TOWARDS A NIGERIAN OBJECTIVES BASED TRIPLE PEAKS FINANCIAL REGULATION

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ABSTRACT

TOWARDS A NIGERIAN OBJECTIVES-BASED TRIPLE PEAKS FINANCIAL REGULATION

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This is a normative research on how best to structure financial regulatory agencies and principles consistently with the core objectives of financial regulation in such a manner that can yield an effective regulatory framework for Nigeria. It moves forward the debate on what an effective financial regulatory ought to be relative to a country's national context, its developmental stage and how international financial regulatory best practice principles can be 'woven' into the design of an enduring regulatory architecture in a developing economy such as Nigeria.

The thesis contributes to three areas namely: the literature on comparative financial regulation, financial legal transplantation, and financial regulatory reform. On comparative financial regulation, it contributes a developing world perspective on the legal and institutional challenges of financial regulation and how to deal with these challenges. On financial regulatory transplantation, it contributes to the debate on how best to conceptualise a financial regulatory architecture that mirror contemporary international best practices and that fits into the Nigerian context. In relation to financial regulatory reform, the thesis makes two major sub-contributions. First, it links financial regulation in Nigeria with robust and multi-layered regulatory accountability mechanisms including judicial and democratic accountability. Second, it generates principles that can be transformed into laws and policies to achieve the following: (a) the imposition of mandatory inter-agency co-ordination among financial regulators; (b) imposition of a statutory duty on financial regulators to prevent regulatory failure; (c) the imposition of liability for a supervisory failure induced collapse of a financial institution and (or) a financial crisis; (d) the use of irreversible convertible debentures as a corporate governance disciplinary mechanism to deter imprudent business model and to serve as a forward looking strategy to address the 'historical inevitability of financial crises' in the unlikely event that the financial regulatory system fails.

DEDICATION

To my late elder sister, Miss Suliat Adeola Famuyiwa, my late elder brother Mr. Ganiyu Famuyiwa and my late father Chief Sikiru Taiwo Famuyiwa for your joint and several sacrifice and support, once earthly but now unseen; and for your souls to repose in joyful acknowledgement that Kazeem, your brother and son, made you proud!

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To speak more modestly and directly, I should before I introduce the reader to the thesis, look around for a moment and acknowledge my debt of gratitude to a number of people in the course of this research and my tuition generally at Keble College and Law Faculty, University of Oxford. I appreciate the guidance of Mr. Justice James Joshua Edelman of the Supreme Court of New South Wales (formerly, Professor of the Law of Obligations, University of Oxford) who encouraged me to study for a doctorate degree at the University of Oxford. I am immensely and eternally indebted to Professor Fidelis Oditah QC, SAN, my supervisor, whose critical intervention, support, understanding and advice saw me through those turbulent times in my doctoral journey. I equally express my profound gratitude to my examiners, Professors Dan Prentice and Phillip Wood QC, for the invaluable support, guidance and advice they freely offered from my Qualifying Test to the *Viva Voce*.

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Kazeem Olumide Famuyiwa
Keble College, Oxford,
21 August 2015

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AC	Appeal Cases (UK)
ACE	Advisory Committee of Experts
ACGS	Agricultural Credit and Guarantee Scheme Fund
ACP	Autorité de Contrôle Prudentiel (France)
AFM	Financial Market Authority (the Netherlands)
AIM	Alternative Investment Market
AMCON	Asset Management Corporation of Nigeria
AMF	Autorité des Marchés Financiers (France)
All ER	All England Law Reports
ASIC	Australian Securities and Investments Commission
APRA	Australian Prudential Regulatory Authority
ATRRS	Accounting Transactional Recording and Reporting System
BaFin	Bundesanstalt für Finanzdienstleistungsaufsicht (Germany)
BCBS	Basel Committee on Banking Supervision
BCCI	Bank of Credit and Commerce International
BCFP	Bureau of Consumer Financial Protection
BdP	Central Bank of Portugal
BNB	Bulgarian National Bank
BNM	Bank Negara Malaysia
BoE	Bank of England
BOFIA	Banks and Other Financial Institutions Act
BOI	Bank of Industry (Nigeria)
BoG	Bank of Greece
BPP	Bureau of Public Procurement
BPP	Bureau of Public Procurement
BROOK. J. CORP. FIN. & COM. L.	Brooklyn Journal of Corporate, Financial & Commercial Law
BRROK. J. INT'L L.	Brooklyn Journal of International Law
CAA	Commissariat aux Assurances (Luxembourg)
CAC	Company Affairs Commission
CAR	Capital Adequacy Ratio
CBI	Central Bank of Ireland
CBN	Central Bank of Nigeria
CDRC	Corporate Debt Restructuring Committee
CFRN	Constitution of Federal Republic of Nigeria
CFTC	Commodity Futures Trading Commission
Ch.	Chancery (Cases, UK)
CMHC	Canadian Mortgage and Housing Corporation
CMOs	Capital Market Operators

