for SMEs is very low.** Nigeria lags significantly behind comparator countries, with access to finance described as the biggest obstacle to development after the lack of a reliable supply of electricity.⁴¹ Banks and SMEs lack capacity and suffer institutional deficiencies, holding back higher credit growth in the sector

75. **The microfinance sector has undergone significant changes and continues to be in a state of transition.** The 2005 Microfinance Policy Framework, revised in 2011, provided the basis for the emergence of the microfinance sector. The government is pursuing a financial inclusion agenda with highly ambitious targets, but at the moment lacks an implementation strategy. Licensing requirements could usefully be reviewed.

76. **There are five active Development Finance Institutions (DFIs), but their financial state is precarious, preventing them from meeting their mandates.** The DFIs specialize in agriculture, housing, the SME sector, export-imports, and infrastructure. However, the financing gaps that they are established to address are not well defined, and often their mandate deviates from the targeted market failure.

77. **The CBN administers nine Development Finance Schemes (DFSs) aimed at addressing diverse agendas in development finance.** These schemes combine lines of credits and guarantees. The majority are aimed toward a developmental objective, although

⁴⁰ The FSB KA provides an example of seven days as a “prompt payout.”

⁴¹ World Bank Enterprise Surveys.

some have been used to bail out or restructure troubled sectors (as in the case of the recently-constituted airline scheme). All represent a contingent liability to the FMoF. Given their mixed performance and the contingent liability they represent, the FMoF should review their appropriateness, design and performance.⁴² Bailout related activities should not be financed by the CBN.

78. **Housing finance remains underdeveloped.** Mortgage loans outstanding represent just 0.36 percent of Nigeria's 2011 GDP, while the estimated housing shortfall is thought to be as much as 16 million units. The gap between production and demand is growing as Nigeria urbanizes and the population increases. Primary Mortgage Institutions (PMIs) have been unable to deliver the finance necessary to allow for the required investment into the housing sector. The CBN's new regulatory framework for PMIs, raising minimum capital to ₦5 billion, should help rationalize the sector. Standardization of the mortgage underwriting process and documentation would create a more efficient system and prepare lenders for a secondary mortgage market.

VII. PAYMENT SYSTEMS

79. **Nigeria continues reforms with regards to payment systems.** These include the real time gross settlement (RTGS) system, the Nigeria Interbank Settlement System (NIBSS), and the Mobile Payment Services (MPS). The CBN established the RTGS User Technical Committee to determine whether the new RTGS system meets user requirements, as well as to obtain feedback and gauge user satisfaction with regard to its effectiveness and efficiency. The NIBSS' switching capability, service quality and governance need to be significantly augmented. Given the CBN's oversight role, it should divest its shareholding in NIBSS and no longer play an active role in its management. The 2009 Regulatory Framework for Mobile Payment Services needs to be revised to level the playing field and intensify competition. The Payments System Management Bill needs to be enacted and RTGS related operational rules updated.

VIII. ANTI-MONEY LAUNDERING AND COMBATING OF FINANCING TERRORISM (AML/CFT)

80. **Despite Nigeria's high-level political commitment to work with the Financial Action Task Force (FATF) and the Inter Governmental Action Group Against Money Laundering in West Africa (GIABA) to address its strategic AML/CFT deficiencies, it has not made sufficient progress in implementing its action plan, and certain strategic AML/CFT deficiencies remain.** Nigeria should continue to work on addressing these

⁴² A revising and rediscounting scheme (RRF) that was introduced in 2002 has had only one application and the SME scheme established in 2010 with a target of ₦200 billion has only guaranteed ₦1.3 billion for a total of 25 SMEs.

deficiencies, including remaining issues regarding criminalization of money laundering and terrorist financing. The FATF encourages Nigeria to continue implementing its action plan.

81. Nigeria is due to undergo a comprehensive assessment of its AML/CFT framework for the purposes of its FSAP Update.⁴³ Nigeria was last assessed against the AML/CFT standard in 2008, by GIABA. The evaluation report highlighted a number of significant AML/CFT deficiencies and, consequently, a relatively low level of compliance with the FATF standard. As a result, Nigeria was placed under monitoring by the FATF International Cooperation Review Group. While the Nigerian authorities have agreed to an action plan to address the deficiencies and taken steps to enhance the AML/CFT framework, these measures were not considered sufficient by the FATF, and Nigeria—alongside other jurisdictions—was included in the FATF’s June 2012 Public Statement. In line with FSAP policies, the FSAP mission pressed the authorities for their commitment to undergo an AML/CFT against the FATF 2012 Recommendations by March 2014. In preparation for such assessment, Nigeria should address its principal AML/CFT deficiencies and challenges including but not limited to: (i) the criminalization of terrorism financing; (ii) the revision of the AML/CFT laws and regulations consistent with the new FATF Recommendations; (iii) enhancing the legislation establishing the Nigerian Financial Intelligence Unit as an autonomous operational agency; (iv) enhancing the role and capacity of the supervisory agencies in AML/CFT supervision, particularly that of the central bank; and (v) strengthening AML/CFT supervision of designated non-financial institutions including through a restructuring and retooling of the Special Control Unit Against Money Laundering.

⁴³ Under the May 2006 and June 2011 IMF Executive Board decisions, the FSAP policy requires that every initial FSAP and FSAP update incorporate a full AML/CFT assessment. It also requires the AML/CFT assessments to be conducted to the extent possible within 18 months before or after the relevant FSAP mission and approximately every five years.

Appendix I. Nigeria: Risk Assessment Matrix

Nature/Source of Main Threats	Likelihood of Realization of Threat (in the next two years) (high, medium or low)	Expected Impact on Financial Stability if Threat is Realized (high, medium or low)
1. Oil price shock	<p><i>Assessment: Medium</i></p> <ul style="list-style-type: none"> • The risk of a substantial oil price shock remains significant due to the uncertainties faced by the global economy. • After declining by about 20 percent in 2012:Q2, the Nigerian oil price has recovered to around US\$110 per barrel. 	<p><i>Assessment: High</i></p> <ul style="list-style-type: none"> • Given Nigeria's heavy reliance on oil exports and revenue, oil price volatility directly affects the whole economy. • A sharp decline in oil prices could sharply increase NPLs, particularly in sectors related to petroleum.
2. Domestic political instability	<p><i>Assessment: Medium</i></p> <ul style="list-style-type: none"> • The recent attacks by the Boko Haram terrorist organization and the subsequent curfews in the affected regions have started affecting economic activity and public confidence. 	<p><i>Assessment: Medium to High</i></p> <ul style="list-style-type: none"> • Banks in the northern regions may see increased deterioration of asset quality as uncertainties increase with the deterioration of the political environment.
3. High interest rates, partly on account of quasi-fiscal and contingent fiscal liabilities	<p><i>Assessment: Medium to High</i></p> <ul style="list-style-type: none"> • CBN has expressed its commitment to bring inflation down and maintain a stable exchange rate. To achieve these objectives would require high interest rates in the environment of continued fuel subsidies, directed credit schemes, and the possible realization of large contingent liabilities (e.g., AMCON bonds). 	<p><i>Assessment: Medium</i></p> <ul style="list-style-type: none"> • Limited threat from direct interest rate risk, but bank holdings of AMCON bonds could negatively affect bank capitalization and banks' liquidity ratios. • Potential increase in loan defaults if borrowers do not have capacity to pay.
4. Poor bank earnings	<p><i>Assessment: Medium</i></p> <ul style="list-style-type: none"> • Eight of the 20 banks suffered negative earnings in 2011. • Partly caused by provision expenses. 	<p><i>Assessment: Medium</i></p> <ul style="list-style-type: none"> • Continued asset quality deterioration would further negatively affect bank earnings. • In addition, tighter bank underwriting standards could constrain credit growth.

Appendix II. Stress Testing Matrix (STeM)

Appendix Table 1. Nigeria: Solvency Risk Stress Tests

Scope	Assumptions	
	Bottom-Up by Banks	Top-Down by FSAP and CBN Team
<i>Institutions included</i>	Ten largest banks (eight reported results)	All 20 commercial banks
<i>Market share</i>	Around 77 percent of total assets	100 percent
<i>Data and baseline date</i>	Audited, June 2012	Supervisory, August 2012
<i>Methodology</i>	Internal Models	Sensitivity analysis and reverse stress tests
<i>Stress test horizon</i>	Static (point in time)	Static (point in time)
<i>Shocks</i>	Sensitivity Analysis	
	Credit Risk	
	Deterioration of asset quality (aggregate)	Same
	Concentration risk (large borrowers, sectoral shocks)	Same
	N/A	Reverse stress on asset quality—haircut on aggregate standard loans
	Market Risk	
	Exchange rate risk—shock to Net open position	Same
	Interest rate risk—shift to local currency yield curve	Same
Equity Risk—shock to equity price index	Same	
Multi-factor Assessment		
Simultaneous credit and market risk shocks	Same	
<i>Risks/factors assessed</i>	Credit losses, earning losses and solvency	
<i>Calibration of risk parameters</i>	Based on an actual point in time (historical highs) or proxies. Expert judgment due to data limitation for a macro modeling	
<i>Regulatory standards</i>	Basel I (accompanied by local regulatory standards)	
<i>Results</i>	CAR/shortfall, group-wide and by bank Pass or fail; number of banks and percentage of assets that fail Distribution of capital ratios across the system by bank group/type	CAR/shortfall, system-wide and by bank Pass or fail; number of banks and percentage of assets that fail; number of insolvent banks post-shock Distribution of capital ratios across the system by bank group/type

Appendix Table 2. Nigeria: Liquidity Risk Stress Tests

Scope	Assumptions	
	Bottom-Up by Banks	Top-Down by FSAP and CBN Team
Institutions included	N/A	All 20 commercial banks
Market share	N/A	100 percent
Data and baseline date	N/A	Supervisory, June 2012
Methodology	N/A	Schmieder, Puhr, and Hasan (2011) Integrated Liquidity framework—bank run test and funding risks
Risks/factors assessed	N/A	Deposit run Short term funding risk Funding liquidity & market liquidity maturity mismatch/rollover risk concentration of funding
Regulatory standards	N/A	Basel 1 and local regulatory standards
Results	N/A	Liquid asset ratios/shortfall; number of failed banks

Appendix Table 3. Nigeria: Interest and Exchange Rate Risk Stress Tests

Scope	Assumptions	
	Bottom-Up by Banks	Top-Down by FSAP and CBN Team
Institutions included	Ten largest banks (eight reported results)	All 20 commercial banks
Market share	Around 77 percent of the total assets	100 percent
Data and baseline date	Audited, June 2012	Supervisory, June 2012
Methodology	Internal models	Sensitivity analysis and reverse stress tests
Risks/factors assessed	Same as top-down	Shifts in yield curve Depreciation of the Naira
Regulatory standards	Same as top-down	Basel 1 and local regulatory standards
Results	CAR/shortfall, system-wide and by bank. Pass or fail; number of banks and percentage of assets that fail. Distribution of capital ratios across the system by bank group/type.	CAR/shortfall, system-wide and by bank. Pass or fail; number of banks and percentage of assets that fail. Distribution of capital ratios across the system by bank group/type.

Appendix III. Status of Implementation of 2002 FSAP Recommendations

High Priority Recommendations	Status
Macroeconomic and monetary policies	
Unify the exchange rate in line with the advice already provided by the IMF. The unification of the exchange rate through moving to a market-based mechanism of its determination is essential to reduce distortions in the foreign exchange market and eliminate incentives for banks and their clients to engage in very lucrative arbitrage opportunities at the cost of neglecting their core business activities.	Implemented
The CBN should gradually reduce its reliance on rigidly defined direct monetary controls (cash reserve and liquidity ratios) in favor of market-based instruments. This can be achieved with possible technical assistance to enhance the effectiveness of indirect instruments in managing liquidity and in sterilizing large injections of liquidity by the government.	Largely implemented
Discontinue the CBN's practice of being the de facto residual taker of T-bills issued by the government to roll over its domestic debt stock. Alternatively, move away from the use of the "stop rate" and allow commercial banks and other holders of T-bills to roll over the whole amount of government debt.	Implemented
Ensure that "ways and means" advances are fully paid each year and not automatically transformed into T-bills and held by the CBN.	Implemented
Financial institutions and their supervision	
Move aggressively and expeditiously to effect the smooth exit of unsound banks. Avoid open-bank assistance by liquidating distressed banks that cannot be sold to qualified buyers with strong previous track records.	Not implemented
Ensure that, as a result of banks' exit and new licensing, the total number of banks in the system does not increase beyond the current level. This is necessary due to, among other things, the current lack of qualified management and the scarcity of supervisory resources.	Implemented
Take strong measures to better control insider lending by (i) broadening the definition of insider lending to include significant owners/shareholders; (ii) requiring that advances to insiders be deducted from capital for regulatory purposes; (iii) introducing an aggregate limit on total insider advances; (iv) introducing the legal concept of "significant shareholder" and requiring prior the CBN approval of transfers of significant shareholdings; and (v) providing the CBN with the power to deem a party related to a bank even if not captured in the legal definition of related party.	In progress
Take strong measures to improve compliance with regulations by (i) adopting a zero tolerance policy for misreporting by banks, matching the severity of the supervisory response to the seriousness of the problem; (ii) substantially increasing the penalties for all violations of regulations that represent purposeful falsification of reports or accounts	In progress

High Priority Recommendations	Status
or are violations of law; and (iii) in cases of repeated violations or breaches of serious prudential criteria, using the powers of the BOFIA to remove management and directors and exclude them from the banking industry.	
Strengthen significantly the monitoring of foreign exchange net open position limits for banks.	Implemented
Use the most recent on-site examinations as the basis for off-site rating of management quality in individual banks to reduce the focus on compliance and differentiate more adequately in terms of the quality of management (e.g., the bank's strategy, viability, extent of risk taking). Annualize income statements for all banks irrespective of the fiscal year of the reporting bank to facilitate peer comparisons and analysis of the banking system.	Implemented
Amend NDIC decree to eliminate need for various approvals of the minister of finance in dealing with problem banks.	Implemented
Catalyze the establishment of an active independent Bankers Association.	
Eliminate the directive encouraging banks to invest 10 percent of pretax earnings in the equity of small businesses; as such investing is not prudent.	No longer relevant
Grant no new licenses for PMIs. PMI's minimum capital requirements should be increased and limits on lending to one credit risk and to insiders should be reduced to the same levels as required for banks. PMIs in good health should be encouraged to apply for a commercial bank or a finance company license and those that are not sound should be closed. The FMFL and the FMBN should be closed. Focus the National Housing Fund (NHF) on providing long-term funds to banks and other healthy financial institutions desiring to extend mortgages at market rates and lift restrictions on margins and on lending rates.	PMI – Implemented FMBN – Not implemented
The OFID should assist troubled community banks with preparing and implementing restructuring plans. Those not meeting all licensing criteria should be given three years to comply. No new licenses should be granted for community banks not already in operation until an adequate supporting apex is in place.	Implemented
The NAICOM should enhance solvency examinations by relying more on outside auditors and actuaries for the basics and actively continue to eliminate insolvent insurance companies to strengthen the industry.	Implemented
The Investment and Securities Tribunal should be established as required by the Investment and Securities Act.	Implemented

Medium-Term Recommendations	Status
Financial institutions and their supervision	
Conduct a broad review and complete revision of the BOFIA to provide a coherent legislative framework.	In progress
Issue additional prudential guidelines to address issues of corporate governance in financial institutions, including qualification and experience requirements for non-executive directors, internal controls, and risk management.	Insurance - Partly implemented Capital market operators - Not implemented
Introduce prompt corrective action provisions to speed up resolution of problem banks and NBFIs.	In progress
Revise capital adequacy requirements for banks so that risk-weightings are consistent with the Basel Capital Accord. Phase in requirements for capital adequacy above 8 percent (12 percent recommended minimum).	Implemented
Use an average (preferably daily) for deposit levels for each bank over a period of time (e.g., three months) when calculating NDIC payments, to reduce incentives for window dressing.	Not implemented
Following the establishment of an independent Bankers Association, reduce the number of Bankers' Committee meetings and the scope of topics presented in those meetings, to catalyze increased self-governance initiatives by the banking industry.	No longer relevant
Rebuild the NBFIs sector on solid grounds and establish a supportive regulatory and supervisory environment. The OFID should be restructured by reorganizing its teams in units specialized by category of institution. Some NBCB and FMBN supervisory staff should join the OFID, bringing in valuable expertise and addressing the shortage of staff, while the OFID should outsource any capacity building initiative. The OFID urgently needs to modernize its data collection and processing and develop an efficient off-site surveillance system which can identify potential problems, initiate prompt corrective action, and guide on-site inspections. On the legal side, it is urgent that the powers of previous regulators be withdrawn. In addition, the BOFI, the CBN, and NDIC Acts should be amended and guidelines modified to eliminate regulatory gaps and provide deposit insurance for community banks that become fully licensed based on stronger screening than what is now taking place. The government should consider whether to compensate depositors in community banks that are to be wound-up.	Work in progress
Establish a cut-off date for public pension schemes in public enterprises and convert the defined benefit plans to defined contribution plans with appropriate transition rules. Undertake staff audits and actuarial assessments of the existing plans.	Implemented

Appendix IV. Profit and Loss Sharing Banking in Nigeria

82. **Islamic banking, which is also referred to as Profit/Loss Sharing (PLS) Banking in Nigeria, refers to a system of banking that complies with Islamic law or Shariah law. Nigerian PLS banking is at early infant stage.** There are two banks, which were given the special licenses to conduct PLS banking early 2012, namely Jaiz Bank Plc (Jaiz) and Stanbic IBTC Bank (Stanbic). In Nigeria, PLS banking is in two distinctive modes, that is stand-alone license (Jaiz) and window license of the conventional outfit (Stanbic). Both modes of operations are subject to meeting applicable standards and guidelines to ensure that the PLS banking operations are fully Shariah compliant.

83. **In a dual banking system in which conventional and PLS banking products are offered in parallel, a critical aspect of the regulatory and supervisory frameworks is the consistency of rules and regulations across sectors to eliminate possibilities for regulatory arbitrage.** At the same time, there is a need to reflect the differences in the nature of risk inherent in PLS banking products and services. In view of being in the infancy stage, the existing regulatory and supervisory frameworks for conventional banks are also applicable for PLS banks, and the CBN has yet to carry out detailed studies on the need (if any) to modify the existing frameworks to cater for risks specific to PLS banking business. However, there is a specific regulation (*Framework for the Regulation and Supervision of Institutions Offering Non-interest Financial Services in Nigeria*) which focuses mainly on Shariah compliant guidelines. All PLS banks are required to set-up *Advisory Committee Experts (ACEs)*, to oversee the Shariah compliant aspects of the operations, while a requirement to have internal Shariah advisors within the bank helps to operationalize the Shariah ruling by these committees. The set-ups at individual bank level are complemented by the *CBN Advisory Council of Experts (CACE)* at CBN level. In any instance of conflicting Shariah views between the individual banks' ACEs and CACE, the ruling of CACE will prevail.

84. **The CBN's risk-based supervisory (RBS) approach is the universal approach and hence should be, and has been, appropriately applied to the two PLS banks.** Since the two banks commenced operations in 2012, there has yet to be a completed supervisory assessment on them. Currently, the CBN supervisors, via a specific supervisory division that supervises PLS banks, are in the midst of completing the first round of supervisory assessment on these banks' operations, and expect to complete the whole process by end-2012.

85. **From a legal perspective, the PLS banking operation is governed by the same banking act applicable to conventional banks namely, Banks and Other Financial Institutions Act (BOFIA).** To ensure that the PLS banking operation can be carried out appropriately and not be subjected to the restriction of conventional banking activities in the BOFIA, the CBN via Section 52 of the Act (*exemption for community banks or PLS banks from the provision of the Act*) has provided the relevant exemption to PLS banks, namely to

carry out asset trading activities to assist the PLS banking activity, which are mostly asset-based. Nevertheless, there was no specific circular issued to the current PLS banks on the exemption given.

86. **Being very new and still at the infant stage of development of PLS banking, there are several areas that need the CBN's serious attention.** It is critical for these gaps to be addressed at the early stage to ensure that PLS banking starts on the right and robust ground.

87. **Explicit legal support is required to promote the PLS banking operations.** Although Section 52 of the BOFIA is in place to support the setting-up of PLS banking operations, the CBN needs to be explicit in its licensing on the applicability of the section, to clearly indicate that PLS banking operations are allowed to carry out asset-based transactions. This is critical to avoid future legal complication that can expose the PLS banks to soundness issues e.g., nonperforming customers who may use legal loopholes.

88. **As far as the tax implication is concerned, Federal Inland Revenue Services (FILS) via its Board Technical Committee, has set-up a sub-committee on non-interest banking whose task is to address the issue of tax neutrality for PLS banking, which includes exemption from capital gains tax and multiple stamp duties on the transfer of assets for the purpose of PLS banking transactions.** *The Islamic Finance Council of the U.K.* was also consulted as Islamic banking in the U.K. has addressed the issue effectively. However, the proposal has yet to be finalized, and since the two banks are heading toward the end of their first year of operation, the issue needs to be finalized soonest.

89. **Another area that requires serious attention is the legal implication of the Shariah rulings by the CACE.** All legal issues for commercial transactions are addressed via civil courts, and these include the PLS banking transactions. Currently, there is no legal provision that requires a court of law to consult CACE on a PLS banking transaction. It is critical for the court of law to understand a Shariah ruling by CACE, which may be taken on the basis of financial stability. Therefore, the CBN should consider making a platform for consultation available to judges that preside on PLS banking transactions. The CBN may also consider having representatives from the legal community as members of CACE, to advice on legal related matters.

Liquidity and Supervisory Infrastructure to Support PLS Banking Operations

90. **Currently, the PLS banks are allowed to enter into interbank transactions with the conventional banks via conventional interbank products, to help these banks in liquidity management.** Moving forward however, such exemption from Shariah rulings may

expose these banks to reputational risk.⁴⁴ On this note, the CBN has taken the initiative to introduce interbank instruments that are Shariah compliant. The Committee of Governors has recently approved three interbank instruments namely Wadi'ah (safe-keeping) interbank placement, non-interest CBN notes, and the use of U.S. dollar ABS Sukuks (with strong international ratings). The other proposal for CBN to issue Ijarah (lease-based) Sukuks was put on hold for further study. It is recommended that the initiatives be implemented as soon as possible, to avoid the reputational risk of not having Shariah systems, and to ensure efficient use of appropriate interbank instruments for liquidity management purposes. The CBN may also consider reviewing the CBN Act which prohibits it from entering into asset trading transactions, so that it can issue asset-based Sukuks to assist the liquidity management of PLS banks.

91. **The RBS framework is sufficiently universal to enable it to be applied to PLS banking operations.** However, there may be a need to introduce Shariah non-compliant risk elements into the framework to ensure PLS banks are not exposed to unnecessary reputational risk arising from Shariah noncompliant activities. Capacity building of the CBN supervisors is expected in the area of PLS banking. Similar to the recommendations on the ROSC/BCP assessment, the CBN may consider having Shariah specialists as part of the proposed Specialist Risk Unit.

Prudent Implementation of International Capital and Accounting Standards

92. ***The Islamic Financial Services Board (IFSB), which is the counterpart of the BCBS for Islamic finance, had issued Capital Adequacy Standard (CAS-2005) as guidance for supervisory authorities across the globe.*** The standard is similar to *Basel II (Pillar I) Accord* for the standardized approach. The most distinctive difference is the risk absorbent feature of profit sharing funding. The standard basically allow for risks on assets funded by *profit-sharing investment accounts (PSIA)* to be deducted from capital adequacy calculations so as to reflect the true nature of the Islamic banking funding structure. The CBN is currently in the midst of implementing *Basel II Accord* for the conventional banks, and it is just a matter of time before the *CAS-2005* of IFSB is applied to the PLS banks. However, any jurisdiction including Nigeria should be very diligent in considering the implementation of this specific element in *CAS-2005*. Understanding the different players/characters in the PLS banking system is critical to the success of this element. Otherwise, it may lead to an under-capitalised PLS banking system, which will expose the system to financial instability.

⁴⁴ Although the current arrangement is Shariah-wise acceptable, by requiring that any gain from the interbank transactions is not recognized on the PLS banks' books, and PLS banks are required to distribute the gain for charitable purposes.

93. **In terms of accounting and disclosure requirements, the PLS banks are guided by the *Framework for the Regulation and Supervision of Institutions Offering Non-Interest Financial Services (paragraph 12.0)*.** The guidance expects PLS banks to adhere to the accounting and disclosure standards of *Nigerian Accounting Standards Board (NASB)*, *IFSB, Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI)* and *International Financial Reporting Standards (IFRS)*. Similarly in this situation, CBN also needs to be mindful of the differences between these various standard-setting bodies. Specifically there are two areas that need to be carefully analysed before implementing the relevant accounting and disclosure standards:

- *Treatment of PSIA.* AAOIFI standards treat PSIA as off-balance sheet items since the loss from the investment is technically fully borne by the investors. However, based on IFRS principals, the volatility of PSIA's return still affects the return to the banks, and hence the exposures must be treated as on-balance sheet items.
- *Treatment of Profit Equalization Reserves (PER)/Investment Risk Reserves (IRR).* AAOIFI allows the use of PER/IRR as income smoothing mechanism but IFRS is very strict in allowing for any generic nature of reserves to be provided without any support of empirical studies.

94. **The above differences may lead to different disclosure objectives and the CBN needs to fully internalize which objective it expects to achieve.** In any case, the financial stability objective must be a top priority for any regulatory and supervisory stance that the CBN plans to take.

Appendix V. Key Tables

Appendix Table 4. Nigeria: Selected Economic and Financial Indicators, 2009–14

	2009	2010	2011	2012	2013	2014
	Act.	Act.	Est.	Proj.	Proj.	Proj.
National income and prices	(Annual percentage change, unless otherwise specified)					
Real GDP (at 1990 basic prices)	7.0	8.0	7.4	6.3	7.2	7.0
Oil and Gas GDP	0.5	5.2	-0.6	1.8	4.9	3.3
Non-oil GDP	8.3	8.5	8.9	7.1	7.5	7.6
Production of crude oil (million barrels per day)	2.2	2.5	2.4	2.4	2.5	2.6
Nominal GDP at market prices (trillions of Naira)	25.1	34.4	37.8	43.3	49.2	54.6
Nominal non-oil GDP (trillions of Naira)	17.7	19.9	22.5	26.9	31.2	36.2
Nominal GDP per capita (US\$)	1,110	1,465	1,522	1,644	1,724	1,797
GDP deflator	-4.4	26.8	2.3	7.8	6.1	3.6
Non-oil GDP deflator	5.7	3.5	4.0	11.6	8.1	7.7
Consumer price index (annual average)	12.5	13.7	10.8	12.4	8.6	8.2
Consumer price index (end of period)	13.9	11.7	10.3	11.0	9.5	7.0
FGN gross debt (percent of GDP)	15.2	15.5	17.2	17.7	17.4	17.6
Of which: domestic debt (percent of GDP)	12.9	13.2	14.9	15.3	14.2	14.1
Consolidated government operations²	(Consists of federal, state, and local governments; percent of GDP)					
Total revenues and grants	17.8	20.0	29.9	28.2	27.5	26.0
Of which: oil and gas revenue	10.6	14.0	23.4	21.7	20.8	19.1
Total expenditure and net lending	27.3	26.9	29.4	27.0	26.9	26.2
Of which: fuel subsidies ³	1.3	2.3	4.7	3.6	2.0	1.9
Overall balance	-9.5	-6.9	0.5	1.2	0.6	-0.2
Non-oil primary balance (percent of non-oil GDP)	-26.8	-34.3	-36.0	-30.5	-29.3	-26.9
Excess Crude Account/Sovereign Wealth Fund (US\$ billions)	7.1	2.7	4.6	12.7	20.7	26.8
Money and credit	(Change in percent of broad money at the beginning of the period, unless otherwise specified)					
Broad money (percent change; end of period)	17.1	6.9	15.4	10.0	18.6	18.2
Net foreign assets	-10.9	-10.3	5.5	14.1	12.4	12.1
Net domestic assets	28.0	17.2	9.9	-4.2	6.2	6.1
Credit to consolidated government	9.7	12.3	4.9	-9.9	-2.8	-4.0
Credit to the rest of the economy	21.3	-4.2	36.5	7.9	12.0	11.6
Velocity of broad money (ratio; end of period)	1.6	1.7	1.8	1.8	1.8	1.7
Treasury bill rate (percent; end of period)	4.0	7.5	14.3
External sector	(Annual percentage change, unless otherwise specified)					
Exports of goods and services	-33.4	36.5	20.1	7.4	4.4	0.4
Imports of goods and services	-22.6	36.6	27.2	7.6	5.7	6.2
Terms of trade	-16.5	9.9	9.1	1.4	-0.3	-1.6
Price of Nigerian oil (US\$ per barrel)	61.8	79.0	109.0	111.3	110.1	105.3
Nominal effective exchange rate (end of period)	82.2	83.6	82.2
Real effective exchange rate (end of period)	110.0	120.7	119.4
External debt outstanding (US\$ billions)	4.0	5.1	5.6	6.4	9.4	11.2
Gross international reserves (US\$ billions)	42.4	32.3	32.6	46.0	53.6	63.4
(equivalent months of imports of goods and services)	7.4	4.5	4.2	5.6	6.1	6.9

¹Large errors and omissions in the balance of payments suggest that the current account surplus is overestimated by a significant but unknown amount.