CMVM	Securities Market Commission (Portugal)
CMU	Crisis Management Unit
CONN.INS.L.J.	Connecticut Insurance Law Journal
CPAR	Country Procurement Assessment Review
CPIA	Country Policy and Institutional Assessment
CPS	Country Partnership Strategy
CRMS	Credit Risk Management System
CSCS	Central Securities and Clearing Systems
CSOs	Civil Society Organizations
CSSD	Corporative Societies Supervision and Development Authority (Cyprus)
CSSF	Commission de Surveillance du Secteur Financier (Luxembourg)
DFI	Deposit Finance Institution
DFSA	Danish Financial Supervisory Authority
DIS	Deposit Insurance Scheme
DLR	Dominion Law Report
DMO	Debt Management Office
DNM	Dutch Central Bank
DPO	Development Policy Credit
e-FASS	Enhanced Financial Analysis and Surveillance System
ECA	Excess Crude Oil Account
ECB	European Central Bank
ECGI	European Corporate Governance Institute
EDS.	Edited/Editors
eFASS	Electronic Financial Analysis and Surveillance System
EFCC	Economic and Financial Crimes Commission
EFSA	Estonian Financial Supervision Authority
EIA	Environmental Impact Assessment
EITI	Extractive Industries Transparency Initiative
ELA	Emergency Liquidity Assistance
EWHC	High Court of England and Wales
FATF	Financial Action Task Force
FCA	Financial Conduct Authority
FDIC	Federal Deposit Insurance Corporation
FED	Federal Reserve (US)
FHA	Federal Housing Authority (Nigeria)
FHC	Federal High Court (Nigeria)
FHFA	Federal Housing Finance Authority (US)
FHFB	Federal Housing Finance Board (US)
FIN-FSA	Finnish Financial Supervisory Authority (US)

FIO	Federal Insurance Office (US)
FIRS	Federal Inland Revenue Service (Nigeria)
FMA	Financial Markets Authority (Austria)
FMoF	Federal Ministry of Finance
FRB	Fiscal Responsibility Board
FRC	Financial Reporting Council
FSA	Financial Services Authority
FSC	Financial Supervision Commission (Bulgaria)
FSMA	Financial Services and Markets Act
FSMA	Financial Services and Markets Authority (Belgium)
FSRCC	Financial Services Regulatory Coordinating Committee
FSSA	Financial System Stability Authority
FSS2020	Financial Sector Strategy 2020
FTCA	Federal Tort Claims Act (US)
GASAB	Government Accounting Standards Advisory Board
GFC	Global Financial Crisis
GSE	Government Sponsored Enterprises
GDP	Gross domestic product
GEO. L.J.	Georgetown Law Journal
GIFMIS	Government Integrated Financial Management Information System
HARV. BUS. L. REV.	Harvard Business Law Review
HCMC	Hellenic Capital Market Commission
HFSA	Hungarian Financial Supervisory Authority
ICCS	Insurance Company Control Service (Cyprus)
IFC	International Finance Corporation
IFRS	International Financial Reporting Standards
IOSCO	International Organisation of Securities Commissions
IPO	Initial Public Offering
IPPIS	Integrated Payroll and Personnel Information System
IPSAS	International Public Sector Accounting Standard
IMF	International Monetary Fund
ISP	Insurance Institute of Portugal
IST	Investment and Securities Tribunal (Nigeria)
LGA	Local Government Areas
LIBOR	London Inter-Bank Offer Rate
LQR	Law Quarterly Review
M&E	Monitoring and Evaluation
MDAs	Ministries, Departments and Agencies
MFB	Microfinance Bank
MLR	Modern Law Review
MoF	Ministry of Finance (Nigeria)