²For 2013 and 2014–15, the budget oil price is assumed to be US\$78 and US\$75 a barrel, respectively.

³For 2012, includes one-off payment of about 1 percent of GDP to settle arrears accrued in 2011.

Source: Nigerian authorities and IMF staff estimates and projections.

Appendix Table 5. Nigeria: Financial Soundness Indicators

	Dec-08	Dec-09	Dec-10	Dec-11	Jun-12
Growth Rates					
Total Assets	46.6	-3.6	-8.8	36.9	-2.2
Total loans	62.3	0.2	-10.8	21.3	5.4
Deposits	65.0	18.4	-11.3	30.2	-1.6
Due from banks in Nigeria	119.3	-69.7	-25.8	20.2	-47.8
Due from banks abroad	61.9	-18.3	-3.0	41.5	10.3
Government securities	-23.4	13.4	45.2	96.3	-9.9
Capital Adequacy					
Core Capital/RWA	21.5	4.9	2.2	18.4	17.8
Total Qualifying Capital/RWA	21.9	4.1	1.8	18.2	17.7
NPL – Specific provisions/Core Capital	9.1	106.8	192.7	9.4	5.1
Asset Quality					
NPLs/Total Loans	6.3	27.6	15.7	4.8	4.0
Specific provisions/NPLs				55.5	67.9
Earning Assets/Total Asset	94.6	93.6	94.0	94.8	95.3
Earnings and Profitability					
Return on Average Assets	3.7	-8.9	3.0	-0.1	1.2
Return on Average Equity	20.7	-222.8	39.4	-0.4	8.9
Net Interest Margin			6.0	4.5	3.2
Interest margin to gross income	58.3	57.8	53.7	45.2	64.6
Personnel to non-interest expenses	44.8	47.6	42.8	36	43.6
Liquidity					
Liquid assets/Total assets	17.6	16.5	17.2	25.7	39.0
Liquid Assets/Total Deposits	52.9	36.5	39.2	58.9	56.5
Loans/Total Deposits	66.6	56.4	56.6	52.8	56.5

Source: Nigerian authorities and IMF staff calculations.

Appendix Table 6. Nigeria: Credit Risk Sensitivity Analysis

		Top Down Stress Test for 20 Banks								
		System Level				Outlier Banks (CAR < 10%) ¹		Outlier Banks (Tier I CAR < 6%) ²		Insolvent Banks
		CAR	Tier II / RWA	NPL Ratio	Losses (% of Total Capital)	Number of Outlier Banks	Share in Total Assets	Number of Outlier Banks	Shares in Total Assets	Number of Outlier Banks
Baseline:		18.5	18.4	4.5		1.4		1.4	1	
	System Level									
Shock 1:	NPLs increase by 100%	17.3	17.2	8.7	8.8	1	2.0	1.0	2.0	1
Shock 2:	NPLs increase by 200%	15.2	15.1	13.0	26.7	3	9.7	3.0	6.9	1
Shock 3:	NPLs increase by 300% (Historical)	12.9	12.8	17.3	53.9	7	21.6	7.0	12.5	3
	Sectoral Loans									
Shock 1:	Increases in Agricultural NPLs by 100%	18.5	18.4	4.4	0.2	0	0.0	0.0	0.0	1
	Increases in Agricultural NPLs by 200%	18.4	18.4	4.5	0.3	0	0.0	0.1	2.0	1
	Increases in Agricultural NPLs by 300%	18.4	18.3	4.6	0.5	1	2.0	0.0	2.0	1
Shock 2:	Increases in Oil and Gas NPLs by 100%	18.3	18.3	5.0	1.0	0	0.0	0.0	0.0	1
	Increases in Oil and Gas NPLs by 200%	18.1	18.0	5.7	2.7	0	0.0	0.0	0.0	1
	Increases in Oil and Gas NPLs by 300%	17.8	17.8	6.3	4.4	0	0.0	0.0	0.0	1
Shock 3:	Increases in Telecom NPLs by 100%	18.4	18.4	4.8	0.3	0	0.0	0.0	0.0	1
	Increases in Telecom NPLs by 200%	18.4	18.4	5.2	0.4	0	0.0	0.0	0.0	1
	Increases in Telecom NPLs by 300%	18.4	18.3	5.7	0.8	0	0.0	1.0	2.0	1
Shock 4:	Increases in Real Estate and Const. NPLs by 100%	18.4	18.3	4.6	0.3	0	0.0	0.0	0.0	1
	Increases in Real Estate and Const. NPLs by 200%	18.4	18.3	4.8	0.5	0	0.0	0.0	0.0	1
	Increases in Real Estate and Const. NPLs by 300%	18.4	18.3	5.0	0.9	0	0.0	0.0	0.0	1
Shock 5:	Increases in General NPLs by 100%	18.4	18.3	5.1	0.8	0	0.0	1.0	2.0	1
	Increases in General NPLs by 200%	18.1	18.0	5.9	2.4	0	0.0	1.0	2.0	1
	Increases in General NPLs by 300%	17.8	17.7	6.6	4.6	1	2.0	1.0	2.0	1
Shock 6:	Increases in General Commerce NPLs by 100%	18.3	18.2	5.2	1.0	0	0.0	0.0	0.0	1
	Increases in General Commerce NPLs by 200%	18.2	18.1	6.0	2.2	0	0.0	0.0	0.0	1
	Increases in General Commerce NPLs by 300%	19.9	17.8	6.8	4.0	0	0.0	0.0	0.0	1
Shock 7:	Combined Shock (Oil and Gas, General and General Commerce) by 300%	15.9	15.8	11.1	20.0	4	12.5	2.0	6.9	1

¹Excluding the bank that is insolvent even before the stress tests.
²Including the bank that is insolvent before tests. Other banks that become insolvent are included in the other outlier banks.

Source: Top Down: CBN and IMF staff calculations.

Appendix Table 6. Nigeria: Credit Risk Sensitivity Analysis (continued)

Top Down Stress Test for 20 Banks									
System Level					Outlier Banks (CAR < 10%) ¹		Outlier Banks (CAR < 10%) ²		Insolvent Banks
CAR	Tier I/ RWA	NPL Ratio	Losses (% of Total Capital)	Number of Outlier Banks	Share in Total Assets	Number of Outlier Banks	Shares in Total Assets	Number of Outlier Banks	
Deterioration of Standard Loans									
Shock 1:	Increase in Agricultural NPLs by 10%								
	18.5	18.4	4.7	0.2	0	0.0	0.0	0.0	1
	Increase in Agricultural NPLs by 20%								
	18.4	18.4	5.0	0.3	0	0.0	1.0	2.0	1
	Increase in Agricultural NPLs by 40%								
	18.4	18.3	5.7	0.9	1	2.0	1.0	2.0	1
Shock 2:	Increase in Oil and Gas NPLs by 10%								
	18.1	18.0	6.5	2.9	0	0.0	0.0	0.0	1
	Increase in Oil and Gas NPLs by 20%								
	17.3	17.2	8.6	8.5	1	2.8	0.0	0.0	1
Shock 3:	Increase in Oil and Gas NPLs by 40%								
	15.5	15.4	12.9	23.5	2	16.6	2.0	4.9	1
	Increase in Telecom NPLs by 10%								
	18.4	18.3	5.2	0.5	0	0.0	0.0	0.0	1
	Increase in Telecom NPLs by 20%								
	18.3	18.2	6.1	1.3	0	0.0	0.0	0.0	1
Shock 4:	Increase in Telecom NPLs by 40%								
	17.9	17.9	7.9	3.8	0	0.0	0.0	0.0	1
	Increase in Real Estate and Const NPLs by 10%								
	18.4	18.3	4.8	0.4	0	0.0	0.0	0.0	1
	Increase in Real Estate and Const NPLs by 20%								
	18.3	18.3	5.3	1.0	0	0.0	0.0	0.0	1
Shock 5:	Increase in Real Estate and Const NPLs by 40%								
	18.1	18.0	6.2	2.7	0	0.0	0.0	0.0	1
	Increase in General NPLs by 10%								
	18.4	18.3	5.3	0.8	0	0.0	0.0	0.0	1
	Increase in General NPLs by 20%								
	18.2	18.1	6.3	1.9	0	0.0	0.0	0.0	1
Shock 6:	Increase in General NPLs by 40%								
	17.5	17.4	8.2	6.7	1	2.8	0.0	0.0	1
	Increase in General Commerce NPLs by 10%								
	18.3	18.2	5.5	1.3	0	0.0	1.0	2.0	1
	Increase in General Commerce NPLs by 20%								
	18.0	17.9	6.6	3.7	1	2.0	1.0	2.0	1
	Increase in General Commerce NPLs by 40%								
	17.1	17.0	9.0	10.2	1	2.0	1.0	2.0	1
Concentration Risk									
Shock 1:	The top single borrower defaults								
	17.5	17.4	8.5	6.9	0	0.0	0.0	0.0	1
Shock 2:	The top group borrower defaults								
	16.9	16.8	10.2	11.7	0	0.0	1.0	2.0	1
Shock 3:	The top three single borrowers default								
	14.2	14.1	14.9	37.4	2	4.5	1.0	2.8	1
Shock 4:	The top three group borrowers default								
	12.7	12.6	17.9	55.7	6	30.2	2.0	4.9	1
Shock 5:	The top five single borrowers default								
	11.3	11.2	19.5	77.9	9	52.6	3.0	10.6	1
Shock 6:	The top three group borrowers default								
	5.5	5.4	28.7	293.1	13	73.1	9.0	47.5	2
Reverse Testing									
Shock 1:	The haircut on standard loans causing 50% of sector to fall below 10% CAR (Haircut 20%)								
	8.5	8.4	24.3	143.9	11	69.6	6.0	37.6	2
Shock 2:	The haircut on standard loans causing sector to fall below 10% CAR (haircut 16%)								
	11.0	10.9	20.6	84.2	7	40.5	5.0	23.8	1

¹Excluding the bank that is insolvent even before the stress tests.

²Including the bank that is insolvent before tests. Other banks that become insolvent are included in the other outlier banks.

Appendix Table 7. Nigeria: Interest Rate Risk Sensitivity Analysis (Banking Book)

		Top Down Stress Test						
		System Level		Outlier Banks (CAR < 10%)		Outlier Banks (Core CAR < 6%)		
		CAR	Core CAR	Losses (% of Total Capital)	Number of Outlier Banks	Shares in Total Assets	Number of Outlier Banks	Share in Total Assets
Baseline:		18.5	18.4		1	1.4	1	1.4
Shock 1:	Parallel upward shift of the Naira yield curve by 500 bps	18.4	18.3	0.4	0	0.0	0	0
Shock 2:	Parallel upward shift of the Naira yield curve by 1000 bps	18.3	18.2	1.3	1	1.9	0	0
Shock 3:	Parallel upward shift of the Naira yield curve by 1500 bps	18.1	18.0	2.5	1	1.9	0	2
Shock 4:	Parallel downward shift of the Naira yield curve by 250 bps	18.5	18.4	0.2	0	0.0	0	0
Shock 5:	Parallel downward shift of the Naira yield curve by 500 bps	18.5	18.4	0.2	0	0.0	0	0
Shock 6:	Parallel downward shift of the Naira yield curve by 1000 bps	18.4	18.4	0.3	0	0.0	1	0
Shock 7:	Steepening of the Naira yield curve from 0–1000 bps	16.6	16.5	13.7	2	4.7	1	2
Shock 8:	Parallel upward shift of USD yield curve by 100 bps	18.5	18.4	0.2	0	0.0	0	0

Source: Top Down: CBN and IMF staff calculations.

Appendix Table 8. Nigeria: Foreign Exchange Risk Sensitivity Analysis

		Top Down Stress Test						
		System Level		Outlier Banks (CAR < 10%)		Outlier Banks (Core CAR < 6%)		
		CAR	Core CAR	Losses (% of Total Capital)	Number of Outlier Banks	Shares in Total Assets	Number of Outlier Banks	Share in Total Assets
Baseline:		18.5	18.4		1	1.4	1	1.4
Shock 1:	Naira depreciates against all currencies by 15 percent	18.5	18.4	0.000001	-	0.0	-	0
Shock 2:	Naira depreciates against all currencies by 15 percent	18.5	18.4	0.000023	-	0.0	-	0
Shock 3:	Naira depreciates against all currencies by 15 percent	18.5	18.4	0.000031	-	0.0	-	0

Source: Top Down: CBN and IMF staff calculations.

Appendix Table 9. Nigeria: Equity Price Risk Sensitivity Analysis

	Top Down Stress Test						
	System Level		Outlier Banks (CAR < 10%)		Outlier Banks (Core CAR < 6%)		
	CAR	Core CAR	Losses (% of Total Capital)	Number of Outlier Banks	Shares in Total Assets	Number of Outlier Banks	Share in Total Assets
Baseline:	18.5	18.4		1	1.4	1	1.4
The Equity Price Index drops by 30 percent	18.2	18.2	1.7	0	0.0	0	0.0
The Equity Price Index drops by 70 percent	17.8	17.7	5.1	0	0.0	1	2.0

Source: Top Down: CBN and IMF staff calculations.

Appendix Table 10. Nigeria: Sensitivity Analysis: Multi-Factor Shocks

	Top Down Stress Test							
	System Level			Outlier Banks (CAR < 10%)		Outlier Banks (Core CAR < 6%)		Insolvent Banks
	CAR	Core CAR	Losses (% of Total Capital)	Number of Outlier Banks	Shares in Total Assets	Number of Outlier Banks	Share in Total Assets	Number of Outlier Banks
Baseline:	18.5	18.4		1		1		1
Shock 1: Aggregate NPLs increases 50 percent, Naira depreciates against all currencies by 15 percent and parallel upward shift of the Naira yield curve by 500 bps	17.9	17.8	3.8	0	0.0	1	0.0	1
Shock 2: Aggregate NPLs increases 100 percent, Naira depreciates against all currencies by 30 percent and parallel upward shift of the Naira yield curve by 1000 bps	17.0	16.9	10.9	2	3.9	1	3.9	1
Shock 3: Aggregate NPLs increases 200 percent, Naira depreciates against all currencies by 40 percent and parallel upward shift of the Naira yield curve by 1500 bps	14.8	14.7	30.3	4	11.6	3	11.6	2

Source: Top Down: CBN and IMF staff calculations.

**ANNEXES. OBSERVANCE OF FINANCIAL SECTOR STANDARDS AND CODES
SUMMARY ASSESSMENTS**

This Annex contains the summary assessments of Nigeria's observance of financial standards and codes. These assessments help identify the main strengths of the supervisory, regulatory and market infrastructure framework in managing potential risks and vulnerabilities in the financial system. They also point to areas that need strengthening and further reform.

These summaries are based on detailed assessments of the following international standards:

Basel Core Principles (BCP) for Effective Banking Supervision – by Khairul Ibrahim (external expert) and Carel Oosthuizen (IMF).

IAIS Insurance Core Principles (ICP) – by Mimi Ho (external expert) and Rodolfo Wehrhahn (IMF)

IOSCO Principles and Objectives of Securities Regulation – by Carlos Barsallo (external expert) and Eija Holttinen (IMF).

ANNEX I. COMPLIANCE WITH THE BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

A. Introduction

95. **The assessment of the current state of the implementation of the Basel Core Principles for Effective Banking Supervision (BCP) in Nigeria, against the BCP methodology issued by the Basel Committee on Banking Supervision (BCBS) in October 2006⁴⁵, was completed between August 27 and September 19, 2012, as part of a FSAP update, undertaken jointly by the IMF and the World Bank, and reflects the regulatory and supervisory framework in place as of the date of the completion of the assessment.** The previous BCP assessment was conducted in 2002, in terms of the 1998 BCP methodology, which is not directly comparable to this assessment.

B. Information and Methodology Used for Assessment

96. **The assessment team⁴⁶ reviewed the legal framework for banking supervision and held extensive discussions with the staff of the CBN and the NDIC, which both perform supervision of banks, though the former is the lead supervisor.** The assessors also met with officials of the FMOF, several commercial banks, audit firms and the Chartered Institute of Bankers of Nigeria. The team examined the current practice of on-site and off-site supervision of the CBN and the NDIC.

C. Institutional and Macroeconomic Setting, and Market Structure - Overview

97. **Nigeria has a diverse financial sector.** The number of financial institutions as at December 31, 2011 included the following: 21 commercial banks (CBs) (six banks, including five domestic banks and one pan-African bank, dominate the banking sector) five discount houses (DHs), 876 microfinance banks (MFBs), 107 finance companies (FCs), 101 primary mortgage institutions (PMIs), 31 pension fund administrators (PFAs), five pension fund custodians (PFCs), 1,946 bureaux de change (BDCs), 690 securities brokerage firms, five DFIs, three private credit bureaux, 61 insurance companies, two reinsurance companies, 50 loss adjusters, and the AMCON.

⁴⁵ An updated version of the BCBS's Core Principles for Effective Banking Supervision was issued in September 2012.

⁴⁶ The BCP assessment was conducted by Carel Oosthuizen (IMF) and Khairul Ibrahim (Consultant; Deputy Director with the Banking Supervision Department of Bank Negara, Malaysia.)

Annex Table 1. Nigeria: Structure of the Financial System, 2011
(₦billion, unless specified otherwise)

	2006			2010			2011		
	Number	Assets	In percent of total assets	Number	Assets	In percent of total assets	Number	Assets	In percent of total assets
Commercial banks	25	6,738	90.5	24	15,544	94.8	20	18,477	78.7
Private	25	6,738	90.5	24	15,544	94.8	17	17,548	74.7
Domestic	21	6,456	86.7	20	14,217	86.7	13	14,704	62.6
Foreign	4	282	3.8	4	1,327	8.1	4	2,844	12.1
State-owned	0		0.0	0	0	0.0	3	928	4.0
Institutional investors	124	300	4.0	100	565	3.4	91	3,457	14.7
Insurance Companies	107	n.a.		61	565	3.4	61	622	2.6
Pension Funds	13	300	4.0	30	n.a.		21	2,835	12.1
Unit Trusts	8	n.a.		8	n.a.		8	n.a.	
Other Non-Banks Financial Institutions	1,683	409	5.5	1,619	280	1.7	1,403	1,543	6.6
Finance Companies	112	54	0.7	108	31	0.2	n.a.		
Specialized development institutions	6	n.a.	n.a.	6	250	1.5	6	267	1.1
Securities Firms	581	n.a.		580	n.a.		254	n.a.	
Fund Managers							136	1,085	4.6
Mortgage Institutions	90	114	1.5			0.0			
Microfinance Banks	757	55	0.7	800	n.a.		876	191	0.8
Discount Houses	5	186	2.5			0.0	5	n.a.	
Bureaux de Change	126	n.a.		125	n.a.		125	n.a.	
Asset management Companies (AMC)							1	n.a.	
Other	6	n.a.							
Total financial system	1,826	7,447	100.0	16,389	100.0		23,477	100.0	

Source: CBN.

98. **The CBN, as part of its statutory mandate of promoting a sound financial system in Nigeria, licenses and carries out the prudential regulation and supervision of CBs, other financial institutions (OFIs), DHs, non-interest Banks (NIBs), MFBs, PMIs, FCs, BDCs, and AMCON.** NDIC, on the other hand, administers the deposit insurance scheme and also collaborates with the CBN in the on-site and off-site supervision of commercial banks, merchant banks, and insured MFBs and PMIs. The supervisory departments of the CBN and NDIC had 847 supervisors as at end-December 2011. Each of the CBN and NDIC, respectively, separately maintain off-site supervision function in Abuja and on-site examination function in Lagos. Other sector regulators include the SEC, the NAICOM and the PENCOM for the securities, insurance and pensions sector respectively.

99. **The co-ordination of the activities of the Nigerian banking sector supervisory authorities is conducted under the aegis of the CBN/NDIC Executive Committee on Supervision which should ensure that operations of the two supervisory authorities are coordinated to remove overlaps, avoid gaps and ensure adequate information sharing on issues of supervisory concern.** The Financial Services Regulation Coordinating Committee (FSRCC) provides the platform for the co-ordination among and information sharing with regulatory authorities, inter alia with reference to financial sector stability, and supervision of financial conglomerates, financial holding companies and bank holding companies.

100. **The CBN and NDIC derive their supervisory powers principally from the CBN Act, NDIC Act, and the BOFIA.** Other legislative instruments that impact on banking supervision include the Failed Banks (Recovery of Debts) and Other Malpractices in Banks Act, 2004, the Companies and Allied Matters Act (CAM Act), 2004, the Economic and Financial Crimes Commission Act 2004 and the Money Laundering Prohibition Act 2011. The CBN and NDIC also issue rules and regulations pursuant to their powers under the above-mentioned legislation.

101. **Total banking sector assets stood at ₦18.21 trillion as at end-December 2011, which represented 53.6 percent of GDP.** Of the 21 banks, four are owned by foreign banking organisations while seventeen are domestically controlled. The domestic banks controlled 86.4 percent of industry assets as at end-December 2011 compared with 13.6 percent controlled by foreign institutions. The three domestic banks that were acquired by the AMCON in 2011 controlled 5.0 percent of industry assets.

102. **The banking sector appears relatively sound as at end-December 2011, as shown by soundness indicators, many of which displayed an improving trend.** The ratio of regulatory capital to risk weighted assets increased to 17.8 percent at end-December 2011, representing a 13.6 percentage point increase over the ratio of 4.2 percent recorded at the peak of the banking crisis (end-June 2011). Similarly, the ratio of Tier 1 capital to risk weighted assets of 18.1 percent at end-December 2011 was 13.6 percentage points higher than the level of 4.5 percent achieved at end-June 2011. Asset quality indicators also showed a substantial improvement. The ratio of NPLs to total loans of 4.9 percent showed a decline of 22.5 percentage points from its peak of 28.8 percent at end-June 2010. The level of liquidity in the system also displayed an increasing trend—the ratio of core liquid assets to total assets increased to 25.7 percent at end-December 2011 from 17.2 percent at end-June 2010. Similarly, the ratio of liquid assets to short-term liabilities increased by 11.8 percentage points to 31.2 percent between June 2010 and end-December 2011.

103. **The banking sector has undergone significant change and reform.** After the bank recapitalizations following the 2005–06 banking sector consolidation, Nigeria experienced rapid credit expansion as banks broadened their activities and moved to the untapped retail sector, to borrowers involved in equity market speculation (margin lending collateralized by shares) and acquiring nonbank subsidiaries. The 2005–06 banking sector consolidation generated capacity for several Nigerian banks to expand internationally, establishing subsidiaries particularly in Africa.

104. **The Nigerian economy has experienced a number of domestic and external shocks in recent years, which impacted the banking sector.** The oil price drop and currency devaluation accompanying the 2008 global financial crisis stressed those banks with heavy concentration in the oil and gas sector, while the NSE downturn adversely affected banks exposed to margin lending. In 2008, the Nigerian stock market lost about two-thirds of its value, following a sharp decline in world oil prices and currency devaluation. Banks with

heavy concentration in the oil and gas sector were stressed, while the stock exchange downturn adversely affected banks exposures to margin lending. By 2009, the banking sector was in crisis.

105. **But large buffers, built before the global crisis, and low debt, helped mitigate the impact of the shocks by providing room for expansionary fiscal policy.** Fortunately, the economy continued to grow rapidly at over 7 percent during each year since 2009. Monetary policy was tightened in 2011 after an increase in inflation and a decline in international reserves in 2010. Although the macroeconomic outlook remains positive, substantial risks remain, in view of the fact that oil constitute more than 90 percent of exports and oil receipts generate 75 percent of government revenue, and the recent spate of social unrest in the north of the country continues.

106. **A banking crisis, which involved more than 40 percent of the banking sector assets, came to a head in the second half of 2009.** The authorities identified the following as the main contributing factors:

- Macro-economic instability caused by large and sudden capital inflows.
- Major failures in corporate governance at banks.
- Lack of investor and consumer sophistication.
- Inadequate disclosure and transparency about the financial position of banks.
- Critical gaps in regulatory framework and regulations.
- Uneven supervision and enforcement.
- Unstructured governance and management processes at the CBN/weaknesses within the CBN.
- Weaknesses in the business environment.

107. **A comprehensive set of measures were taken by the authorities to counteract the 2009 banking crisis and, as a result, Nigeria avoided a major economic meltdown, and the economy was stabilized.** The measures adopted in response to the 2009 banking crisis included:

- Special examinations were commissioned in respect of all banks and executed by the CBN and NDIC.
- Ten banks were found to be in a “grave situation” and were intervened.

- The CBN removed eight banks' senior management and replaced them with CBN appointees.
- The CBN provided liquidity support in the amount of ₦620 billion (US\$4.1 billion) in the form of unsecured, subordinated debt. (In essence, this constituted solvency support as well.)
- A blanket guarantee of interbank and foreign credit lines of banks was introduced, and extended (for six-monthly periods) until end-2011.
- The CBN made a public commitment to protect all depositors and foreign creditors against loss and not to permit any bank to fail.
- At the peak of the crisis, the CBN created an expanded discount window which admitted non-federal government securities as eligible securities, while extending the tenure of the facilities to 360 days.
- The FMoF and the CBN established AMCON to support troubled bank resolution, and the banking sector more broadly. AMCON purchased banks' NPLs in exchange for AMCON three-year zero coupon bonds (which are guaranteed by the federal government.) AMCON facilitated mergers and acquisitions of the intervened banks and the creation of bridge banks, which were re-capitalized by AMCON.
- NDIC coverage of insured deposits was recently increased to ₦500,000 for CBs and ₦200,000 for insured community banks.

108. Important reforms, broadly in line with BCBS pronouncements, were instituted.

These reforms included the following:

- The universal banking model was abolished in favour of a "back-to-basics" banking model, and a new bank license regime was introduced.
- Risk-based supervision was embedded.
- The Corporate Governance Code was implemented.
- A number of regulatory prescriptions were issued covering a range of issues, inter alia by way of circular, code, guideline, prudential guideline, framework and regulation, including capital adequacy, risk and risk management and risk-based supervision, credit risk management, large exposures and related parties, margin lending, cross-border supervision, consolidated supervision (only in draft form), fitness and propriety, internal control, disclosure and AML/CFT.
- Adoption of IFRS in 2012.

109. **The financial sector is large, remains dominated by the banking sector, and has significant international linkages.** The Nigerian banking system has undergone significant change in the recent period, and this process is still ongoing. Although the sector remains dominated by domestic institutions, a few international banks have a presence in Nigeria, with a major regional bank headquartered outside Nigeria and active in 32 countries in Africa, having its largest subsidiary in Nigeria. Overall the number of banks has fallen from 89 in 2005 to 21 in 2012. Six of the banks, of which one is the above-mentioned subsidiary, dominate the banking system, with a market share of around 60 percent of total banking sector assets. Three small banks are distressed, the smallest of which is insolvent and the other two being former bridge banks with AMCON being the main owner.

110. **The macroeconomic outlook remains positive, but substantial risks remain.** Like the rest of the Nigerian economy, the financial sector is exposed to the effects of volatility in international markets for commodities and capital. Fortunately, large buffers built before the global crisis, and low debt, helped mitigate the impact of the shocks, by providing room for expansionary fiscal policy.

111. **The Nigerian economy emerged from the banking crisis, and has the potential to enjoy an extended period of strong economic growth.** This could be facilitated by a comprehensive strategy to conclude and exit from the crisis management period; to enhance protection against existing and emerging vulnerabilities; and foster financial deepening that can underpin sustainable growth on an enduring path for the periods ahead.

112. **Although systemic risk has declined since the peak of the recent crisis, the financial system is still exposed to risks from both global and domestic factors.** Though oil prices recovered, a further deterioration in the global environment could result in a sharp drop in oil prices. Also, oil exports could be disrupted. This could impact negatively the current account and fiscal positions, thereby dampening the build-up of international reserves and/or increasing public debt, in the absence of fiscal consolidation. The security situation is concerning, arising from terrorist activity in the north of the country.

113. **The bank regulators and supervisors have an extensive reform agenda.** In addition to IFRS, the authorities intend to implement Basel II and III. New instruments, such as macroprudential, and new techniques, such as stress testing and scenario analysis and analysing financial stability are also important.

D. Preconditions for Effective Banking Supervision

114. **Macroeconomic policies have the potential to pose risk to financial stability.** Sound macroeconomic policies are a precondition to and a foundation of a stable financial system. Failure to implement politically difficult fiscal adjustment measures or curb overly ambitious infrastructure spending could pose a risk to the financial system. Fiscal dominance (arising from the imperative to keep monetary policy tight, in order to counteract the deleterious effects of weak fiscal discipline, consequential pressures on the currency, all of

which fuels inflation, notwithstanding private credit growth sputtering) is a major contributor to an unfavorable trade-off between inflation and growth. This could also put an undue burden on monetary policy to contain inflation and also fight pressures on the currency and international reserves. At times the markets appear confused, perceiving that the CBN is pursuing multiple objectives. Following the crisis, significant efforts are being made to harmonize the structure for the implementation of monetary policy and prudential regulation. Accordingly, a framework has been developed in Nigeria to align financial system stability goals with broad macroeconomic policy. The key areas that are being addressed progressively by the authorities include: policy harmonization and the resolution of the conflict of objectives between the Economic Policy Directorate and the Financial System Stability Directorate of the CBN, the development of a macroprudential toolkit, enhancing the quality of data, and consideration of fiscal and monetary policy instruments that have the potential to impact financial stability.

115. The key elements of required public infrastructure are present, though the qualitative dimensions show weaknesses and vulnerabilities. These key elements include: a system of business laws, including corporate, bankruptcy, contract, consumer protection and private property laws; comprehensive and well-defined accounting principles and rules that command wide international acceptance, in the form of IFRS, which banks are required to adopt with effect from 2012; a system of independent audits for listed companies, as well as for banks, independent assurance for users of financial statements that the accounts provide a true and fair view of the financial position of the company; an independent judiciary and self-regulated accounting, auditing and legal professions; supervision of other financial markets and, where appropriate, their participants; and a payment and clearing system for the settlement of financial transactions. Concerns regarding the qualitative dimensions of public infrastructure arise, inter alia, from weaknesses in policy making and legislative processes, legal uncertainty on key issues, inability to resolve banks promptly, inability to achieve prompt collection of outstanding debts through legal avenues, inability to execute promptly on collateral, unpredictability of legal outcomes, weak ability to prosecute financial crimes, seeming absence of accountability of external auditors, weaknesses in supervision of other financial institutions and markets, and weaknesses in the payments and clearing system (though the Payment System Vision 2020 aims at significant improvements.)

116. Gaps and weaknesses in market discipline was a material contributor to the 2009 banking crisis. Effective market discipline depends substantially on adequate flows of information to market participants, to enable informed decisions, appropriate financial incentives to reward well-managed institutions, and arrangements that ensure investors are not insulated from the consequences of their decisions. In 2010, the CBN issued a circular on minimum disclosure in the financial statements of banks. The implementation of international standards like IFRS and the relevant part/s of Basel II/III should enhance transparency. Since 2010, the CBN has published a Financial Stability Report (FSR) on a bi-annual basis, to focus stakeholders' attention on those factors that predispose the financial system to shock as well as the policies to address these concerns. More attention has focused

on the data quality of regulatory information submissions by banks. Since 2008, the CBN has not issued an annual bank supervision report. With effect from 2011, a semi-annual FSR, which strives to cover also what previously was covered by the annual bank supervision report, has been issued.

117. The Nigerian framework for crisis management and the financial sector safety net was effective in containing (the contagion from) the crisis, though much needs to be done to benefit from the lessons learnt. The CBN took decisive measures to avert a potential systemic crisis by intervening in troubled banks, injecting liquidity into these banks and providing broad guarantees. These quick measures stabilized the banking system and allowed the authorities time to design a strategy to resolve the intervened banks. The resolution strategy ultimately employed consisted of many elements, including: replacing management in a number of banks; recapitalization subject to shareholders' approval; setting up an asset management company, AMCON, to purchase NPLs of banks in exchange for tradable three-year zero coupon bonds issued by AMCON and guaranteed by the federal government; entering into M&A arrangements; and setting up bridge banks that were capitalized by AMCON. All these measures helped the authorities stabilize a banking system that was on the verge of a systemic crisis. The NDIC constitutes an important component of the safety net. Despite the success, the CBN should more fully develop its crisis management and safety net arrangements. Nigeria has taken important steps to facilitate the identification and adoption of a framework for macroprudential policies, with the FSRCC coordinating the supervision of financial institutions and a dedicated department, the Financial Policy and Regulation Department (FPRD), in the CBN having been set up to perform the function of macroprudential supervision. It is necessary to improve bank resolution, inter alia, by specifying preference for depositors and creating a non-judicial/administrative special resolution regime.

E. Main Findings of the BCP Assessment

118. Nigeria has recorded significant improvement in its level of compliance with the BCPs since the last independent assessment by the IMF and the World Bank in 2002. The 2002 independent assessment concluded that Nigeria was compliant with three, largely compliant with 11, materially noncompliant with nine, and noncompliant with two core principles. Considered against the essential criteria, Nigeria is now compliant with one, largely compliant with 17, and materially non-compliant with seven CPs.

119. The improvement in the assessment ratings is attributed to the enhancements of the supervisory capacity of Nigerian banking system supervisors through: (i) the enactment of new laws and amendment of laws; (ii) issuance of various regulations, circulars, and guidelines to address the weaknesses observed during the 2002 assessment; and (iii) reform initiatives embarked upon in the aftermath of the 2009 banking crisis.

Objectives, independence, powers, transparency and co-operation (CP1)

120. **A principal objective of the CBN is to promote financial stability.** The CBN is charged with the primary responsibility of bank supervision and has clear related objectives. The NDIC cooperates with the CBN in discharging the bank supervision responsibility. Though bank supervision is not explicitly clearly stated as an objective of the NDIC, it is implicit. An effective and efficient legislative process through the National Assembly is a necessary precondition to enable congruence and to keep pace with the internationally generally accepted legal and regulatory framework for banking, which is not being achieved currently. It is important to maintain the currency of the legal and regulatory framework, by way of prompt responses (to international policy developments and local needs), through sound policy development and a responsible legislative and regulatory process. (BCP1(1))

121. **The CBN possesses operational independence, transparent processes, sound governance, and adequate resources, and is accountable for the discharge of its duties.** The position of the NDIC in relation to independence and to whom it is accountable is less clear. (BCP1(2))

122. **A legal framework for banking supervision, including provisions relating to authorization of banking establishments and their ongoing supervision is in place.** A thorough review and comprehensive updating of the legal and regulatory framework is necessary. (BCP1(3))

123. **The legal framework for banking supervision empowers the supervisor to address compliance with laws.** The law and regulations appear, implicitly, though not necessarily explicitly, to permit the supervisor to apply qualitative judgment in safeguarding the safety and soundness of the banks within its jurisdiction—this should be made explicit. (BCP1(4))

124. **The legal framework for banking supervision makes provision for legal protection for supervisors—**however, it does not make provision for their concomitant legal costs. (BCP1(5))

125. **Arrangements for sharing information between supervisors and protecting the confidentiality of such information are in place, though the coordination between the CBN and the NDIC may require attention.** (BCP1(6))

Licensing and structure (CPs 2-5)

126. **The permissible activities of institutions that are licensed and subject to supervision as banks are clearly defined, and the use of the word “bank” in names is controlled as far as possible.** (BCP2)

127. **The licensing authority has the power to set criteria and reject applications for establishments that do not meet the standards set.** The licensing process, at a minimum, consists of an assessment of the ownership structure and governance of the bank and its wider group, including the fitness and propriety of Board members and senior management, its strategic and operating plan, internal controls and risk management, and its projected financial condition, including its capital base. Where the proposed owner or parent organization is a foreign bank, the prior consent of its home country supervisor is obtained. Important elements of licensing, including important criteria, and other requirements and process, are implicit and informal—these should be explicitly specified and formalized. The list of prescribed criteria contained in the legal and regulatory framework is incomplete, and the criteria should be focused on outcomes, as opposed to inputs. In addition, the CBN should be required to create a formal audit trail, by the CBN formally and in writing assessing a new bank license application against each and every one of the prescribed criteria. (BCP3)

128. **The supervisor is empowered to review and, if deemed appropriate, to reject any proposals to transfer significant ownership or controlling interest, whether held directly or indirectly in a bank, to other parties.** The supervisor’s flawed powers to review and the supervisor’s weak and inadequate powers to enforce such a rejection should be remedied and bolstered. Furthermore, it is necessary to focus on the beneficial shareholders, as opposed to focusing merely on the registered/nominee shareholders.(BCP4)

129. **The supervisor has the power to review major acquisitions or investments by a bank, against prescribed criteria, including the establishment of cross-border operations, and confirming that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.** (BCP5)

Prudential regulation and requirements (CPs 6-18)

130. **The CBN has set prudent and appropriate minimum capital adequacy requirements for banks (though this applies in respect of a bank’s credit risk exposures only) and has defined the components of capital, (largely) bearing in mind its ability to absorb losses.** These requirements, which are applicable to all banks (both local and foreign, and both internationally active and non-internationally active) are mostly in line with those established in the applicable Basel requirement, apart from some important shortcomings, which need to be rectified. The authorities should develop comprehensive and detailed principles, standards, guidance, prescriptions, statutory returns, and supervisory work programs, inter alia based on and aligned with relevant pronouncements of the BCBS, for all key areas, including risk areas, which would enhance effectiveness, efficiency, consistency, and transparency of and quality control over supervision, thereby enabling more effective challenging of banks by the supervisor. The authorities should perform overall micro/bottom up and macro/top-down stress testing and simulation exercises in relation to all key areas (including risk areas), as a tool to provide forward-looking assessments of a bank’s capacity

(in relation to capital, liquidity and earnings) to withstand extreme but plausible macro-financial shocks. Banks should hold capital also against risk exposures other than credit risk, and hold adequate capital where the Basel I capital requirements are not sufficiently prudent. (BCP6)

131. **The CBN's *Guideline for the Development of Risk Management Frameworks for Individual Risk Elements* generally governs a bank's risk taking and risk exposures.** However, it is overarching and generic, and not supplemented with specific and detailed guidance and prescriptions, implying that there are important gaps and shortcomings in the legal, regulatory, and supervisory framework relating, inter alia, to a bank's risk management. The CBN applies a risk-based approach to supervision, as provided for in the CBN's *RBS Framework*, including to off-site and on-site supervision. Accordingly, the CBN assesses a bank's risk management (which should be under the oversight of the Board of directors and senior management) by gaining an understanding of the risk management policies, strategies, processes and risk appetite/aversion, thereupon assessing the identification, evaluation, monitoring, and controlling or mitigating of all material risks, and then assessing the bank's overall capital adequacy in relation to the bank's risk profile. The CBN also assesses whether these processes are commensurate with the size and complexity of the institution. In line with the CBN's HRD plan for specialist career streams, the CBN should engage specialists to support the regulatory and supervisory functions in addressing specialized and complex issues in a range of areas, including corporate governance, capital and capital management, risk management, accounting and auditing, IT, and project management, to enable the authorities more effectively to challenge the banks. (BCP7)

132. **The legal and regulatory framework requires that a bank has adequate credit risk management policies, strategies and processes, (including to identify, measure, monitor, and control credit risk, including counterparty risk) commensurate with its credit risk profile.** This includes addressing the granting of loans and making of investments, the evaluation of the quality of such loans and investments, and the ongoing administration and management of the loan and investment portfolios. (BCP8)

133. **In general, the law and regulation provides explicit requirements on how a bank should identify and manage problematic loans and adequately provision.** In addition, the RBS approach entails an appropriate review of banks' significant risky asset portfolios. However, with the adoption of IFRS by banks with effect from 2012, the provisioning regime prescribed in the *Prudential Guidelines* should be updated concomitantly. (BCP9)

134. **Though supervisors ensure that banks have policies and processes that enable management to identify and manage concentrations within the portfolio, and supervisors set prudential limits to restrict bank exposures to single counterparties or groups of connected counterparties, there are important gaps, shortcomings and vulnerabilities which require attention.** (BCP10)

135. **Abuses, arising from related party transactions and exposures, and conflicts of interest, were identified as major causes of the 2009 banking crisis.** Hopefully the CBN's action in removing executive management in eight banks and sanctioning directors constituted a reality check, instilled necessary discipline, and will serve as a deterrent. In general, the law and regulations on related parties are sparse and need to be reviewed and enhanced substantially, to prevent related party abuse again posing a significant threat to financial stability. (BCP11)

136. **The CBN has provided over-arching and generic guidance for banks in managing their risks, including country and transfer risk.** Further, the *RBS Framework* provides CBN supervisors with guidance on how to assess significant activities of banks including cross-border operations. With the increasing internationalization of the banking system, country and transfer risk is an emerging risk requiring increasing attention. (BCP12)

137. **The regulatory and supervisory framework for and supervisory approach to market risk should be improved, inter alia, by adoption of the 1996 Market Risk Amendment, and further strengthening regulatory policies.** (BCP13)

138. **CBN supervisors (on an ongoing basis) monitor a bank's (day-to-day) liquidity risk management by assessing a bank's compliance with the (somewhat dated) *Guidelines for the Development of Liquidity Management Policies (2003)*, while being cognizant of a bank's risk profile.** In summary, the guidelines require banks to have a proper strategy for managing liquidity risk, with appropriate internal policies and procedures as well as adequate liquidity contingency plans. (BCP14)

139. **The supervisor is satisfied that a bank has in place risk management policies and processes to identify, assess, monitor, and control/mitigate operational risk, which policies are commensurate with the size and complexity of the bank.** Detailed guidance on operational risk management is lacking. (BCP15)

140. **IRRBB is not separately and specifically identified in the legal, regulatory, or supervisory frameworks as a separate risk.** The IRRBB exposures of banks appear modest, in view of variable interest rates (mostly) applying to both assets and liabilities. Nonetheless, the interest rate profile of the system may change in the future, and it is imperative that the CBN be suitably prepared. (BCP16).

141. **Supervisors are satisfied that banks have in place internal controls that are adequate for the size and complexity of their business.** These should include: clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding the bank's assets; and appropriate independent internal audit and compliance functions to test adherence to these controls as well as applicable laws and regulations. Major failures in corporate governance at banks have been identified as one of the main factors which contributed to the 2009 banking crisis.

Undoubtedly, there were major gaps and breakdowns of internal controls. Though important regulatory reforms have been undertaken and the supervisory approach and processes were significantly enhanced, at this stage it is too early to come to a conclusive conclusion on whether supervisory effectiveness is at an acceptable and satisfactory level, though the signs are positive. However, fundamental concerns include whether the stakeholders (including the internal auditor, the external auditor and the supervisor) are effectively challenging one another, and whether the supervisors are willing to act proactively, not only in respect of compliance issues, such as relating to breaches of prudential requirements but also in respect of corporate governance, risk management and internal control weaknesses, breaches and excesses. Training of all stakeholders on their duties and responsibilities in relation to all key aspects of banking, and the consequences of breaches and failures of such duties and responsibilities, is necessary. (BCP17).

142. **Though relevant legislation (*The Money Laundering Prohibition Act and the Anti-Terrorism Act*), KYC guidelines and other regulations are in place to control and check the abuse of financial services, there remain fundamental gaps and weaknesses.** The CBN supervisors are equipped with an appropriate supervisory programme and have applied this programme to assess banks' compliance with the relevant law and regulations as well as to determine whether a bank has adequate policies and processes in place which would prevent the bank from being used intentionally and unintentionally for criminal activities. In the light of the 2011 FATF conclusion on Nigeria, the governance breakdowns which contributed to the 2009 banking crisis and the 2011 report by the OCC on a particular bank's CML/CFT failings, there remain grave concerns about the quality of implementation and adherence in relation to AML/CFT. As some of the changes to the legal and regulatory framework were implemented only very recently, it is not as yet appropriate to comment on the quality of implementation thereof. (BCP18).

Methods of ongoing banking supervision (CPs 19-21)

143. **The *RBS Framework* provides an adequate supervisory process, essentially based on the risk profiling of banks, enabling the CBN supervisors to have appropriate understanding of the safety and soundness of banks in the system, and has a forward looking focus.** The framework enables a better evaluation of risks, through the separate assessment of inherent risks and risk management processes, which also requires the CBN supervisors to understand the effect of the external environment, firstly at the level of the banking system and, secondly at the level of the whole economy. (BCP19)

144. **There is a proper mix of on-site and off-site supervisors to evaluate the condition of banks and their inherent risks.** However, efforts should be in place to increase the quality of the assessment by having an independent quality assurance process in relation to the ratings of banks. More engagement is recommended with the banks' Board members, particularly the independent and non-executive members, outside the on-site examination period. (BCP20)

145. **Supervisors are empowered to obtain information from banks, but not from entities related to banks, and have a means of collecting, reviewing, and analyzing prudential reports and statistical returns from banks on a solo, but not (as yet) on a consolidated basis, and a means of independent verification of these reports, through either on-site examinations or use of external experts.** (To date, the authorities have not as yet implemented consolidated supervision.) (BCP21)

Accounting and disclosure (CP22)

146. **Generally, the CBN seemingly ensures that each bank maintains adequate records drawn up in accordance with accounting policies and practices that are widely accepted internationally, and publishes, on a regular basis, information that fairly reflects its financial condition and profitability.** However, the 2009 banking crisis came about partly as a result of material failures in this area, and there is a lingering concern that not enough has been done, perhaps, to improve the quality of corporate governance insofar as it relates to and involves the internal audit/auditor or the external audit/auditor, or the quality of the application of accounting, auditing and disclosure. (BCP22).

Corrective and remedial powers of supervisors (CP23)

147. **Supervisors have at their disposal an adequate range of supervisory tools to bring about timely corrective actions.** This includes the ability, where appropriate, to revoke the banking license or to recommend its revocation. These powers were promptly deployed during the 2009 banking crisis. However, there is a concern that the authorities may lack the resolve to fully apply the intervention framework and finally resolve a bank which is hopelessly insolvent. The authorities should apply zero tolerance and act promptly, resolutely, and forcefully in relation to actions or inactions which put financial stability at risk, as well as in relation to corporate governance transgressions, non-compliance with statutory prescriptions, and submission/disclosure of substandard quality of data/information.(BCP23)

Consolidated and cross-border banking supervision (CPs 24-25)

148. **The legal and regulatory framework for consolidated supervision is not yet in place.** Notwithstanding, the CBN performs some elements of consolidated supervision in relation to the interests of a bank. (The draft *Framework for the Consolidated Supervision of Financial Institutions in Nigeria*, which contains a formal process of evaluating the overall structure of the bank and related parties as well as identifying the risks arising from non-banking activities, should provide largely the necessary regulatory platform for an effective supervisory function on consolidated basis, though a legal foundation is also required.) The FSRCC provides a vehicle for coordination among the relevant domestic supervisors and ensures that ongoing supervisory efforts are closely integrated for the local components of a banking group.) (BCP24)

149. **The CBN has in place a *Framework for the Supervision of Cross-Border Institutions* and this document forms the basis of its cross-border supervisory activities.** In addition, the CBN has a unit within BSD, dedicated to the supervision of cross-border institutions. There are MoUs in place with other foreign regulatory agencies in jurisdictions where Nigerian banks have presence. In the case of other jurisdictions which have not signed formal information sharing arrangements with the CBN, there are informal arrangements for information sharing, for instance, in the case of the OCC and U.K. FSA. In certain circumstances, the information sharing via informal arrangements is more active than those via the formal arrangements. Foreign banks operating in Nigeria are subjected to the same regulatory and supervisory regimes as applied to domestic banks. (BCP25)

Annex Table 2. Nigeria: Summary Compliance with the Basel Core Principles - Detailed Assessments

Basel Core Principle	Comment
1. Objectives, Independence, Powers, Transparency, and Cooperation	
1(1). Responsibilities and Objectives	<ul style="list-style-type: none"> • Policy development process is (too) ad hoc and event-driven. • Legislative process not sufficiently responsive. • The NDIC Act does not contain a mandate and/or objective/s clause. • The BOFIA was last amended in 1999 and is dated. • Legal and regulatory framework not sufficiently logically structured and organized, and the internal hierarchy is not clear. • Pronouncements of BCBS not always fully and/or appropriately adopted, sometimes resulting in important deviations. • CBN may be incurring liability toward third parties, by its “prior approval” of a bank’s audited financial statements.
1(2). Independence, Accountability and Transparency	<ul style="list-style-type: none"> • The NDIC’s “functions” clause does not mention bank supervision. • Unclear to whom the NDIC is ultimately accountable. • The NDIC’s operational independence is not specified anywhere. • The BSD staff is permitted to hold and trade shares in banks.
1(3). Legal Framework	<ul style="list-style-type: none"> • Draft updated Code of Conduct and draft Bank Holding Company Framework not yet promulgated.
1(4). Legal Powers	<ul style="list-style-type: none"> • Supervisor not specifically empowered to exercise discretion to apply qualitative judgment re safety and soundness of a bank and thereupon to take corrective, enforcement and/or sanctioning actions against such party/parties. • Supervisor not specifically empowered to have full and unfettered access to all stakeholders involved in a bank.
1(5). Legal Protection	<ul style="list-style-type: none"> • The CBN or the NDIC staff not indemnified against legal costs.
1(6). Cooperation	<ul style="list-style-type: none"> • The CBN/NDIC ExCo on Supervision meets only infrequently.
2. Permissible Activities	<ul style="list-style-type: none"> • The CBN not obliged to maintain/publish a list of licensed banks. • The NDIC not obliged to maintain and publish a list of licensed banks.
3. Licensing Criteria	<ul style="list-style-type: none"> • The list of criteria for a bank license is incomplete. • There is a limited audit trail in respect of the decision-making process relating to a bank license application.

Basel Core Principle	Comment
4. Transfer of Significant Ownership	<ul style="list-style-type: none"> • Section 7(1) of the BOFIA is defective, as it imposes a duty on a bank in a matter which pertains to shareholders. • Approach to fitness/propriety of key shareholders is deficient. • Legal and regulatory framework does not distinguish a beneficial shareholder from a nominee shareholder. • A bank is not required to notify the supervisor should it become aware of any material information which reflects negatively the suitability of a major shareholder. • Fines prescribed in the BOFIA are not in line with the gravity of the offence or sufficient deterrent. • Components of the legislative framework dealing with this topic are scattered throughout the legislative framework.
5. Major Acquisitions	<ul style="list-style-type: none"> • A bank is permitted to take large stakes (even controlling stakes, and even full ownership) in agricultural, industrial and venture capital companies. • Components of the legislative framework dealing with this topic are scattered throughout the legislative framework.
6. Capital Adequacy	<ul style="list-style-type: none"> • Regulatory capital adequacy requirements not strictly in line with Basel I. • A bank from time to time may own an investment in its own capital instruments or in another bank's capital instruments. • The regulatory and/or supervisory framework does not contain any requirements for banks to perform capital management. • No bank holds regulatory capital against any risk other than credit risk. • A bank is permitted to treat the shortfall in regulatory provisions, constituted by the difference when a bank's regulatory required provisions exceed its IFRS credit impairments, as Tier 1 core capital. • Authorities do not consistently and regularly perform overall micro/bottom up and macro/ top down stress testing. • Components of the legislative framework dealing with this topic are scattered throughout the legislative framework. • No assessment, seemingly, of the impact of Basel III, has been undertaken.
7. Risk Management Process	<ul style="list-style-type: none"> • The legal and/or regulatory framework does not contain detailed guidance on all significant existing and emerging risks (e.g., country & transfer risk, market risk, operational risk, and IRRBB). • Legal and regulatory framework does not contain a requirement that approval level of risk exposures be commensurate with the size and risk of the resulting risk exposure. • The CBN does not apply Basel II principles, such as capital management (ICAAP/SREP), which are fundamental to the safety and soundness of a bank and can be implemented independently of Basel II. • The BSD has limited capacity and capabilities to challenge quantitative models effectively, or perform stress tests, or challenge Basel II and III banks. • No guidance has been developed in respect of internal risk management risk models or stress testing. • The BSD's reform agenda, which includes also Basel II and III, constitutes a significant challenge.

Basel Core Principle	Comment
	<ul style="list-style-type: none"> • The BSD may not have specialists who can effectively challenge the banks and related stakeholders in areas such as capital management, risk management, accounting, auditing, information technology, and project management. • Components of the legislative framework dealing with this topic are scattered throughout the legislative framework.
8. Credit Risk	<ul style="list-style-type: none"> • Review and updating cycle for policies is three years. • Potential future exposure of a counterparty credit risk exposure not taken into account.
9. Problem Assets, Provisions, and Reserves	<ul style="list-style-type: none"> • Classification/provisioning of specialized facilities (e.g., agricultural finance) do not take into account qualitative factors. • Supervisors not yet comfortable in validating bank IFRS models. • The CBN has not leveraged off external expertise in relation to IFRS.
10. Large Exposure Limits	<ul style="list-style-type: none"> • Definition of a large exposure is not sufficiently comprehensive. • The legal and regulatory framework does not prescribe who may be empowered to approve a large exposure. • The large exposure limit as defined constitutes a “soft” limit, in the sense that it may be breached subject to supervisory approval, as opposed to a “hard” limit, which may not be breached. • Excess amount, being the amount of a large exposure which exceeds the 25 percent of a bank’s capital limit, does not constitute an impairment of capital. • The CBN supervisors are not empowered to deem a large exposure outside those defined by law.
11. Exposure to Related Parties	<ul style="list-style-type: none"> • Definition of a related party is not sufficiently comprehensive. • The CBN is not empowered to exercise its discretion to deem the existence of relationships as related party relationships. • No legal or regulatory provision prohibits granting of advances to related parties on more favorable terms than corresponding exposures to non-related counterparties and/or that such transactions should be entered into on an arm’s length basis. • The 60 percent limit on the maximum credit exposure to all insiders is high, also relative to international norms. • Breaching of 10 percent limit on individual related party exposures or the limit on aggregated related party exposures does not impact regulatory capital adequacy computation of a bank.
12. Country and Transfer Risk	<ul style="list-style-type: none"> • Notwithstanding some banking groups having significant exposures to country/transfer risk, there is no specific supervisory guidance thereon. • No bank required to hold capital against country/transfer risk.
13. Market Risks	<ul style="list-style-type: none"> • The 1996 Market Risk Amendment has not been adopted. • No bank is required to hold capital against market risk exposures • Guidance on market risk is extremely limited and incomplete. • There is no guidance on the use of internal models • Apart from the NOP limit for FX exposures, there are no market risk limits, thresholds and benchmarks. • The BSD supervisory staff may not be comfortable to confront technical and complex market risk management issues, including valuation of market risk positions, derivatives, stress testing, scenario analysis, and back-testing.