NACRDB	National Agricultural and Co-operative Development Bank
NAICOM	National Insurance Commission
NASB	Nigerian Accounting Standards Board
NBB	National Bank of Belgium
NBER	National Bureau of Economic Research
NBS	National Bank of Slovakia
NCUA	National Credit Union Administration (US)
NDIC	Nigerian Deposit Insurance Corporation
NEAC	National Economic Action Council (Malaysia)
NEEDS	Nigeria Economic Empowerment and Development Strategy
NEP	National Economic Plan (Malaysia)
NLSS	Nigeria Living Standards Survey
NPL	Nonperforming Loan
NPV	Net Present Value
NSE	Nigerian Stock Exchange
NSFR	Net Stable Funding Ratio
NWLR	Nigerian Weekly Law Report
OBA	Open Bank Assistance
OCC	Office of the Comptroller of the Currency (US)
OECD	Organisation for Economic Corporation and Development
OFHEO	Office of Federal Housing Enterprise Oversight (US)
OFISD	Other Financial Institutions Supervision Department
OJLS	Oxford Journal of Legal Studies
OTC	Over the Counter
OUP	Oxford University Press
OSFI	Office of Superintendent of Financial Institutions (Canada)
PEMFAR	Public Expenditure Management and Financial Accountability Review
PENCOM	National Pension Commission
P&A	Purchase and Assumption Transaction
PCA	Prompt Corrective Action
PFA	Pension Fund Administrator
PFC	Pension Fund Custodian
PoS	Point of Sale
PPP	Public Private Partnerships
PRA	Prudential Regulatory Authority (UK)
PSI	Policy Support Instrument
RCF	Resolution Cost Fund
RTGS	Real-Time Gross Settlement
RoE	Return on Equity

SAS	Nigerian Accounting Standards
SEC	Securities and Exchange Commission (separately for Cyprus, Nigeria, and US)
SFSA	Swedish Financial Supervisory Authority
SIB	Savings Investments Board
SIF	Supervisory Intervention Framework
SIFI	Systemically Important Financial Institutions
SMEs	Small and Medium enterprises
SPV	Special Purpose Vehicle
SSRN	Social Sciences Research Network
TSA	Treasury Single Account
UCLA	University of California at Los Angeles
UK	United Kingdom
UKHL	United Kingdom House of Lords
US/USA	United States of America
U.S.C.	United States Congress
VFM	Value for Money
VA. L. REV.	Virginia Law Review
WLR	Weekly Law Report

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Portugal

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CHAPTER ONE

INTRODUCTION AND CONTEXT

1.1 INTRODUCTION

This chapter introduces the thesis' thematic thrust namely: an advocacy for the adoption of an objectives-based triple peaks financial regulation in Nigeria. It presents under separate headings the overview, statement of problem, the factual background, hypotheses, methodologies, academic context, scholarly contribution and the thesis' structure.

This chapter is organised into seven sections. This introduction is the first. The second section presents an overview of the research problem. The third section presents the research hypotheses in terms of the three key questions that are at the heart of the thesis. The fourth section discusses the research methodology. The sixth section articulates the academic context of the research, the received financial regulatory paradigms and aspects of the relevant literature. The seventh section presents its overall structure. The eighth section concludes the chapter.[1]

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[1] We would like the reader to note that going forward and as the context warrants, we might refer to this dissertation interchangeable as 'thesis' or 'research.'

1.2 OVERVIEW OF RESEARCH PROBLEM

This thesis explores and analyses the legal and institutional framework required to address the perennial incidence of banking insolvencies, and in the past few years that of systemic financial crisis in Nigeria.[2] Specifically, it examines the prospects, potentials, and paradoxes of adopting an objectives-based triple peaks regulatory approach as a normative framework for the structuring of financial regulation in Nigeria. This regulatory model refers to a network of emerging policy suggestions that the essential first step in developing a sound financial regulatory architecture is to assign specific goals and instruments to separate agencies.[3]

The rapid ascendancy of this regulatory approach as a framework for anticipating, preventing and mitigating systemic (financial) meltdown is arguably due to the measure of success recorded in its implementation in countries such as Canada and Australia.[4] This thesis examines if and to what extent, this approach may be successfully modified, domesticated and applied

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2 Nigeria is a sub-Saharan African country, ranked alongside Mexico, Indonesia and Turkey as a developing market economy See generally, BBC News Magazine 'The MINT countries: Next economic giants?' Available online at: <http://www.bbc.co.uk/news/magazine-25548060> accessed on 13 February 2014.

3 OECD, *Policy Framework for Effective and Efficient Financial Regulation* (Paris: OECD, 2010) 35 – 39; M. Taylor, 'The Road to "Twin Peaks and the Way Back,' 16 (2010) *Conn. Ins. L. J.* 61; J. Black and S. Jacobzone, 'Tools for Regulatory Quality and Financial Sector Regulation: A Cross-Country Perspective' *OECD Working Paper on Public Governance,* No. 16 OECD Publishing, available online at: <http://dx.doi/org/10.1787/218772641848> accessed on 23 August 2013; The Department of the Treasury (US), *Blueprint For a Modernised Financial Regulatory Structure* (Washington D.C. 2008).