Basel Core Principle	Comment
14. Liquidity Risk	<ul style="list-style-type: none"> • The <i>Guidelines for the Development of Liquidity Management Policies</i>, 2003, are somewhat dated. • Liquidity ratio does not take account of off-balance sheet items. • The CBN has not concluded on the impact of Basel III.
15. Operational Risk	<ul style="list-style-type: none"> • Guidance on operational risk is extremely limited and incomplete • There is no outsourcing policy.
16. Interest Rate Risk in the Banking Book (IRRBB)	<ul style="list-style-type: none"> • There is no guidance on IRRBB. • There is/are not statutory return/s focused on IRRBB. • The results of the FPRD's top-down stress test exercises have not been shared adequately within the BSD. • The BSD does not perform bottom-up stress testing of IRRBB.
17. Internal Control and Audit	<ul style="list-style-type: none"> • The 2009 banking crisis arose from the very issues which the 2006 Corporate Governance Code had warned about.
18. Abuse of Financial Services	<ul style="list-style-type: none"> • Existing laws and regulations are not adequate in relation to the criminalization of AML/CFT. • The recently issued returns are not in electronic format, which would imply significant human and manual intervention, and there does not appear provision for fixing the accountability, for the quality of the information in the returns, to (a) sufficiently senior person/s. • Major failures in corporate governance at banks were a main contributing factor to the 2009 banking crisis. Some of these activities bordered on, if they were not in fact full-blown, criminal acts and activities. • To date, one thematic examination of banks was performed, which highlighted important problems relating to KYC information at the banks. • Important AML/CFT failings were reported by the OCC in relation to a Nigerian bank's branch in the U.S, which failings had not been picked up by the responsible parties in Nigeria.
19. Supervisory Approach	<ul style="list-style-type: none"> • There are no detailed supervisory programs for inherent risks assessment. • RBS process does not cater for structured peer comparison (qualitative and quantitative). • Criteria to assess the direction of risk are not granularly stated in the RBS Framework.
20. Supervisory Techniques	<ul style="list-style-type: none"> • Structured formal quality assurance process to determine the ratings of banks is not in place. • Minimal engagement with the banks' Board members, particularly the independent and non-executive members, outside onsite examination period.
21. Supervisory Reporting	<ul style="list-style-type: none"> • The e-FASS system does not incorporate a workflow component or an on-site component. • A bank is not required to notify the CBN of all material information regarding the bank's activities, structure or overall condition, or material adverse developments.

Basel Core Principle	Comment
22. Accounting and Disclosure	<ul style="list-style-type: none"> • The CBN may be incurring unintended liability and reputational risk by approving a bank's draft financial statements. • The CBN may be hamstrung, by reason of limitations in capacity and capability, in achieving effective challenge in areas of accounting, bank auditing, bank disclosure and corporate governance relating to the roles of bank internal audit/auditors and bank external audit/auditors. • The CBN has not been able to discharge its responsibility to develop reporting templates for reports on a bank's risk management practices, internal control and level of compliance with regulatory practices. • Banks are not required to have formal internal audit, external audit and disclosure policies. • The CBN does not currently obtain access to an external auditor's external audit working papers in respect of a problem bank. • An external auditor making a report in terms of Section 29(7) of the BOFIA may be held to be in breach of confidentiality requirements. • The BOFIA does not specifically and explicitly empower the CBN to remove a bank's auditor who does not discharge his responsibilities satisfactorily.
23. Corrective and Remedial Powers of Supervisor	<ul style="list-style-type: none"> • A part of the Supervisory Intervention Framework may give rise to moral hazard. • The Supervisory Intervention Framework may not be fully aligned with and grounded in the BOFIA. • In the past, the supervisory may not always have acted promptly or forcefully.
24. Consolidated Supervision	<ul style="list-style-type: none"> • The <i>Framework for Consolidated Supervision of Financial Institutions in Nigeria</i> remains in draft. • The CBN is not (explicitly, directly and unambiguously) empowered to obtain information from or supervise a financial holding company's related entities. • The capacity and capabilities to perform consolidated supervision has not been developed. • The BOFIA does not empower the CBN to require a bank to close a foreign office or impose limitations on their activities.
25. Home-host Relationships	<ul style="list-style-type: none"> • The CBN has not as yet performed formal comprehensive assessments of the home and host regulators of Nigerian banks.

Annex Table 3. Nigeria: Recommended Action Plan to Improve Compliance with the Basel Core Principles

Reference Basel Core Principle	Recommended Action	
	Description	Priority (H/M/L)
1. Objectives, Independence, Powers, Transparency, and Cooperation		
1(1). Responsibilities and Objectives	<ul style="list-style-type: none"> • Maintain currency of the legal and regulatory framework, by way of prompt responses (to international policy changes and local developments and needs), through sound policy development and a responsive legislative process. • Perform a BCP self-assessment against the 2012 version of the BCP, and align the updating of the legal, regulatory and supervisory framework and supervisory approach with the 2012 version of the BCP. • Determine objective/s of the NDIC and incorporate within the NDIC Act. • Review thoroughly, and comprehensively update, the BOFIA. • Make current consolidated (updated) version of legislation and regulations readily available in logical format in the public domain at all times. • Rationalize the regulatory framework by reviewing thoroughly the subsidiary legislation (subsidiary to the BOFIA) (which, seemingly, consists of circulars, codes, decrees, frameworks, guidelines, prudential guidelines, regulations, and rules), inter alia also to remove ultra vires provisions contained therein (which, if necessary, should be moved to the BOFIA itself), and thereupon comprehensively update, logically structure in an appropriate hierarchy, and logically reference such subsidiary legislation, and then compile a compendium of such subsidiary legislation, which should be maintained updated. • Specify in the legislation the legal status of and internal hierarchy among the subsidiary legislation (such as a circular, code, decree, framework, guideline, prudential guideline, regulation, and rule). • Withdraw annually, with effect from the end of a year, all circulars issued during that year, with effect from the end of that year and, where necessary and appropriate, in relation to issues and prescriptions which remain relevant and continue needing to be dealt with by way of circular, issue duly updated and amended versions of such circulars with effect from the beginning of the next year. 	<p align="center">H</p> <p align="center">M</p> <p align="center">M</p> <p align="center">H</p> <p align="center">L</p> <p align="center">M</p> <p align="center">L</p> <p align="center">L</p>

Reference Basel Core Principle	Recommended Action	
	Description	Priority (H/M/L)
	<ul style="list-style-type: none"> • Adopt fully (without cherry picking) and appropriately all relevant pronouncements of the BCBS, to avoid important deviations which undermine certainty and consistency, and which can result in unintended consequences. • Require banks to be audited by means of and in line with International Standards of Auditing (ISAs), and that a formal plan be developed and implemented to ensure a high quality application of ISAs. • The CBN should consider how best to be involved, without incurring liability (whether explicitly or implicitly), in the process of finalization of the audited annual financial statements prior to the publication thereof, while simultaneously ensuring that adequate controls are in place to avoid insider abuses. • Ensure that the information disclosed on the websites of the CBN and the NDIC is current, up to date and accurate. • Ensure (in the absence of separate and distinct publications, respectively, covering the macroprudential top down dimension of financial stability, on the one hand, and, on the other hand, covering the microprudential bottom up dimension), that the FSR addresses both these dimensions. 	<p style="text-align: center;">L</p> <p style="text-align: center;">L</p> <p style="text-align: center;">L</p> <p style="text-align: center;">L</p> <p style="text-align: center;">L</p>
1(2). Independence, Accountability and Transparency	<ul style="list-style-type: none"> • Amend the NDIC Act to make provision for a mandate and/or objective/s clause, and spell out clearly and unequivocally to whom or which body the NDIC is accountable. Also, prescribe that the NDIC should have operational independence. • Prohibit all staff of bank supervisory authorities from holding or trading shares in banks, given their access to price sensitive inside information. 	<p style="text-align: center;">L</p> <p style="text-align: center;">H</p>
1(3). Legal Framework	<ul style="list-style-type: none"> • Finalize promptly and implement the draft updated Code of Corporate Governance Code and the draft Bank Holding Company Framework. 	<p style="text-align: center;">M</p>
1(4). Legal Powers	<ul style="list-style-type: none"> • Update the BOFIA specifically and explicitly to authorize the CBN to exercise its discretion and judgment to consider whether or not: <ul style="list-style-type: none"> - a particular situation, circumstance, action or inaction constitutes a threat to financial stability; - a bank is being operated, managed or directed in a safe and sound manner; and - a bank is in a safe and sound condition. <p>(The NDIC Act should contain a corresponding provision.)</p>	<p style="text-align: center;">H</p>

Reference Basel Core Principle	Recommended Action	
	Description	Priority (H/M/L)
	<ul style="list-style-type: none"> • Update the BOFIA specifically and explicitly to empower the CBN to take corrective, enforcement and/or sanctioning actions or undertake the resolution of a bank, where, in the opinion of the supervisor: <ul style="list-style-type: none"> - a situation, circumstance, action or inaction in relation to that bank constitutes a threat to financial stability; and - a bank and/or director and/or management is engaging in unsafe and unsound practices in conducting the business of the bank. (The NDIC Act should contain a corresponding provision.) • Provide in the BOFIA that the CBN has full and unfettered access at all reasonable times to all stakeholders involved in a bank, for purposes of discharging its responsibilities. (The NDIC Act should contain a corresponding provision.) 	<p style="text-align: center;">H</p> <p style="text-align: center;">H</p>
1(5). Legal Protection	<ul style="list-style-type: none"> • Provide for the indemnification, by way of an amendment to the law, of staff of the supervisory authority, against the costs of defending their actions and/or omissions while discharging their duties in good faith. 	L
1(6). Cooperation	<ul style="list-style-type: none"> • Reconsider the raison d'être of the CBN/NDIC Executive Committee on Supervision and, if his committee be found to be necessary and indispensable, update its mandate, objectives and functions to ensure its optimal relevance, and fix the responsibility for driving its agenda. 	L
2. Permissible Activities	<ul style="list-style-type: none"> • Require the CBN to maintain and publish a list of licensed banks. • Require the NDIC to maintain and publish a list of insured institutions. 	<p style="text-align: center;">L</p> <p style="text-align: center;">L</p>
3. Licensing Criteria	<ul style="list-style-type: none"> • Prescribe explicitly and formally in the legal and/or regulatory framework, as follows: <ul style="list-style-type: none"> - a complete listing of the criteria for a bank license against which a bank license application should be considered; - the CBN is required formally and in writing to assess any new bank license application against the prescribed bank licensed criteria, and that the CBN should document the nature and extent of the work performed and the conclusions reached in relation to each criterion individually, and also overall; - the CBN is not empowered to issue a bank license to a shell entity, a shelf company, or a tax haven domiciled entity; 	M

Reference Basel Core Principle	Recommended Action	
	Description	Priority (H/M/L)
	<ul style="list-style-type: none"> - the criteria for issuing a license are consistent with those applied in ongoing supervision; - a license obtained based on false information shall be revoked by the CBN; and - that the CBN should have policies and processes in place to monitor the progress of new entrants into the banking sector in meeting their business and strategic goals, and to determine that supervisory requirements outlined in the license approval are being met. • Specify explicitly and formally in the legal and/or regulatory framework that the CBN is required to consider and conclude on whether or not the new bank license application satisfactorily meets at least the following criteria: <ul style="list-style-type: none"> - evaluate, by review of the (proposed) legal, managerial, operational and ownership structures of a (proposed) bank and its wider group, whether or not such structures would hinder effective supervision on both a solo and a consolidated basis; - identify and evaluate whether or not the (proposed) major/significant/controlling (ultimate beneficial) shareholders, and others that may exert significant influence, are suitable; - assess whether the ownership structure of the (proposed) bank is sufficiently transparent; - identify the (proposed) sources of the (proposed) initial capital for the (proposed) bank, and evaluate whether or not such sources are acceptable; - evaluate whether or not the (proposed) directors and senior management of the (proposed) bank are suitable, in view of their capacity and capability and integrity (fit and proper test), and in view of any potential for conflicts of interest; - evaluate whether or not the (proposed) strategic and operating plans of the (proposed) bank, including the system of corporate governance, risk management and internal controls, and including those related to the detection and prevention of criminal activities, as well as the oversight of the proposed outsourced functions, are acceptable; - evaluate whether or not the (proposed) operational structure reflects and is appropriate for the (proposed) scope and degree of sophistication of the (proposed) activities of the bank; - evaluate whether or not the pro forma financial statements and projections for the (proposed) bank are adequate for purposes of assessing the adequacy of the financial strength of the (proposed) bank and the capacity of the (proposed) bank to support its strategy; 	M

Reference Basel Core Principle	Recommended Action	
	Description	Priority (H/M/L)
	<ul style="list-style-type: none"> - evaluate whether or not the board, collectively, has a sound knowledge of each of the types of activities the (proposed) bank intends to pursue, and of the associated risks; - evaluate whether or not the (proposed) controlling/significant/major shareholders would be in a position to provide the necessary additional financial support to the (proposed) bank to enable it to execute its strategic plan and achieve its strategic aims; and - evaluate whether or not the (proposed) major/significant/controlling shareholders would be in a position to provide the necessary additional financial support to the (proposed) bank in the event of a loss suffered as a result of an extreme but plausible event. 	
<p>4. Transfer of Significant Ownership</p>	<ul style="list-style-type: none"> • Recast the BOFIA—Section 7— to ensure that it can have effect. (For example, the obligation to obtain the prior consent of the governor should be imposed on shareholders, as opposed to the bank itself, as only the shareholders, and not the bank itself, can effect a change of control of the bank or give effect to a disposal of the whole of the business of the bank, or effect an amalgamation or merger of the bank, etc.) In addition, empower the supervisor to stop, neutralize, or overturn transactions which proceed without the supervisor’s approval or despite the supervisor’s approval. • Permit only fit and proper persons to obtain a shareholding exceeding 5 percent, which constitutes a significant shareholding, in a bank. Accordingly, the prior approval of the CBN should be obtained by a (prospective) shareholder prior to the (prospective) shareholder’s shareholding in a bank exceeds a 5 percent shareholding in the bank. The CBN should base its assessment of the application on whether the prospective significant shareholder is fit and proper and would be in a position to support the bank in time of stress and need. In the event of a transaction in violation of this provision, the CBN should be empowered to suspend such (beneficial) shareholder’s voting rights and dividend rights on all his shares in the bank, until the situation is regularized. Should a significant shareholder in future fail the fit and proper test, the significant shareholder would be required immediately to dispose of his shareholding above 5 percent in the bank. A significant shareholder is required, on an annual basis, to complete and submit to the BSD a form containing his identity, contact details and details of his significant shareholding in a bank. 	<p>M</p> <p>M</p>

Reference Basel Core Principle	Recommended Action	
	Description	Priority (H/M/L)
	<ul style="list-style-type: none"> • Prescribe that no person, whether natural or legal may obtain control over a bank without the prior written consent of the CBN. Furthermore, prescribe that where a transaction is concluded which results in breach of (the amended) Section 7(1), the (beneficial) shareholders' voting rights and dividend rights in respect of all such (beneficial) shareholder's shareholding in the bank, at the instance of the CBN, could be suspended until such time as the CBN is satisfied as to the fitness and propriety of the new shareholder and has given its consent to such a transaction. • Consider, in the light of the current approach to fit and proper requirements relating to shareholders, whether Circular BSD/DO/CR/2/2000, dated March 23, 2000, is still relevant and, if not, withdraw it. • Define the concept of a beneficial shareholder (in contradistinction with a nominee shareholder). In addition, wherever the submission of shareholder information is dealt with in the legal and regulatory framework, it should be made clear that it means the submission of information on the beneficial shareholder. (Accordingly, it should be incumbent upon the supervisor to ensure that beneficial shareholders are and remain fit and proper and in compliance with the legal and regulatory framework.) • Require a bank to notify the supervisor as soon as it becomes aware of any material information which may negatively affect the suitability of a significant shareholder. • Review the legal and regulatory framework from time to time and update fines to ensure that they are in line with the gravity of the offence and to constitute a sufficient deterrent. • Consolidate, rationalize, logically organize, and simplify components of the legal and/or regulatory framework which deal with issues pertinent to BCP4. 	<p style="text-align: center;">M</p> <p style="text-align: center;">L</p> <p style="text-align: center;">M</p> <p style="text-align: center;">M</p> <p style="text-align: center;">L</p> <p style="text-align: center;">L</p>
5. Major Acquisitions	<ul style="list-style-type: none"> • The legal and/or regulatory framework should prescribe sufficiently comprehensively and clearly how a bank, when considering a (proposed) acquisition or investment, is required to distinguish between cases which are required to be dealt with by way of, respectively, an ex ante application, an ex post application, an ex ante notification and an ex post notification, and other cases. 	<p style="text-align: center;">L</p>

Reference Basel Core Principle	Recommended Action	
	Description	Priority (H/M/L)
	<ul style="list-style-type: none"> • Consideration should be given to scrapping the provisions which permit a bank to hold shares in agricultural, industrial, and venture capital companies. • Consolidate, rationalize, logically order, and simplify components of the legal and/or regulatory framework which deal with issues pertinent to BCP5. 	<p style="text-align: center;">M</p> <p style="text-align: center;">L</p>
6. Capital Adequacy	<ul style="list-style-type: none"> • Ensure that the regulatory capital adequacy requirements, at a minimum, are strictly in line with the Basel I, also in relation to Tier 1 and Tier 2 regulatory eligible capital components. • Require a bank, in relation to a capital instrument of the bank or of another bank, to impair its regulatory eligible capital in an amount equal to: <ul style="list-style-type: none"> - its investment therein (whether directly or indirectly, e.g., via a subsidiary); - its financing the purchase thereof (whether directly or indirectly, e.g., via a subsidiary); - its provision of financing facilities for the purchase there for (whether directly or indirectly, e.g., via a subsidiary); - its provision of financing (whether directly or indirectly, e.g., via a subsidiary) against collateral in the form thereof; and - its provision of financing facilities (whether directly or indirectly, e.g., via a subsidiary) against collateral thereof. • Develop and maintain updated comprehensive and detailed principles, standards, guidance, prescriptions, statutory returns, and supervisory work programs, inter alia based on and aligned with relevant pronouncements of the BCBS, for all key areas, including corporate governance, capital and capital management, significant existing and emerging risks, which would enhance effectiveness, efficiency, consistency, quality control and transparency of supervision, thus enabling more effective challenging of banks by the supervisor. • Require banks to hold adequate regulatory eligible capital also against significant risk exposures: <ul style="list-style-type: none"> - other than credit risk; and - credit risk exposures not prudently captured by Basel I. • Prescribe that the shortfall in regulatory provisions, constituted by the difference when a bank's regulatory required provisions exceed its IFRS credit impairments, does not constitute or qualify as Tier 1 core capital. 	<p style="text-align: center;">M</p> <p style="text-align: center;">H</p> <p style="text-align: center;">M</p> <p style="text-align: center;">M</p> <p style="text-align: center;">H</p>

Reference Basel Core Principle	Recommended Action	
	Description	Priority (H/M/L)
	<ul style="list-style-type: none"> <li data-bbox="630 310 1312 621">• Perform, and require banks to perform, overall micro/bottom up and macro/top down stress testing, scenario analyses and simulation exercises in relation to all key areas, including risk areas, as a tool to provide forward-looking assessments of a bank's capacity (as constituted by its capital, liquidity and earnings) to withstand extreme but plausible macro-financial shocks. The results should be taken into account when establishing and reviewing (a bank's) policies, processes, limits, thresholds, and benchmarks. <li data-bbox="630 638 1312 726">• Consolidate, rationalize, logically order, and simplify components of the legal and/or regulatory framework which deal with issues pertinent to BCP6. 	<p data-bbox="1377 310 1398 338">H</p> <p data-bbox="1377 638 1398 665">L</p>
7. Risk Management Process	<ul style="list-style-type: none"> <li data-bbox="630 747 1312 961">• Prescribe that the approval level of risk exposures be commensurate with the size and risk of the resulting risk exposure, and significant risk exposures (say, exceeding a prescribed percentage of a bank's capital) should be decided by the bank's senior management or even a higher level body (such as the Board Risk Committee, or even the Board itself.) <li data-bbox="630 978 1312 1100">• Consider the selective implementation, in the interim, of Basel II principles to ensure that the relevant elements of risk and risk management are embedded in banks' capital management. <li data-bbox="630 1117 1312 1302">• Develop and issue specific guidance to govern the application of internal risk management models, to ensure that sound principles, practices, and controls are applied, and that the measurement and assessment of significant existing and emerging risks yield reasonably prudent outcomes. <li data-bbox="630 1318 1312 1478">• Reconsider the quality and quantity of supervisory resources required to enable the regulatory and supervisory authorities to discharge their responsibilities effectively, given also the regulatory reform agenda, including the implementation of IFRS, Basel II and III. <li data-bbox="630 1495 1312 1864">• In line with the HRD plan for specialist career streams, engage specialists to support the regulatory and supervisory functions in addressing specialist and complex issues in the areas of capital and capital management, corporate governance, credit risk and credit risk management, country and transfer risk and country and transfer risk management, market risk and market risk management, liquidity risk and liquidity risk management, operational risk and operational risk management, accounting and auditing, information technology and project management, thus enabling the supervisory authority to effectively challenge banks and all related 	<p data-bbox="1377 747 1398 774">M</p> <p data-bbox="1377 978 1398 1005">L</p> <p data-bbox="1377 1117 1398 1144">L</p> <p data-bbox="1377 1318 1398 1346">H</p> <p data-bbox="1377 1495 1398 1522">H</p>

Reference Basel Core Principle	Recommended Action	
	Description	Priority (H/M/L)
	<p>stakeholders, including (Boards of) directors, executive management (including the CEO, COO, CFO, CRO, CIA, CIO, CCO, etc) and external auditors.</p> <ul style="list-style-type: none"> Consolidate, rationalize, logically arrange, and simplify components of the legal and/or regulatory framework which deal with issues pertinent to BCP7. 	L
8. Credit Risk	<ul style="list-style-type: none"> Where relevant, also apply, mutatis mutandis, BCP7's recommendations. Require that a bank's Board regularly reviews the CRM strategy, significant policies and processes, while ensuring that these are consistent with the risk appetite. Prescribe that the approval level for credit exposures should be commensurate with the size and risk of the resulting credit exposure. Prescribe that major credit risk exposures exceeding a certain amount or percentage of a bank's capital and also especially risky credit risk exposures should be decided by the bank's senior management or even a higher level body (such as the Board Credit Committee or the Board itself.) Prescribe that a bank should consider the potential future exposure of a counterparty credit risk exposure to capture the material risks inherent in individual products or transactions. 	M M M M L
9. Problem Assets, Provisions, and Reserves	<ul style="list-style-type: none"> Require that the classification and provisioning of specialized facilities (e.g., agricultural finance, project finance, object finance, real estate finance, SME finance, and mortgage finance) also take into account qualitative factors. Build expertise in IFRS, especially in the validation of banks' impairment provisioning models. Leverage off external auditors' expertise, as an interim measure, in relation to assessing the reasonableness of the classification and provisioning process and outcomes. 	M M L
10. Large Exposure Limits	<ul style="list-style-type: none"> Standardize, inter alia through definition, terminology relating to large exposures, whether single entities or groups of connected entities. Expand the definition of large exposures to include: <ul style="list-style-type: none"> subsidiaries and affiliates of a counterparty of a bank; parties that are controlled by or have significant influence over a counterparty of a bank; parties to whom a counterparty of a bank are exposed in terms of transactions which are not arm's length transactions; and the notion of economic dependency. 	L M

Reference Basel Core Principle	Recommended Action	
	Description	Priority (H/M/L)
	<ul style="list-style-type: none"> • Prescribe that all large exposures (being exposures exceeding 10 percent of a bank's capital) should be decided by the bank's senior management or even a higher level body (such as the Board's Credit Committee or the Board itself.) • Amend the legal and regulatory framework to impose a (maximum) 25 percent large exposure limit which may not be exceeded and in relation to which the CBN should be prohibited from granting any exception or condonation. • Prescribe that any amount of an exposure in excess of the large exposure limit (of a (maximum) of 25 percent of capital) constitutes an impairment of capital for purposes of computing regulatory eligible capital. • Prescribe that the total outstanding exposure (on and off balance sheet) by a bank to all tiers of government (other than the sovereign itself), and their agencies shall not at any point in time exceed 10 percent of the total credit portfolio, and that any excess amount above 10 percent of the total credit portfolio limit shall constitute an impairment of capital for purposes of computing regulatory eligible capital. • Develop and impose limits for sectoral exposures of banks, especially in relation to the oil and gas sector and the telecommunications sector. • Empower the CBN to exercise its discretion, where relevant and on a case by case basis, to deem the existence of large exposure relationships, for purposes of determining the total amount of a bank's exposure to a particular counterparty or group of connected counterparties, in addition to those connected counterparty relationships defined in the law. 	<p style="text-align: center;">M</p> <p style="text-align: center;">M</p> <p style="text-align: center;">M</p> <p style="text-align: center;">M</p> <p style="text-align: center;">M</p> <p style="text-align: center;">H</p>
11. Exposure to Related Parties	<ul style="list-style-type: none"> • Standardize, inter alia through definition, terminology relating to related parties and insiders. • Expand the definition of related party and insiders to include: <ul style="list-style-type: none"> - subsidiaries and affiliates of a bank; - parties that are controlled by or have significant influence over related parties of a bank; - parties to whom the related parties of a bank are exposed in terms of transactions which were not arm's length transactions; and - the notion of economic dependency. • Strengthen the definition of related parties by designating, inter alia, also external auditors as related parties. 	<p style="text-align: center;">M</p> <p style="text-align: center;">H</p> <p style="text-align: center;">M</p>

Reference Basel Core Principle	Recommended Action	
	Description	Priority (H/M/L)
	<ul style="list-style-type: none"> • Prescribe that all matters involving related party exposures should be decided by the bank's Board of directors. • Empower the CBN to exercise its discretion, where relevant and on a case by case basis, to deem the existence of related party relationships, for purposes of determining the total amount of a bank's exposure to a particular related party or group of connected related parties, in addition to those related party relationships defined in the law. • Prohibit the granting of advances to related parties on more favorable terms than corresponding exposures to non-related counterparties and/or to ensure that such transactions are concluded on an arm's length basis. • Prohibit related parties from being involved in the decision-making process in relation to a related credit or credit facility. • Require that the monitoring and reporting of related party transactions be discharged by way of an independent credit review process. • Adjust substantially downwards the current 60 percent aggregate related party limit. • Amend the legal and regulatory framework to impose a 10 percent single related party limit and an aggregate related parties limit, which limits may not be exceeded and in relation to which the CBN should be prohibited from granting any exception or condonation. • Constitute the total amount of an exposure to a related party as an impairment of capital, which means that such an exposure should be deducted for purposes of determining a bank's regulatory eligible capital. 	<p>H</p> <p>H</p> <p>H</p> <p>H</p> <p>H</p> <p>H</p> <p>H</p> <p>H</p>
12. Country and Transfer Risk	<ul style="list-style-type: none"> • Apply also, mutatis mutandis, relevant BCP7 recommendation/s. • Manage country and transfer risk as a separate risk, in light of the nature and extent of the activities of the banking sector and of individual banks, which constitute it as an emerging and, perhaps, even a significant risk exposure in the case of certain banks. • Require a bank to hold an appropriate (in other words, in relation to the threat which a bank's risk exposure poses to economic value) amount of regulatory eligible capital against significant country and transfer risk exposure. 	<p>M</p> <p>M</p> <p>M</p>
13. Market Risks	<ul style="list-style-type: none"> • Apply also, mutatis mutandis, relevant BCP7 recommendation/s. • Adopt the 1996 Market Risk Amendment. 	<p>H</p> <p>H</p>

Reference Basel Core Principle	Recommended Action	
	Description	Priority (H/M/L)
	<ul style="list-style-type: none"> • Manage market risk as a separate risk, in light of the nature and extent of the activities of the banking sector and of individual banks, which constitute it as an emerging and, perhaps, even a significant risk exposure, in the case of certain banks. Pay particular attention to a bank's treasury and ALCO. • Require a bank to hold an appropriate (in other words, in relation the threat which a bank's risk exposure poses to economic value) amount of regulatory eligible capital against significant market risk exposure. • Improve the competencies of supervisory staff in relation to market risk and market risk management. 	<p style="text-align: center;">M</p> <p style="text-align: center;">H</p> <p style="text-align: center;">M</p>
14. Liquidity Risk	<ul style="list-style-type: none"> • Apply also, mutatis mutandis, relevant BCP7 recommendations. • Update the <i>Guidelines for the Development of Liquidity Management Policies</i>, 2003, in light of the important subsequent reforms relating to liquidity risk management, including the BCBS's Principles for Sound Liquidity Risk Management and Supervision, 2008. For example, the guidelines should be enhanced by considering the following issues: <ul style="list-style-type: none"> - provide a clear expectation on the roles and functions of the management vis-à-vis Asset-Liability Committee (ALCO); - require that net funding requirements need to be assessed in the context of a broader review of how other risks could impact the need for funding; - set limits or ratios to prevent concentration of funding from top depositors, by maturity, and from volatile sources; - require banks to have separate CFPs for overseas branches or subsidiaries; - require clear escalation procedures detailing when and how each of the CFP plans can and should be activated, and determine the expected lead time needed to tap additional funds from each of the contingency sources under a stress scenario; - require the establishment of internal limits or ratios to address diversification and concentration, and identify the party responsible for monitoring and reviewing such limits and ratios; - require that banks establish internal policies to govern the classification of liquid assets to ensure no over-reliance on illiquid assets; and - incorporate in the liquidity ratio requirement also the potential impact of crystallization of OBS obligations. 	<p style="text-align: center;">M</p> <p style="text-align: center;">M</p>

Reference Basel Core Principle	Recommended Action	
	Description	Priority (H/M/L)
	<ul style="list-style-type: none"> • Require a bank with significant multiple currency exposures to have proportionate risk management strategies, policies, and processes governing its foreign currency operations. Consideration should also be given to imposing separate liquidity ratio requirements in relation to each currency. • Conclude on and respond to the quantitative impact assessment of the liquidity prescriptions (Liquidity Coverage Ratio and Net Stable Funding Ratio) contained in Basel III. 	<p style="text-align: center;">M</p> <p style="text-align: center;">L</p>
15. Operational Risk	<ul style="list-style-type: none"> • Apply also, mutatis mutandis, relevant BCP7 recommendations. • Manage operational risk as a separate risk, in light of the nature and extent of the activities of the banking sector and of individual banks, which constitute it as a significant risk exposure. • Require banks to hold an appropriate (in other words, in relation to the threat which a bank's risk exposure poses to economic value) amount of regulatory eligible capital against significant operational risk exposure. • Improve the competencies of supervisors in relation to operational risk and operational risk management. • Develop guidance in relation to banks' outsourcing activities. 	<p style="text-align: center;">M</p> <p style="text-align: center;">M</p> <p style="text-align: center;">H</p> <p style="text-align: center;">M</p> <p style="text-align: center;">M</p>
16. Interest Rate Risk in the Banking Book	<ul style="list-style-type: none"> • Apply also, mutatis mutandis, relevant BCP7 recommendations. • Manage IRRBB as a separate risk, in light of the nature and extent of the activities of the banking sector and of individual banks, which constitute it as a significant risk exposure. • Require banks to hold an appropriate (in other words, in relation to the threat which a bank's risk exposure poses to economic value) amount of regulatory eligible capital against significant IRRBB risk exposure. • Improve the competencies of supervisors in relation to IRRBB and IRRBB management. • FRPD's top-down stress test exercises (including shocks on IRRBB) results should be shared adequately with the BSD. 	<p style="text-align: center;">M</p> <p style="text-align: center;">M</p> <p style="text-align: center;">H</p> <p style="text-align: center;">M</p> <p style="text-align: center;">M</p>
17. Internal Control and Audit	<ul style="list-style-type: none"> • Training (in all aspects of banking, especially including corporate governance (including the roles and responsibilities of the various stakeholders, such as directors, senior management, CEO, COO, CFO, CRO, CIA, CCO, external auditors and supervisors), capital management, risk management (including key risks such as credit, market, operational, IRRBB, country and transfer risks, and issues such as concentration and large 	<p style="text-align: center;">H</p>

Reference Basel Core Principle	Recommended Action	
	Description	Priority (H/M/L)
	<p>exposures, and related parties and internal controls) of all stakeholders (including Boards of directors, executive management, bank personnel, external auditors and supervisors, including the consequences of breaches and failures of such duties and responsibilities, should be undertaken on an ongoing basis.</p>	
18. Abuse of Financial Services	<ul style="list-style-type: none"> • Amend the relevant laws and regulations to bring them in compliance with international standards. • Require that the AML/CFT statutory returns, to be completed by a bank, are in electronic format, to facilitate effectiveness and efficiency and to minimize human manual intervention. Also, the returns should be signed off by senior personnel who should be held responsible and accountable for the quality of the information submitted. Sound validation, inter alia, by way of on-site verification and editing controls, should be in place to ensure optimal quality information is uploaded to the relevant database/s. • Launch initiatives to improve the effectiveness of AML/CFT in Nigerian banks, including focused thematic examinations of various aspects of a bank's AML/CFT functions, and perform quality control checks to control and monitor such effectiveness. <p>Maintain a no-tolerance policy in respect of criminality and corporate governance abuses and breakdowns, react promptly, firmly and forcefully, and impose strong and effective sanctions.</p>	<p>H</p> <p>M</p> <p>M</p> <p>H</p>
19. Supervisory Approach	<ul style="list-style-type: none"> • Include peer comparison among banks with similar risk profiles, to enrich the RBS information and improve the assessment. • Develop specific and granular criteria for assessment of the risk direction. Among others, CBN may consider the utilization of scenario-based stress testing whereby CBN supervisors can leverage off the proposed top-down stress test exercises conducted by Financial Regulation & Policy Department. 	<p>M</p> <p>L</p>
20. Supervisory Techniques	<ul style="list-style-type: none"> • Develop an independent formal governance process for quality assurance of overall supervisory ratings determined for banks and supervision in general, which may include the involvement of the CBN's risk management and internal audit functions. • Ensure regular and timely communication of any supervisory issues with members of a bank's Board, even outside the on-site examination process. 	<p>M</p> <p>L</p>

Reference Basel Core Principle	Recommended Action	
	Description	Priority (H/M/L)
21. Supervisory Reporting	<ul style="list-style-type: none"> • Give consideration to incorporating into the e-FASS system a workflow module (for handling also correspondence and other routine supervisory tasks) and an on-site supervision module (including work programs and work papers), to leverage e-FASS and optimize the efficiency of supervision. • Require a bank to notify the CBN of all material information regarding the bank's activities, structure or overall condition, or material adverse developments, as soon as possible. 	<p>L</p> <p>M</p>
22. Accounting and Disclosure	<ul style="list-style-type: none"> • Reconsider the wisdom of prior approval by the CBN of a bank's draft annual audited financial statements, as provided for by Section 27 of the BOFIA, as it holds the potential for the CBN to be held (co-) responsible (whether explicitly or implicitly) for the content of the annual audited financial statements upon publication thereof. • Establish and maintain a specialist function within the CBN/BSDFRPD on bank accounting, auditing, disclosure, and the corporate governance roles of bank internal and external auditors. Task this specialist function with ensuring that the legal, regulatory and supervisory framework and the supervisory approach and practices are in line with sound internationally generally accepted standards and practices. The (senior) specialist should be responsible for driving the agenda relating to accounting, auditing, disclosure, and corporate governance issues relating to bank internal and external audit/auditors, both internal (within the CBN) and externally, in relation, firstly to banks, but, also, in relation to other stakeholders, such as the accounting and auditing profession's representative bodies, the individual accounting and auditing firms and the FRCoN. So, for example, the periodic meetings between bank supervisors and FRCoN to discuss issues of common interest relating to bank audits and accounting should be reinstated and the agenda driven by the (senior) specialist. The specialist function should develop a reporting template for, and indicate the frequency of reporting on, the reports to be rendered to the CBN by external auditors of banks on a bank's risk management practices, internal controls and level of compliance, to give effect to the provisions of Section 7.1.4 of the Bank Corporate Governance Code. • Require a bank to develop and implement formal policies in relation to internal and external audit and disclosure. 	<p>L</p> <p>H</p> <p>M</p>

Reference Basel Core Principle	Recommended Action	
	Description	Priority (H/M/L)
	<ul style="list-style-type: none"> • Amend the legal and/or regulatory framework to require that the CBN may obtain access to an external auditor's external audit working papers in respect of a bank, when a bank becomes a problem bank. • Prescribe by way of the BOFIA that an external auditor who, in good faith, furnishes a report, as provided in Section 29(7) of the BOFIA, to the CBN, is protected against claims of having breached any confidentiality. • Amend the BOFIA so that it specifically and explicitly empowers the CBN to remove a bank's auditor who does not discharge his responsibilities satisfactorily. 	<p style="text-align: center;">M</p> <p style="text-align: center;">L</p> <p style="text-align: center;">M</p>
23. Corrective and Remedial Powers of Supervisor	<ul style="list-style-type: none"> • Ensure Part 4, titled Supervisory Actions in the Event of a Systemic Banking Distress, of the document titled <i>Supervisory Intervention Framework</i>, is not in the public domain, for avoidance of moral hazard. • Review and, if necessary, effect the necessary amendments to ensure that the Supervisory Intervention Framework is fully aligned with and grounded in the provisions of the BOFIA, and is not open to the charge that it or some of its provisions are <i>ultra vires</i>. • Apply zero tolerance, <i>inter alia</i> in relation to actions or inactions which put financial sector stability or the safety and soundness of a bank at risk, such as corporate governance transgressions and noncompliance with statutory prescriptions. • Supervisors should act promptly, resolutely and forcefully in applying corrective, enforcement and sanctioning actions, and in resolving problem banks, especially in instances which hold the potential to imperil financial stability. 	<p style="text-align: center;">L</p> <p style="text-align: center;">M</p> <p style="text-align: center;">H</p> <p style="text-align: center;">H</p>
24. Consolidated Supervision	<ul style="list-style-type: none"> • Ensure the comprehensive incorporation into the BOFIA of necessary enabling provisions to facilitate the implementation and performance of consolidated supervision. • Expedite the finalization of the draft framework for consolidated supervision and implement it post haste. • Enhance the supervisory capacity and capabilities in relation to consolidated supervision. • Amend the BOFIA to specifically and clearly empower the CBN to require a bank to close a foreign office or impose limitations on their activities under specified circumstances, namely should the CBN determine that the oversight by the bank and/or supervision by the host supervisor is not adequate relative to the risks the office presents and/or it cannot gain access to the information required for the exercise of supervision on a continuous basis. 	<p style="text-align: center;">H</p> <p style="text-align: center;">H</p> <p style="text-align: center;">H</p> <p style="text-align: center;">M</p>

Reference Basel Core Principle	Recommended Action	
	Description	Priority (H/M/L)
25. Home-host Relationships	<ul style="list-style-type: none"> • Empower the CBN to share information with other supervisory authorities. • Carry-out a one-off review exercise of, and thereafter at regular intervals, review all the host supervisory authorities to assess the nature and quality of the regulatory and supervisory frameworks, supervisory approaches and quality of supervision, including enforcement and resolution. 	<p style="text-align: center;">L</p> <p style="text-align: center;">M</p>

Authorities' response to assessment

150. The supervisory authorities (the CBN and the NDIC) express their appreciation for the comprehensive review of the regulatory and supervisory framework for the Nigerian banking system, carried out by the IMF/World Bank assessment team. The assessment has largely achieved its objective of benchmarking Nigeria's supervisory system against the Basel Core Principles and has also helped in focusing attention on areas where there are gaps and weaknesses that would require more work to further strengthen banking supervision and the overall stability of the Nigerian banking system.

151. Coming at the time it did, it is not unexpected that the outcome of the assessment exercise would be influenced largely by (the run-up to) the banking crisis and the experiences in 2008-2009. The crisis severely tested the resilience of the Nigerian banking system and the capabilities of the supervisors—in response to the crisis, the authorities took unprecedented and extraordinary measures to ameliorate the impact, and also launched reforms which entailed the overhaul of regulations as well as practices underlying supervision. While certain aspects of the reforms had been concluded prior to the commencement of the assessment exercise, other key aspects were either being concluded or were ongoing at the time of the assessment, e.g., Basel II/III and IFRS. The final assessments were not fully reflective of this aspect of the reforms. The continuing and effective implementation of the reforms should result in significant improvement in the level of compliance in the short to medium term. The authorities will not relent on their resolve to ensure that the regulations keep pace with developments in the banking system.

152. The authorities appreciate the recommendations arising from the assessment, including the need to adopt the relevant BCBS pronouncements and ensure their full alignment with local regulations; develop and maintain a well-structured compendium of supervisory regulations; enhance supervisory capacity and capabilities in relation to consolidated supervision; and have in place a more responsive legislative review process, among others. The prospect of significant consequential improvements to the legal, regulatory and supervisory frameworks and processes stiffen the authorities' resolve at ensuring full and effective implementation of the recommendations. Some of the

recommendations, especially those that relate to improvement to the legal framework, will require the involvement and cooperation of stakeholders other than the supervisory authorities.

153. Finally, the authorities commend the efforts of the IMF and World Bank in promoting stability and effective supervision of the global financial system and look forward to continued dialogue with the IMF and World Bank, beyond the FSAP exercise.

ANNEX II. OBSERVANCE OF THE IAIS INSURANCE CORE PRINCIPLES

A. Introduction and Scope

154. **This assessment provides an update on the significant regulatory and supervisory development in the Nigerian insurance sector since 2001.** Nigeria undertook an initial FSAP in December 2001, which included a review of the structure of Nigeria's insurance market and the supervisory framework and approach. Nigeria has also undertaken reviews of its observance of international accounting and auditing standards (2004 and 2011), and corporate governance (2008).

155. **This report is a full assessment of Nigeria's compliance with the Insurance Core Principles (ICPs) of the International Association of Insurance Supervisors (IAIS), as adopted in October 2011.** The review was carried out as part of the 2012 FSAP assessment of Nigeria, and was based on the regulatory framework in place, the supervisory practices employed, and other conditions as they existed in September 2012. The assessment was carried out by Dr. Rodolfo Wehrhahn, Technical Assistance Advisor in the Financial Supervision and Regulation Division, a part of the Monetary and Capital Markets Department, IMF and Mrs. Mimi Ho, Insurance Supervision Advisor contracted by the IMF, during September 9–19, 2012.

156. **The assessment is based solely on the laws, regulations and other supervisory requirements and practices that are in place at the time of the assessment.** Ongoing regulatory initiatives, such as proposed legislation, are noted by way of additional comments. The authorities provided a comprehensive self-assessment and other pertinent information such as reports, studies, public statements, websites, and guidelines. The assessors also met a number of Nigerian insurers, industry associations and other stakeholders.

157. **The assessors are grateful to the authorities for their full cooperation,** thoughtful logistical arrangements and coordination of various meetings with insurers and industry associations. In-depth discussions with and briefings by officials from NAICOM facilitated a robust and meaningful assessment of the Nigerian regulatory and supervisory regime for the insurance sector.

B. Executive Summary

158. **Insurance activity in Nigeria is regulated by two Acts and supervised by the National Insurance Commission.** The Insurance Act, No. 1 of 2003 governs the licensing and the operation of insurers, reinsurers, intermediaries, and other providers of related services. The National Insurance Commission Decree, No. 1 of 1997 established the National Insurance Commission (NAICOM) as the supervisory institution with the power of inspection, remedial and enforcement actions, and composition of fines. NAICOM is funded

by industry levy and government grants, 50 percent of which is for operational purposes, 30 percent for upgrading industry capacity and 20 percent for industry development and compensation. Insurers must be established as limited liability companies under the Companies and Allied Matters Act, 1990.

159. **The insurance sector is an underdeveloped part of the Nigerian financial sector with assets less than 2 percent of GDP.** Assets of the life business are about half of the assets of the non-life sector, reflecting the low level of activity in savings and investment insurance products. In terms of gross written premium, the insurance sector grew at an average rate of 23 percent from 2001 to 2010 but remains very small. The total premium income was ₦201 billion in 2010⁴⁷, representing 0.7 percent of GDP or only just above a tenth of the average penetration of the OECD countries. The gross written premium is estimated to be ₦232 billion in 2011.

160. **NAICOM has made a lot of effort over the past five years to improve the regulatory environment.** Following the recapitalization of insurers and reinsurers in 2007 aimed at eliminating unprofitable and insolvent companies, NAICOM has upgraded its regulatory requirements, including a voluntary code on corporate governance, operational guidelines, risk management framework, KYC and AML/CFT requirements, and the adoption of IFRS. When fully implemented, these initiatives will significantly improve the regulatory environment for the industry. A critical success factor is to provide NAICOM officers with the necessary technical knowledge and supervisory skills suitable for the new regime.

161. **The supervisory framework still needs urgent improvements.** Poor accounting and auditing practices results in supervisors spending too much time in verifying the accuracy of financial data. Supervisors spend more time verifying data than analyzing them. This not only hinders effective supervision, but also timely disclosure of information to policyholders and the market in general. Further, the solvency regime, valuation and the reserve requirements need to be upgraded to capture the nature of risk inherent in each insurer.

162. **The business viability of several insurers is under stress.** The substantial increase in the minimum capital requirements in 2007 led to a reduction from 104 to 60 insurers in 2008. Some insurers need capital injection to comply with solvency requirements. Few insurers have made profits for 2011 according to the unofficial numbers available to NAICOM as of September 2012. The drop in stock prices of over 60 percent since 2007 has affected investments in the insurance sector resulting in several publicly traded insurers

⁴⁷ 1 US\$ = 157.5 ₦ as at 25 Aug 2012.

losing all share premia and are currently trading at nominal value or the minimal share value required for listing.

163. **Government is actively pursuing policy to address the need for the sector to grow; however, enforcement of compulsory insurance is suboptimal.** There are six classes of compulsory insurance but enforcement is weak. More effective enforcement will provide a substantial stable premium income for the industry. NAICOM recognizes this and has been working with other relevant authorities to strengthen enforcement. Under this initiative, a motor insurance database will be launched in the coming months, aiming to stamp out rampant fake motor insurance certificates, by providing a quick and easy way for the enforcement agency and customers to verify the authenticity of insurance certificates.

164. **Sufficient investment instruments exist to cover current short term insurance liabilities, but, as the annuities and long term insurance markets develop, there will be a need for longer term investment instruments.** Both life and non-life companies have similar investment portfolios. The asset composition of insurers consists of short-term money market and bank deposits (30 percent), stock and private debentures (another 30 percent) and real estate, loans and government paper (40 percent). The need for liquid assets reflects the current short duration of the existing liabilities in both non-life and life.

165. **Consumer protection needs to be treated with high priority.** As the compulsory insurance is enforced, the cost of intermediation of compulsory insurance and the purchase of retirement annuities need to be addressed to improve efficiency of the market. NAICOM should improve the disclosure standards, requiring intermediaries to disclose their capacity to act (whether as agent or broker), their financial interest in the policy, and any conflict of interest that might affect their recommendation of products. For annuities, electronic bidding models like the one existing in Chile would benefit the annuitants by enhanced cost transparency and reducing intermediation costs.

C. Main Findings

166. **The legal status of guidelines issued by NAICOM should be clarified.** NAICOM has the power under the law to make regulations and issue guidelines. The issuance of regulations is subject to the minister's approval while the issuance of guidelines is not. NAICOM has issued a number of significant prudential requirements in the form of guidelines, such as minimum capital, technical provisions; investment limits and risk management, although the AML/CFT requirements were issued in the form of regulations. NAICOM has taken the position that guidelines have the force of law, on par with regulations. The position has not yet been tested in courts. While the insurers have thus far complied with guidelines when prompted, it is nevertheless important to have legal certainty.

167. **Prudential and solvency requirements should be updated to better reflect the risk profile of the operations.** Technical provisions and solvency margins are factor-based without regard to the nature of risks. The basis of estimating liabilities is left to the insurers or actuaries in the case of life business. The regime is in urgent need of revamping to become commensurate with the intended move toward a risk-based supervision framework.

168. **Poor accounting and auditing practices result in supervisors spending too much time in verifying the accuracy of financial data.** Supervisors spend more time verifying data than analyzing data. This not only hinders effective supervision, but also timely disclosure of information to policyholders and the market in general. NAICOM should collaborate with the FRC to improve the reliability of the audited financial statements so that supervisors are able to focus more on both quantitative analysis and qualitative aspects of supervision. NAICOM should also take insurers and directors to task for submitting inaccurate information to promote proper corporate governance.

169. **The substantial increase in the minimum capital requirements in 2007 led to a reduction from 104 to 60 insurers in 2008.** Further market consolidation, albeit at a lower scale, is expected in the coming months as a result of the banking regulation that requires banks to divest their non-banking activities, including insurance, by April 2012.⁴⁸ Non-life insurance is more developed than life insurance. All non-life lines of business are offered, and their market share is balanced between motor, marine and aviation and property. Traditional life insurance is offered, of which around 70 percent corresponds to group life. However, modern life products, such as critical illness or inflation indexed benefits, are not readily available.

170. **Given the existing premium volume, the high capital requirements present a challenge to the attractiveness of the sector.** Except for the largest insurers, the return on equity is low as a result of low premium volume and high capital base. While the high capital is sensible to ensure professionalism in the industry, there is a need to study the appropriateness of the capital requirement to balance risk, return and development. The minimum paid-up capital should be evaluated when introducing risk-based capital so that capital adequacy will reflect the risks that the insurer takes on.

171. **There are few professional qualified actuaries working in Nigeria.** The use of actuarial valuation is not mandatory for non-life insurers and it is only required every three years for life insurers. The low demand for external actuaries is covered by one actuarial firm. The leading institution in Nigeria offering an actuarial science degree program is the University of Lagos, Lagos, Nigeria. The institution has been providing a bachelor degree

⁴⁸At the date of the assessment, the divestiture was largely completed, except one or two banks that require additional time to restructure. However, new statistics are not yet available post-divestiture.

program for many decades. There is a local actuarial society called the Nigerian Actuarial Society which, like the University, has been in existence for more than two decades. The Actuarial society is affiliated to the International Actuarial Association (not a full member), however it has not been very active in promoting development of the profession and further education of the local actuaries and does not provide accreditation. Currently only five professionals working in Nigeria are fellows of foreign actuarial associations. The introduction of IFRS is creating demand for actuaries that currently the country cannot provide.

D. Summary of Observance of the Insurance Core Principles

Annex Table 4. Nigeria: Summary of Observance of the Insurance Core Principles

Insurance Core Principle	Comment
1. Objectives, Powers and Responsibilities of the Supervisor	<p>The NA identifies NAICOM as the authority responsible for insurance supervision. While the supervisory objective is clearly defined, it narrowly focuses on the effectiveness of regulation and supervision. Given the nascent state of the Nigerian insurance market, it is advised that NAICOM expand the objective to include the creation of a fair, safe and stable insurance sector for the benefit and protection of policyholders.</p> <p>NAICOM has the power to issue regulations, with the minister's approval.</p> <p>NAICOM also has the power to issue guidelines, without the need to obtain minister's approval. NAICOM has taken the position that guidelines have the force of law, on par with regulations. NAICOM has issued a number of guidelines on significant prudential matters such as minimum capital, solvency margin, investment limits, technical provisions, and risk management. NAICOM is advised to seek legal clarity on the legal force of guidelines.⁴⁹</p> <p>The power of NAICOM to take corrective and enforcement action is discussed in ICPs 10 and 11. NAICOM's ability to conduct group-wide supervision is discussed in ICP 23.</p>
2. Supervisor	<p>The statutory responsibilities of NAICOM are clearly established under legislation. NAICOM relies mainly on industry levy for its financial resources, which allows it to have the independence in setting its own salary levels, despite it having to seek approval of the National Salaries, Income and Wages Commission.</p> <p>Ministerial approval is required for stronger preventive and enforcement actions, such as removing of officers, or taking control of insurers. To enhance operational independence and to facilitate timely supervisory action, NAICOM should be the final authority in exercising its supervisory powers for operational matters, such as appointment and dismissal of control positions.</p>

⁴⁹For example, the revised minimum paid-up capital requirement contained in a 2005 guideline is in contradiction of the amounts specified in the primary legislation. Without legal certainty of the enforceability of guidelines, insurers could challenge the new capital requirements. In fact, even if the guidelines have the force of law, they cannot contradict the provisions in the primary legislation.

Insurance Core Principle	Comment
	<p>NAICOM has introduced many needed improvements to its regulatory and supervisory regime: the recapitalization in 2005, the introduction of corporate governance code in 2009 and risk management framework in 2012, the adoption of IFRS in 2012 and the proposed transition to risk-based supervision. Adequate skills and knowledge are essential to effective implementation of these new initiatives.</p> <p>While the use of external consultants is a welcome stop-gap measure to supplement specialist knowledge of a supervisor, NAICOM appears to engage external consultants in routine on-site inspections. Since inspection is an integral part of supervisory function, NAICOM should strive to strengthen its human capital, so that it will not rely on third-party consultants to carry out routine on-site inspections. (Also see ICP 9.)</p>
3. Information Exchange and Confidentiality Requirements	<p>Legislation does not provide explicit power for NAICOM to exchange information with relevant regulators. In practice, NAICOM exchanges information with other national regulators regularly through the FSRCC. It has recently concluded an information exchange MOU with Ghana and is in the process of pursuing MOUs with Kenya, Gambia, South Africa and Uganda. For legal clarity, the NA should be amended to give NAICOM explicit power to exchange supervisory information subject to appropriate confidentiality, purpose and use safeguards. NAICOM is encouraged to accede to the IAIS multilateral MOU.</p> <p>NAICOM should also establish procedures for handling requests for information in the absence of an MOU to ensure consistent assessment of such requests and safeguarding confidentiality of information.</p>
4. Licensing	<p>The IA defines the insurance activities to be licensed, prohibits unlicensed insurance activities, defines the permissible legal structure of insurers and specifies the licensing requirements and procedures. License applications are processed in a timely manner. NAICOM discloses grounds for rejection and rejected applicants may appeal the decision to the minister. NAICOM has the power to impose conditions or restrictions on a license, although this has not been done in practice.</p> <p>In addition to the current licensing requirements, NAICOM is advised to consider the applicant's corporate governance framework and its group structure to ensure it is not too complex to be effectively supervised.</p> <p>Currently, a non-life insurer is permitted to conduct all lines of business, regardless of the lines of business proposed at the licensing stage. To ensure that insurers have the necessary financial resources and competence in writing business, NAICOM is advised to consider granting licenses by lines of business.</p>
5. Suitability of Persons	<p>In addition to directors, CEO, branch managers and company secretary, NAICOM should also ensure that significant owners and key persons in control positions are suitable.</p> <p>Currently, NAICOM approves the appointment of CEO, and asks new directors to submit Personal History Statement. The board of directors is ultimately responsible and accountable for an insurer. To ascertain that insurers are managed by suitable persons, NAICOM should consider explicitly approving the appointment of directors, on par with the appointment of CEOs. Likewise, NAICOM should ensure the suitability of heads of key control positions by requiring their appointments to be explicitly approved.</p> <p>The suitability test that NAICOM currently carries out is negative confirmation of criminal and supervisory indicators. NAICOM is advised to include competence,</p>

Insurance Core Principle	Comment
	<p>financial and other indicators in assessing the individual's suitability.</p> <p>To ensure continued suitability on an ongoing basis, NAICOM should formalize the existing practice of subjecting newly appointed directors to a suitability test by requiring insurers to report any changes in board membership to NAICOM. This should be extended to include key persons in control positions as well.</p>
6. Changes in Control and Portfolio Transfers	<p>Current legislation addresses the situations where (i) an insurer amalgamates itself with another insurer, (ii) an insurer transfers all or part of its business to another insurer, or (iii) an insurer acquire a portfolio of insurance business from another insurer. It does not address the situation where a person gains control of an insurer through other means, such as acquiring shares of the insurer. The Operational Guidelines bridge the gap by requiring "all changes in ownership of any insurance and re-insurance company that will entitle any individual to control (directly or indirectly) up to 25 percent holding of its shares must be cleared with the Commission before such transactions are concluded."</p> <p>It is not clear that the 25 percent change in control requirement in the Operational Guidelines is enforceable, as it is not derived from any provisions in the primary legislation. NAICOM should seek amendment of the primary legislation to solidify its supervisory intention. At the same time, NAICOM should clarify (i) whether the threshold shareholding is based on issued shares or voting shares; and (ii) if it applies to both acquisition and disposal of shares.</p> <p>NAICOM may wish to consider progressive thresholds, rather than a single-point threshold. For example, an insurer should notify NAICOM when an individual gains control of 5 percent, 10 percent, and 20 percent of its voting shares.</p> <p>NAICOM should be able to identify the intended beneficial owner, and evaluate the application as if it were an application for a new license, taking into account how policyholders' interests might be affected.</p>
7. Corporate Governance	<p>A voluntary code of corporate governance has been in place since 2009, establishing the governance structure for insurers and intermediaries. Since this is a relatively new code in Nigeria, there are several fine-tuning changes that NAICOM may wish to consider to improve the code:</p> <ul style="list-style-type: none"> • Various regulators have issued corporate governance codes: the Corporate Affairs Commission, the Stock Exchange, NAICOM, and CBN. These regulators should discuss and consider a unified code to avoid market confusion. • Independent directors are expected to have a "critical" role in evaluation of the board's performance. At the same time, CGCG requires an outside consultant to perform such evaluation. Clarification should be given regarding the role of independent directors in evaluation of board performance, relative to the external consultant. • Section 5.04(xi) of CGCG states: "Any individual taking major action in the running of the company must either be a member of the Board, the management or paid consultant." The role of paid consultant in the running of the company is unclear. • Responsibility of the board should be to "establish" strategy, not merely review. • CGCG states that the appointment of the external auditor is subject to NAICOM approval. NAICOM has not explicitly required insurers to do so. • CGCG advocates disclosure of conflict of interest disclosure by all employees to the board or shareholders. To avoid the board being inundated