4 L. Ratnovski and R. Huang, 'Why are Canadian Banks More Resilient?' (2009) *International Monetary Fund (IMF) Working Papers Series*, available online at: <http://ssrn.com/abstract=1442254> accessed on 10 September 2012

as a normative framework for the reform of Nigeria's financial regulatory system to effectively anticipate and prevent financial crisis.

Summarily, the questions posed in this research are twofold. *First,* what are the financial regulatory issues responsible for and accentuated by the Nigerian financial crisis of 2008-09, and how can the Nigerian financial regulatory system be reformed to address these issues, including the question of supervisory negligence implicated in that crisis? *Second,* what are the paradoxes, pitfalls and prospects of adopting an objectives-based triple peaks approach as a framework for structuring financial regulatory principles and institutions for Nigeria? To resolve these questions and more specifically to propose normative regulatory principles and institutional configuration for the reform of Nigerian financial regulatory framework, this thesis provides a theoretical examination and discussion of how structuring regulatory agencies and principles in line with the core goals of financial regulation, which draws lessons from comparators countries, conjoined with the use of tort law negligence liability, can yield an effective framework for Nigeria.

1.3 The Nigerian Financial System and Regulatory Issues

This section presents a map of the Nigerian financial system. The map is linked to a brief discussion of the Nigerian financial crisis of 2008-09. The discussion in turn prefaces a discussion of three causal manifestations of the 'crisis' of financial regulation in Nigeria. The section ends with a consideration of the problem of addressing the crisis of financial regulation through piecemeal reforms. '

1.3.1 The Nigerian Financial System

The Nigerian financial system comprises the financial regulatory system and the financial market.

1.3.1.1 The Financial Regulatory System

The Nigeria financial regulatory system comprises regulatory agencies that oversee the implementation of financial laws and policies namely: the MoF, CBN, NDIC, SEC, NAICOM, PENCOM and courts such as the FHC and IST. The MoF is the government ministry responsible for the control and management of the public finance of the Federation. Its functions include preparing annual estimates of revenue and expenditure for the Federal government, formulating policies on fiscal and monetary matters, maintaining internal and external value and stability of the Nigerian currency. The CBN is the central bank and prudential regulator and supervisor for the banking sector. The objects of the CBN are set out in the *Central Bank of Nigeria Act 2007*

(*CBN Act*),[5] and its principal objects include ensuring monetary and price stability and promoting a sound financial system in Nigeria. The CBN enforces the provisions of *Banking and Other Financial Institutions Act* (BOFIA), the legislation that regulates banks. The NDIC enforces the provisions of the *NDIC Act* (the legislation that establishes the deposit insurance scheme); supervises insured deposit money banks; [6] and acts as the resolution authority as well as bank liquidator. However, the NDIC consults the CBN on capital injection into banks.[7] The SEC enforces the provisions of the *Investment and Securities Act* (ISA), the law that regulates the capital market.[8] The NAICOM enforces the provisions of the *NAICOM Act* and the *Insurance Act,* the two statutes that regulate the insurance sector.[9] PENCOM enforces the provisions of the *Pension Reform Act of Nigeria,* the statute that regulates pension matters.[10]

There are also self-regulatory organisations that prescribe code of ethics for their members. They include, the Chartered Institute of Bankers (CIBN), Institute of Chartered Accountants (ICAN), Association of National Accountants (ANA), Chartered Institute of Stockbrokers (CIS), Association of Stock Broking Houses of Nigeria (ASBHN), Association of Issuing Houses of

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5 *Section 2 of the CBN Act.*

6 *Part VI of NDIC Act.*

7 *Sections 31 and 34 of BOFIA.*

8 *Section 13 of ISA, 2007.*

9 *Sections 1, 6 and 7 of the National Insurance Commission Act No. 1 of 1997.*

10 *Sections 14 and 15 of the Pension Reform Act of Nigeria, Act No. 2 of 2004.*

Nigeria (AIHN), Association of Capital Market Registrars (ACMR), Association of Corporate Trustees (ACT), Financial Market Association of Nigeria (FMAN), Capital Market Solicitors Association (CMSA), and the Association of Bureau de Change Operators of Nigeria. Generally, they have the powers to sanction erring members in line with their code of ethics. The judiciary also plays a role.