Insurance Core Principle	Comment
	<p>with declarations, such disclosure should be made to management, except in the case of senior management and key people in control positions.</p> <ul style="list-style-type: none"> • Other than the audit committee, the roles of other board committees are not specified. CGCG could be expanded to require each board committee to have terms of reference. • CGCG indicates that head of internal audit is to report to the MD/CEO. Internal audit should have a direct reporting line to the audit committee of the board to be consistent with international best practice. <p>NAICOM informed that the FRC is leading a project to unify the various codes of corporate governance.</p> <p>In approving the appointment of directors, NAICOM should take into account the mix of knowledge, skills and expertise of directors. To ensure greater independence of the boards, the number of independent directors should be increased from the current number of one.</p>
8. Risk Management and Internal Controls	<p>NAICOM has issued comprehensive RM Guidelines, requiring insurers and reinsurers to establish effective risk management and internal controls with effect from July 2012. The board of directors is required to submit an annual declaration to NAICOM, certifying the insurer's compliance with the RM Guidelines and that the board is satisfied with the efficacy of the process and systems of producing financial information. NAICOM has conducted training for the industry and its staff to ensure consistent understanding of the requirements. NAICOM is in the process of revising its inspection manual to include the new RM Guidelines. Given the newness of the framework, the effectiveness of its implementation is yet to be seen.</p> <p>NAICOM currently does not address the insurer's accountability for outsourced activities. Due to the shortage of professionals in the market, outsourcing is not uncommon. Therefore, NAICOM should clarify the insurer's responsibility when outsourcing material functions, including selecting the service provider, approving procedures, service contract, review of contract, and accountability for outsourced functions.</p> <p>NAICOM should also expand on the requirement for insurers to have disaster recovery/business continuity plan, by (i) specifying the required recovery time based on functional criticality, and (ii) requiring periodic testing of the business continuity plan.</p>
9. Supervisory Review and Reporting	<p>Experience has shown that the audited financial statements may contain serious mistakes. Thus off-site supervisors spend an inordinate amount of time in verifying the accuracy of the audited financial information, crowding out time available for quantitative analysis of the performance of the insurers. NAICOM is advised to collaborate with the FRC to improve the quality of audits, and to take stern action against any insurer and its directors for not having appropriate systems in place to ensure the reliability of financial information, so that resources can be channelled to more strategic supervisory work.</p> <p>IFRS has been adopted from 2012. The industry's preparedness to produce financial reporting on IFRS may be questionable based on the 2012 quarterly returns. Together with FRC, NAICOM should work with the industry to identify the obstacles to the implementation of IFRS.</p> <p>NAICOM engages external consultants in conducting on-site inspections. Section 35 of NA permits the use of consultants in conducting inspections under special circumstances. It is not apparent that the use of consultants is permitted for</p>

Insurance Core Principle	Comment
	<p>routine or targeted inspections. Moreover, since on-site inspection is an integral part of supervision, enabling supervisors to have firsthand knowledge of the operations, NAICOM should develop its own supervisory capacity and use consultants only in specialized fields such as IT risk assessment or forensic investigations.</p> <p>Both onsite and offsite supervision is currently compliance driven. With the release of the RM Guidelines and the impending move to risk-based supervision, NAICOM needs to develop a comprehensive staff training program on understanding risks, evaluating effectiveness of risk management and internal controls, and assessing the financial resilience of an insurer.</p>
10. Preventive and Corrective Measures	<p>NAICOM has a wide range of preventive and corrective measures at its disposal under the legislation. It has exercised its intervention powers in performing its supervisory duties. However, certain supervisory actions are subject to minister's approval, which may hinder its ability to take timely action when necessary. To ensure timely action, NAICOM should have the autonomy to take preventive and corrective action without applying to minister for approval.</p> <p>NA provides that NAICOM may, with minister's approval, apply to the President to revoke an insurer's license. IA, on the other hand, provides that NAICOM may cancel the license under certain circumstances. As there is no practical difference between revocation and cancellation, NAICOM's power to revoke/cancel a license should be consistent in the two legislations.</p>
11. Enforcement	<p>Similar to ICP 10, NAICOM has a wide range of enforcement power and it has exercised its power in performing its supervisory duties. However, certain actions are subject to minister's approval, which may hinder its ability to take timely action when necessary. To ensure timely action, NAICOM should have the autonomy to take enforcement action without applying to minister for approval.</p>
12. Winding-up and Exit from the Market	<p>The procedures for the winding-up and exit of an insurer from the market are clearly set out in legislation. The Court hears the winding-up applications in priority to other matters to avoid a lengthy legal process. Policyholders have priority claim on an insurer's assets above other unsecured creditors. And the statutory deposit provides for additional asset safety in a winding up situation to policyholders.</p> <p>While it may be appropriate for policyholders to bring legal action against an insurer, the ability to petition the Court to liquidate an insurer may afford too much power to any 50 individuals. It may in fact be detrimental to the public and other policyholders. The power to wind-up an insurer should be the sole responsibility of the insurance supervisor. It is recommended to remove this provision from the legislation.</p>
13. Reinsurance and other Forms of Risk Transfer	<p>While NAICOM has issued guidelines on the Board's and senior management's respective responsibilities in setting reinsurance policy, the appropriateness of the reinsurance protection is required. The determination of the reinsurance programs should consider effective risk transfer and protection of the solvency of the insurer. Mandatory cessions and the exclusive use of local reinsurance should be waived by NAICOM if contravening the board's reinsurance policy.</p> <p>It is advised that NAICOM should expand the scope of the reinsurance component of onsite inspection programs to take into account the reinsurance guidelines, and include consideration of liquidity and reinsurers' payment patterns.</p>

Insurance Core Principle	Comment
	<p>Reinsurance programs should only be allowed that pass a risk transfer test and to enhance transparency side letters should be forbidden by requiring the entire contract clause in each treaty.</p>
14. Valuation	<p>The introduction of IFRS standard for reporting is welcomed. The market-consistent valuation of assets and enhanced disclosure will improve transparency of the industry. However, full implementation of IFRS will require a few years until it is understood and properly applied. During this transition period NAICOM is recommended to remain vigilant to avoid misuses or errors in the valuations and application of IFRS.</p> <p>The definition of admissible assets for solvency purposes together with the concentration and class limits appear to be sufficient for the existing investment environment and insurance products. Also, reinsurance recoverable should call for provisioning beyond a reasonable aging period.</p> <p>The valuation of liabilities is weak and needs to be overhauled:</p> <ol style="list-style-type: none"> 1. For non-life business, Section 20 of IA requires insurers to maintain provisions for unexpired risks, and outstanding claims with 10 percent margin for IBNR. Section 21 of IA requires insurers to maintain a contingency reserve to cover fluctuations in investments and underwriting experience. <ul style="list-style-type: none"> • There are no requirements for an actuarial valuation of the sufficiency of the reserves, nor the appropriateness of the IBNR calculation or adjustments according to the experience observed. 2. For life business, Section 22 of IA requires insurers to maintain a general reserve equal to net liabilities of policies in-force determined by an actuary. The actuarial valuation is done every three years and an additional 25 percent of net premium for every year between valuations is added to the reserve. In addition, a contingency reserve is required that is equal to 1 percent of the gross premiums or 10 percent of the profits (whichever is greater) and accumulated until it reaches the amount of the minimum paid-up capital. <ul style="list-style-type: none"> • The actuarial valuation needs to be on an annual basis and the actuarial standards specified in regulation either explicitly or with a reference to existing international actuarial standards. 3. For reinsurers' business, Section 23 of IA requires reinsurers to maintain a general reserve fund which is credited with (a) not less than 50 percent of its gross profit for the year where the fund is less than the authorized capital; and (b) not less than 25 percent of its gross profit for the year where the fund is equal to or exceeds the authorized capital. <ul style="list-style-type: none"> • The prescribed reserves have no relationship with the assumed liabilities and an actuarial valuation of the sufficiency of the reserves, like in the case of non-life insurers, is recommended. <p>The contingency reserve requirement introduces a prudent element into the liabilities calculation but its use needs to be specified and allowed for those specified situations like the statistical deviation of claims or the occurrence of extreme events, otherwise the contingency reserve will only be of value in extreme situations of insolvency.</p>

Insurance Core Principle	Comment
	<p>There are six actuaries in Nigeria, one of whom is no longer working in the profession. Of the remaining five, four are working with three companies, leaving only one consulting actuary to meet the needs of the industry. NAICOM could consider using the Education Fund to develop university programs to groom future actuarial professionals.</p>
15. Investment	<p>NAICOM is open and transparent as to the regulatory investment requirements that apply. The requirements are set in the IA and in the Operational Guidelines. They address to a certain extent security, liquidity and diversification through limits by issuer, by deposits held in a single bank, and by the classes of investments, with lower limits for riskier assets. However, there are no explicit requirements on the credit standing, level of liquidity or asset liability matching for the selection of investments.</p> <p>Going forward NAICOM should consider introducing a well-defined overarching prudent man type of concept to guide the investments of insurers. This will cover all risks, like credit, concentration, liquidity, etc., without leaving a regulatory gap and without being too prescriptive. In the initial stage of introduction, close monitoring and detailed guidance on what is expected from the investment policy is recommended.</p> <p>While IFRS and the risk management requirements will to a certain extent encourage the proper understanding and valuation of all investments, there is no explicit requirement on the use of more complex and less transparent classes of investments or investment in markets or instruments that are subject to less governance or regulation. The introduction of explicit requirements on the use of these more complex and less transparent classes of investments is recommended to accompany the market development toward the use of more complex investments. Given the current level of investment expertise in the industry, prohibition of the use of derivatives is also recommended.</p> <p>There is some level of segregation of the policyholder funds. Regulation states that all investments relating to insurance funds need to be earmarked. However, there are no requirements to have those assets in trust or with a custodian. It is recommended to require that policyholders' assets related to investment products are segregated in independent trusts.</p>
16. Enterprise Risk Management for Solvency Purposes	<p>The ERM framework has just been implemented two months ago. Each insurer has submitted its RM framework to NAICOM. The effectiveness of the framework is yet to be seen.</p> <p>There are a few key elements that NAICOM should include in the RM Guidelines, e.g., stress testing as a tool to assess risk, asset-liability management, and insurer's own assessment of solvency.</p>
17. Capital Adequacy	<p>The existing solvency regime is not useful to effectively supervise and monitor the resilience of insurers. There is urgent need for enhancements.</p> <p>The current solvency regime uses a percentage of premium as the solvency margin for non-life insurers. For life insurers the solvency requirement is based on full reliance on an actuarial sufficiency valuation. Reinsurers are excluded from solvency requirements except for their non-life business, which is similar to the direct non-life insurers. There is some conservatism in the introduction of contingency reserves and limitation on the dividend distribution but the current solvency regime does not address the risks assumed by the insurers.</p>

Insurance Core Principle	Comment
	<p>NAICOM is aware of the drawbacks of such a simplistic solvency regime and as part of its strategic plan to move toward risk-based supervision, NAICOM intends to move toward a regime of risk-based capital. It is recommended to treat this initiative with highest priority. NAICOM should review the appropriateness of the existing minimum paid-up capital under the pending risk-based capital regime.</p>
18. Intermediaries	<p>NAICOM has rigorous licensing requirements for intermediaries. Licenses are annually renewable. NAICOM relies on insurers to control their agents. Ongoing supervision of brokers and loss adjusters is limited in scope.</p> <p>The requirements on proper handling of clients' money are comprehensive and adequate. However, a great amount of premium receivables still exists in the balance sheets of insurers. NAICOM needs to increase its efforts to reduce the amount of outstanding premiums that remains with the brokers. One possible way to address the issue is to require premium payments to be exclusively done through bank accounts.</p> <p>There are basically no disclosure requirements for brokers when dealing with prospects and customers. Insurance intermediaries should be required to disclose their capacity as agents or brokers, how they are paid, range of products, potential conflict of interest when the intermediary is part of an insurance group, etc.</p>
19. Conduct of Business	<p>The analysis that NAICOM conducts in approving products is superficial. Premium rates are approved without challenge. In substance, product approval does not appear to be an effective tool to achieve fair treatment of customers.</p> <p>The relevant market conduct requirements in the IA are scattered and not sufficiently comprehensive. NAICOM is advised to issue market conduct regulations incorporating the principles of treating customers fairly in each stage of insurance business: product design, marketing, fact-finding, giving advice, underwriting, policy service and claim.</p> <p>NAICOM should require segregation of insurance funds for participating and non-participating business to facilitate the proper determination of experience sharing. There should be requirements on the profit sharing between participating policyholders and shareholders. Actuaries should be required to certify that the allocation of bonuses to participating policies meets regulatory requirements and policyholders' reasonable expectations.</p> <p>NAICOM should also address the advisory and disclosure standard for participating products, with emphasis on distinguishing guaranteed versus non-guaranteed elements of the policy.</p> <p>Customer complaints are an indicator of weakness in operation or internal controls. NAICOM should require insurers to have in place complaints handling procedures and examine how insurers handle complaints during on-site inspections.</p>
20. Public Disclosure	<p>Approved annual financial statements are published in newspaper. Annual reports are available to the public from the Companies Registrar and the NAICOM. However, there are no requirements on the content of the annual report. Consequently, policyholders and market participants in most if not all cases do not have access to relevant information, such as the insurer's strategies, risks, financial condition, and performance. The situation is likely to improve with the adoption of IFRS from 2012. NAICOM should monitor the quality of disclosures made by insurers and issue guidelines and/or guidance notes in the future if appropriate.</p>

Insurance Core Principle	Comment
	<p>The current timeline of releasing financial statements is too long. NAICOM should shorten the timeline to ensure more timely dissemination of information. The possibility of a reduction to three months from the current six months for the submission of the annual statements should be considered, in conjunction with efforts to strengthen the quality of audits.</p>
21. Countering Fraud in Insurance	<p>NAICOM does not explicitly require insurers to have in place procedures to deter, detect, prevent and remedy frauds. Nonetheless, the requirement to file quarterly fraud reports is likely to raise awareness of frauds and anti-fraud measures.</p> <p>NAICOM is advised to make use of the information reported to understand the types of fraud risks, to analyze overall market vulnerability, to assess the effectiveness of each insurer's fraud prevention measures, and to improve the overall effectiveness through shared experience, such as the motor insurance verification database.</p>
22. Anti-Money Laundering and Combating the Financing of Terrorism	<p>NAICOM has put in effort to implement an effective AML/CFT regime for the insurance sector. It has promulgated regulations to clearly set out the insurers' AML/CFT responsibilities. A "largely observed" rating is given for the sole reason that the regime is too new for its effectiveness to be observed.</p> <p>While the majority of the insurance business is non-life and the life business is group life, neither of which are prone to AML/CFT abuses, the large minimum capital requirements relative to the business volume could be a source of vulnerability. NAICOM is recommended to critically analyse the strategy and business plans of insurers that are not producing significant business in relation to their capital.</p>
23. Group-wide Supervision	<p>NAICOM is advised to amend primary legislation to develop and be granted explicit power to conduct group-wide supervision, including the supervision of the holding company. This will be of more importance with the introduction of holding companies by banks wanting to retain interests in insurers.</p> <p>NAICOM should require insurance group structure to be sufficiently transparent so as not to hinder group-wide supervision. The group-wide supervision framework should extend the following legal entity requirements to the group level: solvency assessment, governance, risk management, and market conduct.</p> <p>It is noted that there is an ongoing effort to implement a framework of consolidated supervision of financial conglomerates on a group-wide basis. While not finalized, the proposed framework is based on a solo-plus model, consisting of (a) solo supervision of a financial institution and its subsidiaries, plus (b) quantitative and qualitative assessment of the financial conglomerate by the lead regulator to assess the potential impact of other members of the group, including overseas subsidiaries or affiliates, on the operations of the supervised entity. The scope of the quantitative assessment encompasses capital adequacy, intra-group transactions, large exposures and connected lending, and ALM. Qualitative assessment includes structure of the group and inherent risk, group corporate governance, risk management and internal controls, and access to prudential information by different regulators. The framework contemplates cross-border issues in consolidated supervision.</p>
24. Macroprudential Surveillance and Insurance Supervision	<p>NAICOM should consider developing a macroprudential surveillance system, including industry-wide stress tests to identify trends, potential risks and plausible future unfavourable scenarios, so that it may take early action to reduce the likelihood of systemic risk. The existing FSRCC forum is a natural mechanism for cooperation across the entire financial sector.</p>

Insurance Core Principle	Comment
	<p>In performing its macroprudential surveillance, NAICOM should use entity as well as group-wide data to analyze and monitor potential impact on the financial stability of particular insurers and the insurance market as a whole, and to assess whether financial market risks impinge on prudential safeguards.</p> <p>NAICOM should also establish a process to assess the potential systemic importance of insurers, and to develop an appropriate supervisory response.</p>
25. Supervisory Cooperation and Coordination	While the cross-border insurance activity is currently small in scale, NAICOM should start considering cross-border coordination matters. A practical starting point is to build on its MOU with Ghana to include the process for the two supervisors to discuss and determine the need for group-wide supervision and to agree on the designated group-wide supervisor.
26. Cross-border Cooperation and Coordination on Crisis Management	The Nigerian insurance sector is a small part of the financial sector with simple products and not a strong international presence. Therefore cross-border coordination and crisis management has not been a high priority issue. Nonetheless, NAICOM should work toward establishing methodology in identifying SIFIs and protocol on cross-border coordination on crisis management following the IAIS standards for this principle.

E. Recommendations and the Authorities' Responses

Annex Table 5. Recommendations to Improve Observance of ICPs

Insurance Core Principle	Recommendations
1. Objectives, Powers and Responsibilities of the Supervisor	<p>It is advised that NAICOM expand the objective to include the creation of a fair, safe and stable insurance sector for the benefit and protection of policyholders.</p> <p>NAICOM is advised to seek legal clarity on the legal standing of guidelines.</p>
2. Supervisor	<p>To enhance operational independence and facilitate timely supervisory action, NAICOM should be the final authority in exercising its supervisory powers without having to seek the minister's approval for operational matters, such as appointment and dismissal of control positions.</p> <p>NAICOM should strive to strengthen its human capital, so that it will not rely on third-party consultants to carry out routine on-site inspections.</p>
3. Information Exchange and Confidentiality Requirements	<p>For the avoidance of doubt, the NAICOM Act 1997 should be amended to give NAICOM explicit power to exchange supervisory information subject to appropriate confidentiality, purpose and use safeguards.</p> <p>NAICOM is encouraged to accede to the IAIS multilateral MOU.</p> <p>NAICOM should establish procedures in handling request for information in the absence of an MOU to ensure consistent assessment of such requests.</p>
4. Licensing	<p>NAICOM is advised to including considering the applicant's corporate governance framework and its group structure to ensure it is not too complex to be effectively supervision.</p> <p>To ensure that insurers have the necessary financial resources and competence in writing business, NAICOM is advised to consider granting license by lines of business.</p>
5. Suitability of Persons	NAICOM should ensure that significant owners and key persons in control positions are suitable.

Insurance Core Principle	Recommendations
	<p>NAICOM should consider explicitly approving the appointment of directors, on par with the appointment of CEOs.</p> <p>In assessing the suitability of key persons, NAICOM is advised to include competence, financial and other indicators.</p> <p>To ensure suitability on an ongoing basis, NAICOM should formalize the existing practice of subjecting newly appointed directors to suitability test by requiring insurers to report any changes in board membership to NAICOM. This should be extended to include key person in control positions as well.</p>
6. Changes in Control and Portfolio Transfers	<p>It is not clear that the 25 percent change in control requirement in the Operational Guidelines is enforceable, as it is not derived from any provisions in the primary legislation. NAICOM should amend the primary legislation to solidify its supervisory intention. At the same time, NAICOM should clarify (a) whether the threshold shareholding is based on issued shares of voting shares, and (b) it applies to both acquisition and disposal of shares.</p> <p>NAICOM may wish to consider progressive thresholds, rather than a single-point threshold. For example, an insurer should notify NAICOM when an individual gains control of 5 percent, 10 percent, and 20 percent of its voting shares.</p> <p>NAICOM should be able to identify the intended beneficial owner in a proposed change in control application, and evaluate the application as if it were an application for a new license, taking into account how policyholders' interest might be affected.</p>
7. Corporate Governance	<p>Since the CGCG is relatively new, there are several fine-tuning that NAICOM may wish to consider to improve the code:</p> <ul style="list-style-type: none"> • Various regulators have issued corporate governance code: the Corporate Affairs Commission, the Stock Exchange, NAICOM and CBN. These regulators should discuss and consider a unified code to avoid market confusion. • Independent directors are expected to have a "critical" role in evaluation of the board's performance. At the same time, CGCG requires an outside consultant to perform such evaluation. Clarification should be given regarding the role of independent director in evaluation of board performance, relative to the external consultant. • Section 5.04(xi) of CGCG states: "Any individual taking major action in the running of the company must either be a member of the Board, the management or paid consultant." The role of paid consultant in the running of the company is unclear. • Responsibility of the board is to "establish" strategy, not merely review. • CGCG states that the appointment of external audit is subject to NAICOM approval. NAICOM has not explicitly required insurers to do so. • CGCG advocates disclosure of conflict of interest disclosure by all employees to the board or shareholders. To avoid board being inundated with declarations, such disclosure should be made to management, except in the case of senior management and key people in control positions. • Other than the audit committee, the roles of other board committees are not specified. CGCG could be expanded to require each board committee to have terms of reference. <p>CGCG indicates that head of internal audit is to report to the MD/CEO. Internal audit should have a direct reporting line to the audit committee of the board to be</p>

Insurance Core Principle	Recommendations
	<p>consistent with international best practice.</p> <p>In approving the appointment of directors, NAICOM should take into account the mix of knowledge, skills and expertise of directors. There should be more than one independent director.</p>
8. Risk Management and Internal Controls	<p>There are two additional areas that NAICOM could include in the RM Guidelines:</p> <ul style="list-style-type: none"> • Explicit approve the appointment of heads of key control positions. • Clarify the insurer's responsibility in outsourcing material functions, including the selecting the service provider, approving procedures, service contract, review of contract, and insurer's accountability on outsourced functions. <p>NAICOM should also expand on the requirement for insurers to have disaster recovery/business continuity plan, by (i) specifying the required recovery time based on functional criticality; and (ii) requiring periodic testing of the business continuity plan.</p>
9. Supervisory Review and Reporting	<p>NAICOM is advised to collaborate with the FRC to improve the quality of audits, and to take stern action against any insurer and its directors for not having appropriate systems in place to ensure the reliability of financial information, so that resources can be channel to more strategic supervisory work.</p> <p>Together with FRC, NAICOM should work with the industry to identify the obstacles to the effective implementation of IFRS.</p> <p>Onsite inspection is an integral part of supervision, enabling supervisors to have firsthand knowledge of the operations, NAICOM should develop its own supervisory capacity and use consultants only in specialized fields such as IT risk assessment or forensic investigations.</p> <p>Both onsite and offsite supervision is currently compliance driven. With the release of the RM Guidelines and the impending move to risk-based supervision, NAICOM need to develop a comprehensive staff training program on understanding risks, evaluating effectiveness of risk management and internal controls, and assessing the financial resilience of an insurer.</p>
10. Preventive and Corrective Measures	<p>Certain supervisory actions are subject to minister's approval. To ensure timely intervention, NAICOM should have the autonomy to take preventive and corrective action without applying to minister for approval.</p> <p>NA provides that NAICOM may, with minister's approval, apply to President to revoke an insurer's license. IA, on the other hand, provides that NAICOM may cancel the license under certain circumstances. As there is no practical difference between revocation and cancellation, NAICOM's power to revoke/cancel a license should be consistent in the two legislations.</p>
11. Enforcement	<p>Similar to ICP 10, NAICOM should have the autonomy to take enforcement action without applying to minister for approval in order to ensure timely action.</p>
12. Winding-up and Exit from the Market	<p>While it may be appropriate for policyholders to bring legal action against an insurer, the ability to petition the Court to liquidate an insurer may afford too much power to any 50 individuals. It may in fact be detrimental to the public and other policyholders. The power to wind-up an insurer should be the sole responsibility of the insurance supervisor. It is recommended to remove this provision from the legislation.</p>
13. Reinsurance and Other Forms of Risk Transfer	<p>Mandatory cessions and the exclusive use of local reinsurance should be waived if contravening the board's reinsurance policy. It is advised that NAICOM should expand the scope of the reinsurance component of onsite inspection programs to</p>

Insurance Core Principle	Recommendations
	<p>take into account the reinsurance guidelines, and include consideration of liquidity and reinsurers' payment pattern. Reinsurance programs should only be allowed that pass a risk transfer test and to enhance transparency side letter should be forbidden by requiring the entire contract clause in each treaty.</p>
14. Valuation	<p>The valuation of liabilities is weak and needs to be overhauled:</p> <ol style="list-style-type: none"> 1. For non-life business, Section 20 of IA requires insurers to maintain provisions for unexpired risks, and outstanding claims with 10 percent margin for IBNR. Section 21 of IA requires insurers to maintain a contingency reserve to cover fluctuations in investments and underwriting experience. <ul style="list-style-type: none"> • There are no requirements for an actuarial valuation of the sufficiency of the reserves, nor the appropriateness of the IBNR calculation or adjustments according to the experience observed. 2. For life business, Section 22 of IA requires insurers to maintain a general reserve equal to net liabilities of policies in-force determined by an actuary. The actuarial valuation is done every three years and an additional 25 percent of net premium for every year between valuations is added to the reserve. In addition, a contingency reserve is required that is equal to 1 percent of the gross premiums or 10 percent of the profits (whichever is greater) and accumulated until it reached the amount of the minimum paid-up capital. <ul style="list-style-type: none"> • The actuarial valuation needs to be on an annual basis and the actuarial standards specified in regulation either explicitly or with a reference to existing international actuarial standards. 3. For reinsurers business, Section 23 of IA requires reinsurers to maintain a general reserve fund which is credited with (a) not less than 50 percent of its gross profit for the year where the fund is less than the authorized capital; and (b) not less than 25 percent of its gross profit for the year where the fund is equal to or exceeds the authorized capital. <ul style="list-style-type: none"> • The prescribed reserves have no relationship with the assumed liabilities and an actuarial valuation of the sufficiency of the reserves, like in the case of life insurers is recommended. <p>The contingency reserve requirement introduces a prudent element into the liabilities calculation but its use needs to be specified and allowed for those specified situations like the statistical deviation of claims or the occurrence of extreme events, otherwise the contingency reserve will only be of value in extreme situations of insolvency.</p> <p>There is a shortage of actuaries in Nigeria. NAICOM could consider using the Education Fund to develop university programs to groom future actuarial professionals.</p>
15. Investment	<p>NAICOM should consider introducing a well defined overarching prudent man type of concept to guide the investments of insurers. This will cover all risk, without leaving a regulatory gap and without being too prescriptive. In the initial stage of introduction, close monitoring and a detailed guidance on what is expected from the investments' policy is recommended.</p> <p>There should be explicit requirement on the use of more complex and less</p>

Insurance Core Principle	Recommendations
	<p>transparent classes of investments in markets or instruments that are subject to less governance or regulation. Given the current level of investment expertise in the industry prohibition of the use of derivatives is also recommended.</p> <p>It is recommended to require that policyholder's assets of investment product be segregated in independent trusts.</p>
16. Enterprise Risk Management for Solvency Purposes	NAICOM should include the following in the RM Guidelines: stress testing as a tool to assess risk, asset-liability management, and insurer's own assessment of solvency.
17. Capital Adequacy	NAICOM is aware of the drawbacks of current simplistic solvency regime. As part of its strategic plan to move toward risk-based supervision, NAICOM intends to move toward a regime of risk-based capital. It is recommended to treat this initiative with highest priority. NAICOM should review the appropriateness of the existing minimum paid-up capital under the pending risk-based capital regime.
18. Intermediaries	<p>NAICOM should require insurance intermediaries to disclose to customers their capacity as agents or brokers, how they are paid, range of products and potential conflict of interest when the intermediary is part of an insurance group.</p> <p>NAICOM needs to increase its efforts to reduce the amount of outstanding premiums remain with the brokers.</p>
19. Conduct of Business	<p>NAICOM is advised to issue market conduct regulations incorporating the principles of treating customers fairly in each stage of insurance business: product design, marketing, fact-find, giving advice, underwriting, policy service and claim.</p> <p>NAICOM should require segregation of insurance funds for participating and non-participating business to facilitate the proper determination of experience sharing. There should be requirements on the profit sharing between participating policyholders and shareholders. Actuary should certify that allocation of bonus to participating policies meets regulatory requirements and policyholders' reasonable expectation.</p> <p>NAICOM should also address the advisory and disclosure standard for participating products, with emphasis on distinguishing guaranteed verses non-guaranteed elements of the policy.</p> <p>Customer complaint is an indicator of weakness in operation or internal controls. NAICOM should require insurers to have in place complaints handling procedures and examine how insurers handle complaints during on-site inspections.</p>
20. Public Disclosure	<p>There are no requirements on the content of the annual report.</p> <p>Consequently, policyholders and market participants in most cases do not have access to relevant information, such as the insurer's strategies, risks, financial condition, and performance. The situation is likely to improve with the adoption of IFRS from 2012. NAICOM should monitor the quality of disclosures and issue guidelines and/or guidance notes in the future if appropriate.</p> <p>NAICOM should shorten the timeline to ensure more timely dissemination of information. The possibility of a reduction to three months from the current six months for the submission of the annual statements should be considered, in conjunction with efforts to strengthen quality of audits.</p>
21. Countering Fraud in Insurance	NAICOM should explicitly require insurers to have in place procedures to deter, detect, prevent and remedy frauds.

Insurance Core Principle	Recommendations
	NAICOM is advised to make use of the fraud reports to understand the types of fraud risks, to analyze overall market vulnerability, to assess the effectiveness of each insurer's fraud preventive measures, and to improve the overall effectiveness through shared experience.
22. Anti-Money Laundering and Combating the Financing of Terrorism	NAICOM is recommended to critically analyse the strategy and business plans of insurers that are not producing significant business volume in relation to the capital requirements.
23. Group-wide Supervision	<p>NAICOM is advised to amend primary legislation to provide explicit power to conduct group-wide supervision.</p> <p>NAICOM should require insurance group structure to be sufficiently transparent so as not to hinder group-wide supervision.</p> <p>The group-wide supervision framework should extend the following legal entity requirements to the group level: solvency assessment, governance, risk management, and market conduct.</p>
24. Macroprudential Surveillance and Insurance Supervision	<p>NAICOM should consider developing a macroprudential surveillance system, including industry-wide stress tests to identify trends, potential risks and plausible future unfavourable scenarios, so that it may take early action to reduce the likelihood of systemic risk. NAICOM could leverage on the existing FSRCC forum for this purpose.</p> <p>In performing its macroprudential surveillance, NAICOM should use entity as well as group-wide data to analyze and monitor potential impact on the financial stability of particular insurers and insurance market as a whole, and to assess the financial market risks impinge on prudential safeguards.</p> <p>NAICOM should also establish process to assess the potential systemic importance of insurers, and to develop an appropriate supervisory response.</p>
25. Supervisory Cooperation and Coordination	In the immediate term, NAICOM should build on its MOU with Ghana to include the process for the two supervisors to discuss and determine the need for group-wide supervision and to agree on the designated group-wide supervisor.
26. Cross-border Cooperation and Coordination on Crisis Management	Cross-border crisis management is not a high priority for Nigeria at this stage. Nonetheless, NAICOM should work toward establishing methodology in identifying SIFIs and protocol on cross-border coordination on crisis management.

Authorities' Response to the Assessment

172. NAICOM appreciates the work performed by the IMF to prepare this FSAP and are grateful for being given the opportunity to comment on the findings.

173. NAICOM essentially agrees with the recommendations made, some of which actually backs up existing efforts NAICOM has undertaken so far to strengthen insurance supervision.

174. The IMF assessment concludes that "NAICOM has made a lot of effort over the past five years to improve the regulatory environment." NAICOM welcomes the recognition of

the efforts made in particular efforts in our vigilance in ensuring the accuracy of financial information and enforcing compliance according to international best practices.

175. NAICOM have an ambitious agenda to continue to introduce new regulation and tools to keep improving the supervisory action, making it more efficient and adapted to the current economic environment.

176. A new insurance bill which has been under preparation for some time and which will soon be proceeding through the legislative process, would substantially address most of the issues raised in the assessment.

177. The IMF assessment team noted that ICP 18, 19, 20, and 21 are only “Partly observed” because of issues relating to intermediaries disclosure of capacity, outstanding premiums, customer fair treatment and timely dissemination of information for public disclosure. These issues are being addressed; there is a draft guideline on market code of conduct code and another draft guideline on claims and complaints procedure. IFRS transition has also commenced since the beginning of this year and will address many public disclosure areas.

178. The Road Map and ongoing works to transit to Risk Based Supervision and Risk Based Capital will also tackle some of the other concerns raised in the assessment.

179. Some improvements have already been achieved in our HR strategy, through the hiring of staff and professionals from the private sector with industry experience. These efforts will continue; and they will be further supported by on-going plans to develop a robust IT infrastructure. This development will enable full data storage capabilities and enhanced automation of financial data and financial analysis.

180. The recommendations of the IMF are therefore well received and NAICOM will continue to work toward their progressive implementation in the continuous efforts for strengthening insurance supervision.

ANNEX III. IMPLEMENTATION OF THE IOSCO PRINCIPLES AND OBJECTIVES OF SECURITIES REGULATION

A. Summary

181. **The regulatory framework for securities markets in Nigeria has improved markedly since the 2002 FSAP, and particularly in the last five years.** Since the adoption of the Investments and Securities Act 2007 (ISA) and the first set of rules and regulations of the Nigerian Securities and Exchange Commission (SEC), the regulatory framework has been further strengthened and expanded. It now covers more products and market participants, and has addressed the need to improve the quality and timeliness of disclosures and manage the risks inherent in the management of client assets in collective investment schemes.

182. **There are comprehensive legal provisions to ensure a robust governance structure for the SEC.** The requirements for qualifications of Board members, the establishment of fixed terms, the confirmation of nomination and removal by the Senate, and the need of a cause to remove a Board member, as opposed to the former practice of Boards being dissolved by the new Executive, provide for a more robust governance structure. However, the SEC has been without a Board since June 2012. In addition, it does not currently have sufficient internal policies, procedures and practices relating to its core functions. These deficiencies jeopardize the proper governance and functioning of the SEC.

183. **The SEC's independence has improved with the adoption of the ISA, even though certain remaining provisions and practices affect its full independence.** The SEC is self-funded through fees collected from market participants and has the authority to hire its staff and to establish their remuneration. In practice, its dependence on market-based funding creates a need to obtain the resources needed to operate adequately without adding excessive cost to the investors and market participants. The minister of finance has the power to give directives to the SEC, modify or rescind the rules proposed by the SEC and exempt certain persons from the application of the ISA after consultation with the SEC. The last power has been used once. During any period where the SEC is without a Board, the minister of finance must confirm the sanctions imposed by the SEC. Even though the Senate does not have any formal role vis-à-vis the day-to-day operations of the SEC, in practice its views seem to have an impact on the SEC's decisions. The mere existence of these types of legal or practical powers, in particular if they are not transparently exercised, has the potential to undermine the SEC's independence.

184. **The SEC cooperates both at the domestic and international level with its counterparts and other authorities.** The SEC is a member of the Financial Services Regulation Coordinating Committee (FSRCC). The FSRCC members have signed a Memorandum of Understanding (MoU). The SEC is also a member of the Financial Reporting Council (FRC) established by the FRC Act 2011. The SEC and FRC need to

cooperate on financial reporting, corporate governance and auditor independence. The SEC is a signatory to the IOSCO Multilateral MoU (MMoU) and as such it is in a position to fully assist foreign securities regulators and share information with them. So far it has been requested to provide assistance in a limited number of cross-border investigations.

185. The overall level of technical expertise in the key functions of the SEC is less than optimal. The SEC has 17 departments and staff of over 630 people, of which only 30 percent are currently engaged in the core regulatory and supervisory functions. This proportion has increased over the past few years, but the SEC should focus on further increasing it as soon as possible. The coordination in a large organization such as the SEC is challenging, and the current division of responsibilities between the departments seems to create inefficiencies and overlaps. Without sufficient written procedures to serve as guidance and the less than optimal collaboration between the departments, the SEC's discharge of its functions falls short of expectations, mainly in the areas of inspections, investigations and enforcement.

186. The SEC focuses on regulating the products offered to investors through extensive scrutiny of prospectuses for all securities, including collective investment schemes. This approach derives from the regulatory framework that emphasizes initial disclosures to investors. Conduct of business requirements for market intermediaries are largely in place, but the regulatory framework is weak in prudential and organizational requirements, including internal control and risk management. Fund managers and issuing houses are covered by the product-related inspections, whereas broker-dealers have been rarely inspected by the SEC. The few inspections made have been primarily triggered by major deficiencies in the broker-dealers' capital levels. The SEC has indicated that the regular inspections have been recommenced after the mission, but the scope and nature of these inspections has not been assessed.

187. The inadequate regulatory requirements and limited on-site supervision of broker-dealers has the potential of introducing systemic risks to the Nigerian financial system. This was already experienced during the crisis, and partially addressed through the more stringent requirements on margin lending introduced by the CBN and the SEC. Due to the weak financial condition of many broker-dealers and limited ongoing monitoring, new risks may arise and remain unaddressed. As in many countries, the securities settlement system is a potential source of contagion. The SEC should promptly implement a major overhaul of the capital requirements applied to broker-dealers, by raising their initial capital requirements and requiring them to maintain sufficient risk-based capital on an ongoing basis. A new, more robust regime would need to include ongoing monitoring and reporting requirements, accompanied by robust enforcement. Early intervention powers of the SEC should be strengthened and effectively applied.

188. The Nigerian Stock Exchange (NSE) has self-regulatory powers over broker-dealers. It is required to create and enforce its own rules and report on the results of its self-

regulatory activities to the SEC. There is room for improvement in the cooperation and coordination between the SEC and the NSE in broker-dealer supervision. The SEC should also ensure that the NSE, as an operator of key market infrastructure, is subject to robust ongoing supervision to ensure that the planned changes are introduced in a manner that best contributes to the efficiency, integrity and transparency of the Nigerian securities markets. The respective roles of the SEC and NSE will likely need to be reassessed in the context of the NSE's planned demutualization.

189. **The SEC has comprehensive enforcement powers as provided by the ISA.** It has used them for administrative, civil and criminal actions, but work remains to be done to ensure their effective and consistent use. The departments involved in inspections, investigations and enforcement are not communicating and coordinating adequately. The decisions to take enforcement action are not always adopted in a timely manner. The need to take effective enforcement action is essential for building public confidence in the Nigerian securities markets and its regulator.

B. Introduction

190. **An assessment of the level of implementation of the IOSCO Principles in Nigeria was conducted from September 4 to 19, 2012 as part of the IMF-World Bank Financial Sector Assessment Program (FSAP).** The assessment was made by Eija Holttinen, Monetary and Capital Markets Department, IMF, and Carlos Barsallo, MCM expert. The last IOSCO assessment in Nigeria was conducted in 2002.

C. Information and Methodology used for Assessment

191. **The assessment was made based on the IOSCO Objectives and Principles of Securities Regulation approved in 2010 and the Methodology updated in 2011.** As has been the standard practice, Principle 38 was not assessed due to the existence of separate standards for securities settlement systems and central counterparties.

192. **The IOSCO Methodology requires that assessors not only look at the legal and regulatory framework in place, but also at how it has been implemented in practice.** The ongoing global financial crisis has reinforced the need for assessors to make a judgment about supervisory practices and to determine whether they are sufficiently effective. Among others, such a judgment involves a review of the inspection programs for different types of supervised entities, the cycle, scope, basis for and quality of inspections as well as how the agency follows up on findings, including by using enforcement actions.

193. **The assessment benefited from a document prepared by the SEC prior to the mission.** It included references to most of the relevant provisions of the ISA and the SEC Rules and Regulations for the majority of the Principles, inserted into the IOSCO self-

assessment template. The document did not include information on the supervisory and enforcement policies and practices of the SEC. The staff of the SEC used their best efforts to collect this and other missing information during the mission, and most of the information required for a robust assessment was provided by the end of the mission. The depth of the assessment of some Principles was impaired by the fact that the primary expertise for those matters lies outside the SEC.

194. **In addition to the SEC, meetings or conference calls took place with staff from the relevant public sector authorities and some market participants.** These included the Economic and Financial Crimes Commission (EFCC) and Financial Reporting Council (FRC), as well as banks, issuing houses, a fund manager, an audit firm, the Nigerian Stock Exchange (NSE), the Central Securities Clearing System Ltd (CSCS), as well as industry associations (Chartered Institute of Stockbrokers and Association of Stockbroking Houses of Nigeria).

D. Institutional and Market Structure - Overview

195. **The only securities exchange currently operating in Nigeria is the NSE.** Its market capitalization dropped from the end-2008 value of US\$80.6 billion to a low point of US\$27.7 billion, before recovering to US\$52.0 billion at the end of September 2012. At end-September 2012, there were 202 listed companies and 311 dealing members at the NSE; however according to the information provided by the NSE only 254 of those dealing members are currently active. Since the beginning of 2010, only six new companies have listed on the NSE. Despite the large number of dealing members, the largest members are responsible for a significant proportion of trading at the NSE. During the first half of 2012, the market share of the 10 largest dealing members was over 75 percent.

Dealing Member	Value of Trading (US\$)	Market Share (%)
Stanbic IBTC Stockbrokers Limited	223,451,325.88	20.44
Rencap Securities (Nig) Limited	197,661,692.14	18.08
Chapel Hill Denham Mgt Limited	142,633,635.80	13.05
CSL Stockbrokers Limited	65,837,264.75	6.02
A.R.M Securities Limited	51,985,160.78	4.76
FBN Securities Limited	40,206,422.68	3.68
Cordros Capital Limited	35,787,223.41	3.27
Vetiva Capital Management Limited	34,876,701.85	3.19
BGL Securities Limited	22,256,980.55	2.04
Meristem Securities Limited	20,463,608.54	1.87
		76.40

196. **In addition to broker-dealers, the market intermediaries operating in the Nigerian securities markets include issuing houses, underwriters, portfolio managers, and investment advisers.** No up-to-date information on the number of active firms and the extent of their business is currently available, since there is no requirement for the firms to inform the SEC on when they cease to provide the registered functions. In this regard therefore, the information on the SEC website is not reliable.

197. **The collective investment scheme sector remains small.** As at September 7, 2012, the net asset value of the funds under management remained at approximately US\$600 million, managed in only 43 collective investment schemes that were primarily open-ended unit trusts.

Fund Type	Number of Funds	Net Asset Value (US\$)
Equity funds	20	279,741,387.62
Money market funds	2	62,777,006.50
Bond funds	4	31,192,910.64
Real estate funds	2	104,741,806.95
Balanced funds	11	65,502,462.24
Ethical funds	4	37,996,165.68
Total	43	581,951,739.63

E. Preconditions for Effective Securities Regulation

198. **The preconditions for effective regulation and supervision of Nigerian securities markets have improved in the last years, but further changes are needed.** Nigeria operates a federal political structure under the Constitution of the Federal Republic of Nigeria, 1999. The development of the Nigerian legal system has been greatly influenced by its colonial past as a part of the British Commonwealth. Other sources of Nigerian law include local legislation (state and federal), Nigerian case law as well as customary law. The principles of judicial precedent and hierarchy of courts is also a fundamental part of the legal system with the Supreme Court of Nigeria at the apex of the court system.

199. **The Companies and Allied Matters Act (CAMA) provides the main framework for the corporate sector.** The CAMA deals with the incorporation and winding-up of companies as well as provisions concerning shares, debentures, meetings and proceedings, directors, financial statements and audit, and dealings in companies' securities. The CAMA also establishes the Corporate Affairs Commission (CAC), with responsibility for administering the Act and establishing and maintaining a companies' registry. The CAMA works reasonably satisfactorily for the present. The CAMA also covers insolvency proceedings of companies and provides for receivers and managers to be appointed, companies to be wound up and arrangements and compromises to be made with creditors.

The Bankruptcy Act is based on comparable U.K. legislation for personal insolvency. The Banking and Other Financial Institutions Act (BOFIA) regulates general banking matters, including licensing and supervision.

200. **The FRC Act 2011 replaced the NASB with the FRC as the body with oversight responsibilities in the area of the regulation of financial reporting.** The FRC is responsible for issuing accounting standards as well as monitoring and ensuring the accuracy, veracity and fairness of accounting and financial reports of public interest companies in line with applicable standards. The FRC has developed a roadmap for the adoption of IFRS in Nigeria in 2012.

201. **The Investments and Securities Tribunal (IST) provides a process for the resolution of securities markets related cases that do not have to be resolved in the regular court system.** The IST was established in 2002. Decisions by the IST can be appealed to the Court of Appeal and from it to the Supreme Court. Members of the country's financial sector have criticized the judicial system in relation to delays involved in the determination of cases and the level of corruption in the system. Cases taking 10 to 20 years to resolve are not uncommon. Perception of corruption amongst members of the judiciary, particularly in the lower courts is widespread. The federal government's fight against corruption has resulted in an improvement in the perception of the extent of corruption as indicated by Transparency International in 2011, but corruption continues to be a significant problem. In the case of the SEC, its management has expressed zero tolerance on corruption. However, according to information received from both SEC internal and external sources during the mission, challenges remain in ensuring that the SEC staff meets the high integrity requirements expected from public sector officials. Continuing to expeditiously and effectively address the integrity of the court system and of the related investigatory and enforcement authorities is a necessary precondition for the implementation of any credible improvements in the regulation and supervision of Nigerian securities markets.

202. **Nigeria has made a high-level political commitment to address its strategic AML/CFT deficiencies.** However, according to the FATF, Nigeria has not made sufficient progress in implementing its action plan and certain deficiencies remain, including addressing issues regarding criminalization of money laundering and terrorist financing.

F. Main Findings

203. **Principles relating to the regulator.** The SEC has a clear mandate imbedded in the ISA. The ISA does not guarantee full independence of the SEC. The SEC is a member of the FSRCC. Its powers and authorities are sufficient. Certain core regulatory competencies do not appear to be well represented among the current SEC staff, despite the fact that its manpower overall seems ample vis-à-vis the current size and level of development of the Nigerian securities market. Even though increased over the past few years, the proportion of

staff engaged in the core regulatory and supervisory functions is still only 30 percent. The SEC is authorized to issue rules and regulations subject to public consultation. The public consultation process is not well defined and allows for a significant amount of SEC discretion.

204. **Principle relating to self-regulation.** The Nigerian regulatory system makes use of self-regulatory organizations (SRO), but currently only the NSE acts as such. The process for assigning a body as an SRO and the regulatory requirements on other types of SROs than securities exchanges and capital trade points⁵⁰ are unclear.

205. **Principles relating to enforcement.** The SEC's discharge of its functions falls short of expectations, mainly in the areas of inspections, investigations and enforcement. The departments responsible for these functions are not communicating and coordinating adequately. The SEC has comprehensive enforcement powers. It has used them for administrative, civil and criminal actions, but work remains to be done to ensure their effective and consistent use. The decisions to take enforcement action are not always made in a timely manner. The SEC has now outsourced some of its enforcement cases to expedite the processes. However backlogs exist also at the level of the police and the EFCC.

206. **Principles relating to cooperation.** The SEC cooperates both at the domestic and international level with its counterparts and other authorities. It is a member of the FSRCC. The FSRCC members have signed an MoU. It is also member of the FRC established by the FRC Act 2011. The SEC is a signatory to the IOSCO MoU, and as such it is in a position to fully assist foreign securities regulators and share information with them, even though the MoU has so far been used only in a limited number of investigations.

207. **Principles relating to issuers.** The disclosure standards for the Nigerian securities markets are generally sound. The requirements for issuers were recently amended to include new disclosure obligations and to take into consideration the need for internal controls and risk management. The concrete value of the new disclosure requirements will be entirely predicated upon the quality of implementation of the accounting and auditing standards in Nigeria, which is still work in progress.

208. **Principles for auditors, credit rating agencies (CRAs) and other information service providers.** The approval of the FRC Act and the creation of the FRC as the sole regulator responsible for the issuance of accounting standards as well as monitoring and ensuring the accuracy, veracity and fairness of accounting and financial reports of public interest companies is an important improvement. The FRC has developed a roadmap for the adoption of IFRS in Nigeria in 2012. It has yet to start its oversight of companies,

⁵⁰ Capital trade point is the ISA term for the non-exchange multilateral trading systems (see Principle 33).

accountants and auditors' compliance with the accounting and auditing standards. Capital market consultants that provide analytical and evaluative services are subject to registration. There is no specific regulatory framework for sell-side analysts. CRAs that provide credit ratings for securities registered in Nigeria have to be either registered or exempted from registration by the SEC.

209. Principles relating to collective investment schemes and hedge funds. All fund managers and collective investment schemes are required to be registered. Most schemes are unit trusts, and they are required to have a fund manager, trustee and custodian. The fund manager cannot be a related party of the trustee or custodian. The SEC conducts yearly on-site inspections on the schemes, where the focus is on compliance with the legal requirements. Initial disclosure requirements in a partially standardized format apply, but there are no requirements for ongoing and periodic disclosures. Requirements on valuation of CIS assets are in place, while there are no rules on disclosure of prices of fund units. The establishment of hedge funds or marketing of foreign hedge funds to Nigerian investors would require registration by the SEC; currently there are no hedge funds offered to Nigerian investors.

210. Principles relating to market intermediaries. Market intermediaries need to be registered as Capital Market Operators for the specific functions they provide. The licensing process currently focuses on assessing the fitness and propriety of a limited number of sponsored individuals. Controllers are not assessed by the SEC, and the pre-registration inspection and registration committee meeting do not include a comprehensive assessment of the company applying for registration. Initial capital requirements are very low, and they are not adjusted for risk on an ongoing basis. Monitoring of compliance with the capital requirements and early intervention powers of the SEC are not adequate. Most conduct of business requirements are in place, but there are limited organizational requirements. The SEC inspects market intermediaries only for cause, and the amount of inspections has been very low at least during the past three years. The SEC has extensive powers to deal with an intermediary failure, but there is no plan on their use.

211. Principles relating to secondary markets. Securities exchanges and capital trade points are subject to registration. There are very limited requirements on technology, order execution procedures and equitable access to the trading systems. The enforcement action taken by the SEC in 2010 against the previous management of the NSE relating to its persistent governance problems brought the exchange under the SEC's close monitoring; the situation is normalizing after the appointment of the new CEO. Both the SEC and the NSE conduct market surveillance, but have not been effective in detecting, investigating and prosecuting market abuse, even though certain improvements have recently been achieved. There are no regulatory requirements for pre- and post-trade transparency. While the securities settlement system effectively addresses the risk of non-delivery of shares, there are no limits for the value of the cash settlement obligations of broker-dealers.

Annex Table 6. Nigeria: Summary Implementation of the IOSCO Principles

Principle	Findings
Principle 1. The responsibilities of the Regulator should be clear and objectively stated.	The SEC has a clear mandate derived from the ISA. It is a member of the FSRCC and has signed a multilateral MoU which includes other relevant domestic financial regulators.
Principle 2. The Regulator should be operationally independent and accountable in the exercise of its functions and powers.	The ISA does not provide the SEC with full independence. The minister of finance has the power to give directives to the SEC, modify or rescind the rules proposed by the SEC, and exempt certain persons from the application of the ISA after consultation with the SEC. The last power has been used once. The possible need for the SEC to repatriate funds to the Federal Ministry of Finance (FMF) has the potential of undermining the SEC's independence in case of continued operating deficits. Currently, eight of the nine positions of the SEC Board are vacant, with the Director-General as the only Board member. Internally the SEC is functioning with Acting Commissioners. The SEC Board members and staff have legal protection for acts done in good faith. Certain accountability mechanisms are in place, including the requirement to publish an annual report, however overall such mechanisms are not robust. The consultation process is mandated by the ISA, but there is no formal procedure on how to conduct it.
Principle 3. The Regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.	The SEC has adequate powers; however they do not appear to be used effectively. It does not have sufficient policies and governance practices to perform its functions efficiently and effectively. The SEC is self-funded through fees and penalties levied from regulated entities. Market participants do not perceive the SEC as an attractive place to work for the most talented. The overall level of technical expertise in the key functions of the SEC is less than optimal. Its technology infrastructure appears to be insufficient to maintain efficient processes and support its statutory functions.
Principle 4. The Regulator should adopt clear and consistent regulatory processes.	The ISA contains consultation requirements and the SEC consults regularly with market participants; however the consultation process is not well established. Information about certain processes can be accessed via the SEC's web page. Some enforcement sanctions are disclosed. The IST is in charge of providing redress to individuals affected by the SEC's decisions. The SEC is generally required to provide reasons in writing for its decisions. Judicial redress is available.
Principle 5. The staff of the Regulator should observe the highest professional standards, including appropriate standards of confidentiality.	There is a Code of Ethics for SEC employees. The Code includes provisions for disclosure of personal securities transactions to the SEC, confidentiality obligations and sanctions for non-compliance. There are certain cooling-off period provisions in place. However, the Code does not appear to be implemented and enforced in practice. In 2009 the FSRCC initiated discussions on a comprehensive Code of Conduct for financial regulators. The draft Code includes more comprehensive conflict of interest provisions, and prohibitions on ownership and dealing with securities of regulated entities. There is no clear indication when or if the Code will be approved.

Principle	Findings
Principle 6. The Regulator should have or contribute to a process to monitor, mitigate and manage systemic risk, appropriate to its mandate.	The SEC has not established any specific processes for the identification of systemic risk. The FSRCC has set up a sub-committee on financial sector soundness, which has the objective of providing surveillance over potential risks emanating from various sub-sectors of the financial sector. The work is not yet very advanced. The SEC is planning to introduce a risk-based supervisory model, with systemic risk as one element to consider.
Principle 7. The Regulator should have or contribute to a process to review the perimeter of regulation regularly.	Even though the SEC does not have a distinct process to address the perimeter of regulation, it has sought to respond to the emerging regulatory needs. It has referred providers of illegal services possibly falling outside the regulatory perimeter to the criminal authorities. However the internal processes are not optimally set up. Since its mandate includes supervisory coordination, the FSRCC and its subcommittees discuss issues related to the perimeter of regulation. Recently these discussions have focused on consolidated supervision.
Principle 8. The Regulator should seek to ensure that conflicts of interest and misalignment of incentives are avoided, eliminated, disclosed or otherwise managed.	The ISA and the SEC Rules and Regulations impose requirements for the management of conflicts of interest in various manners. For some regulated entities, this is addressed only through specific trading rules applicable to employees. Prohibitions and disclosure obligations address misalignment of incentives of issuers. The monitoring of such obligations by the SEC is not robust.
Principle 9. Where the regulatory system makes use of Self-Regulatory Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, such SROs should be subject to the oversight of the Regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.	Even though the Nigerian regulatory system makes use of self-regulatory organizations, the process for assigning a body as an SRO and the regulatory requirements on other types of SROs than securities exchanges and capital trade points are unclear. The SROs are required to inform the SEC of the disciplinary measures they have taken, and the SEC is not precluded from carrying out inspections of dealing members. In practice the SEC and NSE appear to coordinate and cooperate in their supervisory activities only to a limited extent.
Principle 10. The Regulator should have comprehensive inspection, investigation and surveillance powers.	The SEC has comprehensive powers to request information from and conduct inspections in regulated entities. It has been assigned the power to conduct market surveillance.
Principle 11. The Regulator should have comprehensive enforcement powers.	The SEC has ample powers to request information from regulated entities and third parties. In the case of bank records the SEC relies in practice on the assistance of the CBN. The SEC enforcement tools include fines, bans, and suspension and revocation of registration.
Principle 12. The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.	The regulatory system contains tools for inspection, investigation, surveillance and enforcement. On-site inspections are used mainly in relation to the issuance of new securities, and to verify compliance with the requirements relating to CIS. The SEC has comprehensive enforcement powers, but work remains to be done to ensure their effective and consistent use. In practice enforcement tools are primarily used to tackle minor issues, mostly delays in filing mandatory reports, rather than major violations of securities law and rules. However, the SEC has worked to improve its enforcement capabilities, including by obtaining assistance from a foreign regulator. It has also tried to address its own capacity problems by outsourcing several enforcement cases to law and audit firms.

Principle	Findings
Principle 13. The Regulator should have authority to share both public and non-public information with domestic and foreign counterparts.	The SEC has the power conferred by the ISA to enter into cooperative agreements with domestic and foreign regulators. This broad power includes the power to share information.
Principle 14. Regulators should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts.	The SEC has signed an MoU at the FSRCC level for domestic information sharing among the relevant financial regulators. Cooperation among financial regulators through the FSRCC was reactivated after the crisis. The SEC is a signatory to the IOSCO MMoU. The SEC informed that it has received requests for specific investigatory assistance via the IOSCO MMoU, but information on the total number of requests was not readily available during the mission.
Principle 15. The regulatory system should allow for assistance to be provided to foreign Regulators who need to make inquiries in the discharge of their functions and exercise of their powers.	The regulatory system allows the SEC to provide assistance to foreign regulators. The SEC collects information on behalf of foreign regulators.
Principle 16. There should be full, accurate and timely disclosure of financial results, risk and other information that is material to investors' decisions.	Issuers of public offers are required to submit a prospectus for approval by the SEC. There are periodic and ongoing disclosure requirements applicable to issuers, with the latter arising from the NSE rules. Monitoring of issuers' compliance with their reporting obligations tends to concentrate on administrative aspects rather than fundamental issues, such as monitoring trading disclosures by company insiders. Cross-border offerings are contemplated in the ISA; however they are almost non-existent in practice.
Principle 17. Holders of securities in a company should be treated in a fair and equitable manner.	The CAMA contains the shareholders' fundamental rights, and the ISA includes additional protections through more stringent disclosure requirements. Tender offers are regulated, but rare with only one in the last five years. The legal requirements for the disclosure of major shareholdings are fairly appropriate, but in practice the investors do not have sufficient access to the disclosures since they are not electronically available. The new SEC Corporate Governance Code, while of a voluntary nature, introduces new provisions aligned with best practices and international standards.
Principle 18. Accounting standards used by issuers to prepare financial statements should be of a high and internationally acceptable quality.	For the financial year starting in January 2012 issuers must submit, simultaneously to the SEC and the NSE, their financial statements according to the International Financial Reporting Standards (IFRS). The FRC is responsible for enforcing compliance with the IFRS. However, it has not yet fully established itself as the enforcer of accounting standards due to its recent establishment.
Principle 19. Auditors should be subject to adequate levels of oversight.	With the enactment of the FRC Act in 2011 and the commencing of the FRC's operations as the new auditor regulator, a significant change is expected in the auditor oversight. However due to its recent establishment, its oversight functions are not yet fully operational.
Principle 20. Auditors should be independent of the issuing entity that they audit.	Auditor independence is required in legislation; however the monitoring has in the past fallen short of international standards. The FRC is currently establishing its processes to monitor auditor independence.
Principle 21. Audit standards should be of a high and internationally acceptable quality.	Audits of the financial statements presented to the SEC must be conducted using International Standards on Auditing. The FRC is now responsible for promoting the highest standards among auditors and improving the quality of audit services.

Principle	Findings
Principle 22. Credit rating agencies should be subject to adequate levels of oversight. The regulatory system should ensure that credit rating agencies whose ratings are used for regulatory purposes are subject to registration and ongoing supervision.	Credit ratings are used for various regulatory purposes in Nigeria, and credit rating agencies are subject to a requirement to register with the SEC or, in the case of foreign CRAs, be exempted from registration. They are required to submit periodic reports to the SEC. The SEC has not yet conducted any on-site inspections of CRAs. The IOSCO Code of Conduct Fundamentals for CRAs has not yet been implemented, and only some of its elements are in place through other regulatory means.
Principle 23. Other entities that offer investors analytical or evaluative services should be subject to oversight and regulation appropriate to the impact their activities have on the market or the degree to which the regulatory system relies on them.	Independent sell-side analysts would be regulated as investment advisors, but no such firms currently exist. Those that provide analytical services ancillary to their other activities are subject to the requirements applicable to market intermediaries. Deficiencies exist in the requirements for the management and disclosure of conflicts of interest and related requirements for firms' internal procedures and controls.
Principle 24. The regulatory system should set standards for the eligibility, governance, organization and operational conduct of those who wish to market or operate a collective investment scheme.	All CIS and their fund managers, trustees and custodians are required to be registered. The registration requirement also applies to those that market a CIS. The most important organizational requirements are in place, whereas there are gaps in conduct of business rules. Fund managers and their trustees and custodians are subject to an extensive on-site inspection program, but the recent inspections have not covered the financial capacity of the fund manager and other prudential requirements. Fund managers are required to file comprehensive periodic reports with the SEC.
Principle 25. The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.	Most CIS in Nigeria have adopted the legal form of investment trust, even though other forms are also possible. The current requirements for the segregation and protection of client assets are comprehensive. The SEC has extensive powers to take various enforcement measures, including winding up of a CIS or a fund manager.
Principle 26. Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme.	A potential investor in a CIS needs to be provided with a prospectus registered with the SEC, whose content is subject to minimum requirements. Together with the trust deed, it provides fairly comprehensive information on the CIS, its manager, trustee and custodian. There are no explicit requirements on periodic reporting to investors. The advertisements are subject to the approval of the SEC.
Principle 27. Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.	The regulatory framework requires CIS assets to be valued at fair market price, and the SEC has specified additional requirements for unlisted securities. The auditor of a CIS is required to certify that the scheme has been operated according to the regulatory requirements. The trust deed needs to address the subscription and redemption rights of unit holders, and the manner of calculating the subscription and redemption prices is regulated by the SEC. The industry has developed recommendations on the disclosure of unit prices and the provision of periodic information to investors. The treatment of pricing errors is not addressed in the regulatory framework.
Principle 28. Regulation should ensure that hedge funds and/or hedge funds managers/advisers are subject to appropriate oversight.	There are currently no hedge funds in Nigeria and the SEC Rules and Regulations would need to be amended to allow the establishment of hedge funds. Marketing of a foreign hedge fund to Nigerian investors would also require amendments to the Nigerian regulatory framework.

Principle	Findings
<p>Principle 29. Regulation should provide for minimum entry standards for market intermediaries.</p>	<p>The regulatory framework requires market intermediaries to be registered by the SEC, and the minimum requirements for registration are clearly defined. The registration process focuses on the 3-4 sponsored individuals (as selected by the applicant) for each company applying for registration, instead of subjecting all directors to a full fitness and propriety assessment. Shareholders and other parties in a position to exercise control over the applicant are not evaluated by the SEC. The pre-registration inspection focuses on assessing the facilities of the applicant, and the Registration Committee meeting does not appear to sufficiently scrutinize the applicants. The SEC can cancel registration only as an enforcement measure, which seems to have contributed to the continued existence of many inactive companies.</p>
<p>Principle 30. There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.</p>	<p>The initial capital requirements of market intermediaries are very low, and ongoing capital requirements are not risk-based. The record-keeping and reporting requirements are not sufficient to determine and monitor the development of the capital level of market intermediaries on an ongoing basis. The SEC's possibility to intervene in case of deteriorating capital is limited to failures, insolvency and other "grave" situations, and it is not clear whether it has exercised its powers effectively in such situations. The Nigerian prudential framework for market intermediaries does not currently address risks from outside the intermediary.</p>
<p>Principle 31. Market intermediaries should be required to establish an internal function that delivers compliance with standards for internal organization and operational conduct, with the aim of protecting the interests of clients and their assets and ensuring proper management of risk, through which management of the intermediary accepts primary responsibility for these matters.</p>	<p>The most important conduct of business rules are in place in Nigeria, but the legislative and regulatory framework covers organizational requirements, including responsibility of the management, internal controls, risk management and management of conflicts of interest only in a limited manner. At least during the past three years, the SEC has conducted only for cause inspections of market intermediaries. Its inspection program is complemented by inspections conducted by the NSE (see Principles 9 and 34).</p>
<p>Principle 32. There should be procedures for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.</p>	<p>The SEC has extensive powers to act in the case of a failure of an intermediary, but no examples were available on the use of those powers. Its early warning system is based on quarterly returns, and it does not have a plan for dealing with an intermediary failure. The investor protection fund of the NSE required by law is not yet operational, and the SEC is in the process of establishing the nationwide trust scheme that it is required to maintain under the ISA.</p>
<p>Principle 33. The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.</p>	<p>The requirements for registration as a securities exchange or capital trade point are set out in the ISA. The SEC lacks supervisory expertise in the area of exchange supervision. This combined with the lack of legal clarity on the distinction between various types of trading systems is a source of concern, given the exchanges' role as a key market infrastructure. The regulatory requirements on trading rules and order execution procedures are very limited.</p>
<p>Principle 34. There should be ongoing regulatory supervision of exchanges and trading systems which should aim to ensure that the</p>	<p>Since 2009, the supervision of the NSE has been subject to extraordinary circumstances that culminated to the enforcement measures undertaken by the SEC in August 2010. This has led to a situation where an on-site inspection has not been considered</p>

Principle	Findings
integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.	necessary. The quarterly reporting from the exchange has continued in the normal manner. Both the SEC and NSE conduct market surveillance and supervise broker-dealers. The NSE has suspended a significant number of dealing members in 2011 and 2012, but mostly for reporting delays.
Principle 35. Regulation should promote transparency of trading.	The regulatory framework or the NSE rules do not specify any pre- and post-trade transparency requirements or objectives. The conditions for derogations from pre-trade transparency and waivers from post-trade transparency are not defined in the regulatory framework or NSE rules.
Principle 36. Regulation should be designed to detect and deter manipulation and other unfair trading practices.	The regulatory framework prohibiting market abuse is in place in Nigeria. However, the surveillance and enforcement activities conducted by the SEC and NSE do not appear to be effective in tackling market abuse, even though certain improvements have recently been achieved (see also Principle 12).
Principle 37. Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.	The settlement system operated by the CSCS does not have any particular mechanisms in place to manage the risks arising from the payment obligations relating to the transactions made, beyond relying on the ability of dealing members and ultimately settlement banks to settle the cash leg, where necessary, or resorting to the trade guarantee fund in case of default. The NSE introduced short selling in September 2012 and the arrangements adopted currently appear to address the risks arising from short selling. However, there are no reporting requirements to the market or to the regulator.
Principle 38. Securities settlement systems and central counterparties should be subject to regulatory and supervisory requirements that are designed to ensure that they are fair, effective and efficient and that they reduce systemic risk.	Not assessed.

G. Recommended Action Plan and Authorities' Response

Recommended action plan

Annex Table 7. Nigeria: Recommended Action Plan to Improve Implementation of the IOSCO Principles

Principle	Recommended Action
Principle 2	<ol style="list-style-type: none"> 1) The government should expeditiously appoint the SEC Board members. 2) Going forward, the government should consider staggered terms for the members of the SEC Board. 3) The government should strengthen the independence of the SEC by eliminating (a) the need for the ministerial approval for the SEC Rules and Regulations; (b) the power of the minister of finance to issue directives to the SEC; and (c) the power of the minister of finance to exempt individuals from the application of the ISA.
Principle 3	<ol style="list-style-type: none"> 1) The SEC should establish policies and governance practices to perform its functions efficiently and effectively. 2) The SEC should continue to increase the proportion of staff engaged in the core regulatory and supervisory functions. 3) The SEC should adopt adequate mechanisms to attract talented and skilled staff.
Principle 4	<ol style="list-style-type: none"> 1) The SEC should ensure that its powers and discharge of its functions are consistently applied. 2) The SEC should establish written procedures for its key functions, including rule-making and consultation to ensure due and efficient process. 3) The SEC should consider publishing the comments received to rule consultations.
Principle 5	<ol style="list-style-type: none"> 1) The SEC should strengthen transparency of and compliance with its Code of Ethics and Code of Conduct. 2) The FSRCC should approve the Code of Conduct for Financial Regulators.
Principle 6	The SEC should strengthen its expertise in analyzing the potential systemic risks arising from securities markets.
Principle 7	The SEC should consider adopting a systematic process for the review of the perimeter of regulation.
Principle 8	The SEC should introduce an overarching requirement for the avoidance, management and disclosure of conflicts of interest applicable to regulated entities.
Principle 9	<ol style="list-style-type: none"> 1) The SEC should make a strategic decision on the role of various types of SROs in the regulation and supervision of Nigerian securities markets, and based on that, clearly define the SROs' responsibilities in the regulatory framework. 2) The SEC and NSE should intensify their cooperation and coordination in market surveillance, member supervision and supervision of listed companies.
Principle 12	<ol style="list-style-type: none"> 1) The SEC should review and expand the coverage of its on-site inspection program. 2) The SEC should improve coordination between the departments in charge of registration, monitoring, inspections, investigations and enforcement. 3) The SEC should re-deploy resources to address the more serious securities violations, such as market manipulation and insider trading.
Principle 14	The SEC should ensure that its procedures for providing assistance to foreign regulators are well coordinated and documented.
Principle 17	<ol style="list-style-type: none"> 1) The SEC should, in cooperation with the NSE, improve investors' access to the information on changes in major shareholdings. 2) The SEC should establish effective mechanisms to conduct on-going monitoring of trading by company insiders.

Principle	Recommended Action
Principles 18-21	<ol style="list-style-type: none"> 1) The government should appoint the FRC Board. 2) The SEC and FRC should collaborate in monitoring issuers' IFRS compliance. 3) The SEC should develop its technical expertise in IFRS. 4) The FRC should conduct inspections to monitor auditor independence.
Principle 22	<ol style="list-style-type: none"> 1) The SEC should introduce an on-site inspection program for CRAs. 2) The SEC should implement the IOSCO Code of Conduct Fundamentals for Credit Rating Agencies.
Principle 23	The SEC should ensure that the conflict of interest rules that need to be implemented for all Capital Market Operators sufficiently address the conflicts of interest inherent in the work of sell-side analysts.
Principle 24	The SEC should introduce additional conduct of business requirements for fund managers to ensure fair treatment of clients.
Principle 26	The SEC should develop ongoing and periodic disclosure requirements for fund managers, in coordination with the industry initiatives.
Principle 27	The SEC should ensure that the regulatory framework includes sufficient requirements to ensure availability of up-to-date price information to investors and to deal with any pricing errors in a fair and equal manner.
Principle 29	<ol style="list-style-type: none"> 1) The SEC should amend the regulatory framework to ensure that all directors, significant shareholders and all those in a position to exercise control over a market intermediary are subject to a sufficient fitness and propriety assessment. 2) The SEC should pay more attention in its pre-registration inspection to internal organization, risk management and supervisory systems. 3) The SEC should address the high number of inactive Capital Market Operators by facilitating the easier cancellation of registrations.
Principle 30	<p>The SEC should expeditiously revise the capital requirements of market intermediaries by:</p> <ol style="list-style-type: none"> 1) introducing higher initial capital requirements and ongoing risk-based capital requirements; 2) strengthening the ongoing monitoring of capital levels; 3) facilitating prompt corrective action in case of deteriorating capital levels; and 4) using its existing enforcement tools more effectively to require recapitalization of undercapitalized market intermediaries.
Principle 31	<ol style="list-style-type: none"> 1) The SEC should introduce requirements addressing the responsibility of the management and various organizational requirements for market intermediaries. 2) The SEC should complement, or where appropriate replace, the current product-related on-site inspections with entity-based inspections.
Principle 32	<ol style="list-style-type: none"> 1) The SEC, preferably in cooperation with the other members of the FSRCC, should formalize a written plan for dealing with an intermediary failure. 2) The SEC should try to expeditiously address the current lack of an investor compensation regime in Nigeria.
Principle 33	<ol style="list-style-type: none"> 1) The SEC should increase its expertise in the supervision of exchanges and other trading platforms. 2) The SEC should enhance the operational requirements applicable to trading platforms. 3) The SEC should ensure that the regulatory requirements for various types of trading platforms are clearly and transparently set out in the regulatory framework.

Principle	Recommended Action
Principle 34	<ol style="list-style-type: none"> 1. The SEC should establish an ongoing supervisory program for the NSE, addressing various aspects of its role as an operator of a key market infrastructure and as an SRO. 2. The SEC should ensure that the NSE widens the use of the disciplinary measures available to it beyond suspensions in more serious cases.
Principle 35	The SEC should introduce minimum regulatory requirements on pre- and post-trade transparency, with clear conditions on exemptions and delays.
Principle 36	The SEC should continue to address its current lack of effectiveness in fighting market abuse, and ensure that the NSE also complies with its obligation to refer cases to the SEC.
Principle 37	The SEC should ensure that the CSCS settlement system sufficiently deals with the risk that failed settlement of large transactions can cause to the financial system.

Authorities' response to the assessment

212. We sincerely appreciate the opportunity to provide our written comments on the assessors' report and express our gratitude to the assessors for the scope of their assessment. We welcome the assessment, given our commitment to ensuring best practice regulation and world class capital markets. We agree broadly with most of the recommendations on improving the Nigerian capital market infrastructure and strengthening regulation. We however express strong reservations on many of the observations contained in the report, some of which were not discussed with us by the team during their mission. The assessors in their report concede that 'it was not possible for them to discuss with a sufficient pool of market participants or public sector authorities with tasks relating to securities markets'. This may well have contributed to certain observations and conclusions that do not reflect the current circumstances in the Nigerian capital market. In addition to the acknowledgement of the adequacy of the Investment and Securities Act of 2007, we expected the report to sufficiently highlight the widely acknowledged remarkable improvement in regulatory systems and processes in the Nigerian capital market, since the last assessment in 2002 and 10 years ago and most especially given the results of the proactive and bold reforms that the Commission embarked upon after the recent global financial crisis. Specific comments are presented below

213. The report makes an unfounded reference to the SEC not being free of corruption. We are shocked by this assertion given that the Director General, Ms. Arunma Oteh, has promoted and enforced the highest ethical standards within the SEC and in the Nigerian capital markets, since she assumed office in January 2010. The SEC's zero tolerance stance against corruption and market abuse has equally been widely acknowledged domestically and internationally, encouraging the active participation of international investors (who make up about 70 percent of daily buy side trading by value on the Nigerian Stock Exchange) in the Nigerian capital markets. This allegation is without basis, and was not mentioned to us by the assessors during their mission. For such a serious allegation, albeit unfounded, we would have expected the assessors to provide specifics verbally or in writing, that will enable us investigate and ensure that the efforts of the Commission to become a role model in

securities regulation are not undermined. When we learnt of this allegation through a draft of the assessors' report, we promptly reacted as follows: "It has been widely reported that the Director General of the Securities and Exchange Commission, since her assumption of duty in January 2010, has taken unprecedented steps to eliminate market abuse and corruption from the Nigerian capital market. She has not relented in the drive to root out corrupt practices despite push back from vested interests. These issues are widely reported [in the local and international media]. She took action to strengthen internal controls within the SEC, and has taken steps to initiate a whistle blowing policy." Steps are also being taken to establish an Ethics function and recruit an Ethics officer. We are extremely disappointed to note that while the final version of the report acknowledges the zero tolerance stance of the Director General against corruption, it still retains the weighty and unproven allegation against the Commission.

214. The SEC's Board was reconstituted in December 2012. During their mission in September 2012, the assessors observed that the SEC's Board had not been reconstituted since June 2012 when the tenure of most of the previous Board members expired. It is important to note that the minister of finance provides oversight in the absence of a Board which arose this time because of the rigorous process for the appointment of Board members including the confirmation by the Senate following the appointment by the president on the basis of the recommendation of the minister of finance.

215. The report erroneously states that the SEC is not considered an attractive employer. This assertion is contrary to empirical evidence and does not take account of the growing interest of seasoned professionals in Nigeria's public service. Our most recent recruitment process led to the appointment of 50 excellent candidates from a pool of 34,000 eminently qualified accountants, economists, lawyers and information technology and finance professionals attracted to the SEC. The Commission is also known to attract highly qualified professionals including graduates of Ivy League institutions such as Harvard University, and University of Pennsylvania, New York-admitted attorneys, U.K. qualified chartered accountants, chartered financial analysts and lawyers from top law firms, internationally. We continue to experience the same trend in the ongoing recruitment exercise. We nonetheless recognize that we need to continue to strengthen capacity by increasing the proportion of staff in the core mandate areas of the Commission. On enforcement, we have since taken steps to receive technical assistance from a major international counterpart. The recommendations made were generated jointly with SEC staff and cover delegation of authority, streamlining and strengthening of inspections, investigation and enforcement structures as well as a revamped enforcement manual which when approved by the Board of SEC will make the Commission's enforcement regime, even more effective and efficient.

216. We also do not agree with the assessment on the inadequacy of broker dealer regulation and minimum capital requirements. While the SEC is in the process of fully implementing risk-based supervision, our existing rules and supervision framework have been sufficient to check abuse, and to limit any damage that may result from the failure of

any operator. New policies, regulations and rules have been put in place since the global financial crisis to prevent excessive risk taking such as margin lending without adequate skills and systems to monitor and manage positions. For example, the Nigerian SEC and the CBN jointly issued margin lending guidelines in 2010 amongst other rule changes following the global financial crisis. Mandatory provisions relating to capital requirements have also been closely monitored and enforced. It is important to note that the minimum capital requirements in Nigeria are higher than in a number of jurisdictions including some developed markets. In 2012, we established a Committee that comprised representatives of broker/dealers, the Nigerian Stock Exchange and the Commission to review the existing capital requirements and propose new guidelines, along with fit and proper guidelines for brokers. These guidelines will be presented to the Board of SEC for consideration. Far from the impression created by the report, onsite supervision in 2011 was only suspended in a bid to restructure our inspection mechanisms. It is therefore inappropriate to say we rarely inspect broker dealers. Staff carried out offsite inspections including rigorous reviews of periodic returns, both monthly and quarterly in 2011 and resumed onsite inspections in 2012.

217. The assessment appears to understate the rigour and success of our enforcement efforts. The report suggests erroneously that we have only focused on administrative penalties while since January 2010, we have taken very widely publicized enforcement action against the then leadership of the Nigerian Stock Exchange, and instituted legal proceedings against 260 individuals and entities for various forms of market infractions including insider dealing, share price manipulation and market abuses. As testimony to the quality of our investigations, we have begun to receive favorable court orders for disgorgement of illegally gained profits. Since 2010, we have established effective partnerships with the Attorney General's office, and the Nigeria Police, both of whom have resident officers within the Commission. This has strengthened the Commission's enforcement activities, and made us more effective and efficient including expediting the process of shutting down pyramid schemes and other such fraudulent devices.

218. In certain instances, the assessors did not appear willing to take note of information we provided, which negated their prior assessments. A good example is the SEC's relationship with regulators from other jurisdictions which are governed by bilateral and multilateral memoranda of understanding (MoU's). The assessors specifically claimed that the MOUs were used in a limited manner. We do not understand this claim since all requests made were treated adequately and in many cases were made by highly regarded regulators, and in connection with very important, well-publicized cross border investigations. We do not measure success by the number of requests since it is not our place to solicit them. On a related note, we regret that the assessors do not share our view that the contents of bilateral MoU's do not necessarily have to be published on our website since they are bilateral agreements. We have instead published a list of national regulators with whom we have outstanding MoU's.

219. Though the assessors acknowledge the robustness of investor protection provisions in Nigerian law, they have understated the equally robust disclosure regime. Specifically, we further strengthened our disclosure regime in 2011 by introducing a number of new measures including the introduction of a revised code of corporate governance which requires listed companies to indicate, the extent of compliance with the code, in their annual reports. Nigeria is recognized in indices such as the World Economic Forum's Global Competitiveness Index and the World Bank's Doing Business Report as a leading country for investor protection.

220. We do not understand why the assessors have ignored the robust provisions of our enabling law and in particular Rule 20A, which mandate operators to inform the Commission and to publish in dailies, when they are discontinuing business. It is surprising that contrary to this clear evidence, the assessment retains the claim that such operators are not required to inform us of their discontinuance of any business activity registered with the Commission

221. Another area not acknowledged in the report is the adoption of International Financial Reporting Standards (IFRS), effective 2012. In 2010, the Federal Executive Council, chaired by the President of Nigeria, considered and approved a roadmap in 2010 on the adoption of IFRS prepared by a Committee of industry experts and regulators including SEC. The roadmap articulated a calendar for migration to IFRS including 2012 for listed companies and 2013 for capital market operators. As part of our market development efforts we have since 2010 actively supported the IFRS migration process. Indeed, we received funding support from the World Bank to engage the services of the Institute of Chartered Accountants of England and Wales, and engaged the services of one of the international accounting firms, to assist us with this important initiative.

222. It is also erroneous to retain in the report as the assessors have done, a statement to the effect that we cancel registration of capital market operators only as an enforcement measure. We actively monitor the status of registered entities, and we withdraw registration in justifiable cases. In fact, we recently cancelled the registration for 35 operators, not as an enforcement measure.

223. Contrary to the assessment report, the Commission has a robust consultation process for rule-making. We provided these details and are surprised that our comments are not adequately reflected in the report. Rule-making is an important element of the Nigeria SEC regulatory framework. Rules originate from proposals made by staff, market participants and other stakeholders and are developed and drafted by relevant divisions of the SEC. They are then considered by the Rules Committee (comprising directors in various critical departments) and exposed to the market, via correspondence with the Trade Groups, publication in the national dailies and the SEC website. The comments received from stakeholders are also sometimes discussed at the industry wide capital markets committee meetings. Feedback from the market is collated and used in the final review of the draft Rules and are presented to the Board of the Commission for consideration alongside the draft

Rules. The approved rules are then presented to the Minister for ratification. Section 313 of the Investment and Securities Act specifically requires that the SEC consult in this manner. We therefore believe that we have a comprehensive and inclusive process that compares favorably with the highest standards, globally.

224. We have elaborate rules to deal with the failure of an intermediary, contrary to the assessment report. Sections 48 to 53 of the Investments and Securities Act are entirely dedicated to this matter. They provide elaborate powers to the Commission to resolve the failure or near failure of an intermediary in a manner that avoids contagion.

225. Oversight of the NSE. The nature of the presentation of the issues related to the NSE could give the erroneous impression that there has been insufficient oversight of the NSE. Following the September 2009 inspection of the NSE, the SEC started close monitoring of the NSE. This included bimonthly meetings at the Executive Management level and culminated in an intervention in August 2010. The intervention led to the removal of the leadership of the NSE due to corporate governance lapses and financial mismanagement. An interim team of seasoned professionals was appointed to stabilize the Exchange and oversee the recruitment of a new leadership team. That team made periodic reports, at least, quarterly to the Board of SEC. In addition, SEC appointed eight public interest members to the Council (the equivalent of a Board) of the NSE. Those council members completed their assignment during the 3rd quarter of 2012. The new leadership team that took over starting in April 2011 has taken significant steps to reposition the NSE as a world class exchange with best practice corporate governance practices and trading systems. As indicated in the assessors' report, the SEC through the various mechanisms described above has closely monitored the NSE. Normal annual inspections will resume in 2013.

226. We note that in a number of cases that the final grade assigned by the assessors did not reflect their written assessment or the current circumstances in the Nigerian capital markets. Examples include the assessment of the extent of compliance with principles 24, 26, and 27 with respect to collective investment schemes and Principle 34 with respect to exchanges and trading systems.

227. We appreciate the opportunity to provide the above comments and will be pleased to provide any clarification needed.