The FHC is a federal court with exclusive trial jurisdiction in civil causes and matters relating notably to: banking, banks, and other financial institutions; bankruptcy and insolvency; the operation of the companies; and the administration or the management and control of the Federal Government or any of its agencies.[11] The court specifically adjudicates disputes that may arise from the enforcement of *BOFIA, CBN Act, NDIC Act, Insurance Act, NAICOM Act,* and *ISA*. The IST is a judicial body established by *section 274* of the *ISA 2007*.[12] The Act gives the Tribunal exclusive jurisdiction to hear and determine any question of law or dispute involving: (a) decision or determination of the SEC, (b) SEC and a capital market self regulatory organisation, (c) a capital operator and SEC, (d) an investor and SEC, (e) an issuer of securities and SEC, and (f)

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[11] *Section 249 (1)* of the *Constitution of Federal Republic of Nigeria* (CFRN), 1999 (formerly, *section 228(1)* of the *Constitution of the Federal Republic of Nigeria, 1979*) establishes the FHC as the successor court to the Federal Revenue Court, established by *section 1 (1)* of the *Federal Revenue Court Act of 1973*, now restyled as the *Federal High Court (FHC) Act of 1973*. See for the full list of matters over which the FHC has exclusive jurisdiction: *section 251(1) of the Constitution of the Federal Republic of Nigeria 1999.*

[12] Formerly, *section 224* of the *ISA 1999*.

disputes arising from the administration, management and operation of collective investment schemes.[13] The IST is not expressly mentioned in the *CFRN 1999*, unlike the FHC. However, its creation derives from *section 6(4)(a)* of the *CFRN 1999*. That section empowers the National Assembly of Nigeria to establish courts other than those to which the section relates, but with *subordinate* jurisdiction to that of a High Court.[14]

The regulated financial intermediaries comprise 22 deposit money banks (following the licensing of a commercial bank, Heritage Banking Company Limited in 2012), 2 merchant banks, 4 discount houses, 880 microfinance banks, 66 finance companies, 82 primary mortgage banks, 690 securities brokerage firms, 13 pension fund administrators, 7 pension fund custodians, 2,020 Bureaux-de-Change, a stock exchange, a commodity and securities exchange, 5 development finance institutions, a public credit bureau, 3 private credit bureaux, 45 insurance companies, 2 reinsurance companies, and 50 insurance loss adjusters.[15]

1.3.1.2 The Financial Market

The financial market divides into the money market and the capital market. The **money market** is under CBN's remit. It is a

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13 *Section 284* of the *ISA 2007.*

14 The courts to which the section relates are enumerated in section 4(5) (a) – (k) of the *CFRN 1999* as follows: the Supreme Court of Nigeria; the Court of Appeal; the Federal High Court; the High Court of the Federal Capital Territory; a High Court of a State; the Sharia Court of Appeal of the Federal Capital Territory; a Sharia Court of Appeal of a State; a Customary Court of Appeal of a State; such other courts as may be authourised by law to exercise jurisdiction at first instance or on appeal on matters with respect to the National Assembly, or a House of Assembly of a State may make law.

15 Central Bank of Nigeria, *CBN Annual Report 2012*, (Abuja: Research Department of the Central Bank of Nigeria, 2012) xxxviii. This is the most recent Report.

market for short–term funds dominated by the banking industry and currently accounts for over 80 percent of financial sector assets and represents about 53.6 percent of Nigeria's GDP.[16] Following a programme of consolidation and recapitalization, the number of banks was reduced from about 90 in 2005 to 24 by 2006 and presently there are 22 commercial banks, with ₦18.2 trillion assets and ₦12.5 trillion in deposits (about US$81 billion), and one Islamic (non-interest) bank.[17] Three banks, Stanbic-IBTC, Standard Chartered, and Citibank, are foreign-owned. They hold about 14 percent of assets in the industry.[18]

The **capital market** is under SEC's remit, but the NSE regulates trading on the stock exchange. NSE is a self-regulatory organisation within the SEC's regulatory remit. As of December 31, 2013, the exchange had about 200 companies listed under 33 sectors, with a total market capitalization of about N12.88 trillion ($80.8 billion USD).[19] All listings are included in the NSE All Shares Index. NSE's existence reflects Nigeria's adoption of a self-regulated stock exchange similar to the model in countries such as United Kingdom and United States. However, concerns relating to transparency, conflict of interest, collusion and unfair advantage are often raised in relation to the

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16 *ibid.*

17 *ibid.*

18 *ibid.*

19 See generally the *Stock Market Report* for 09 May 2014 at (n 23) below.

governance of the NSE.[20] For instance, in the notorious 'duel of corporate oligarchs' a past Vice President and later President of NSE was sued for using his position, insider knowledge, and connections in the stock market to depress the shares of a company owned by his corporate rival.[21]

The capital market is further subdivided into equity and debt markets. New issues and existing shares are traded in the primary and secondary equity markets respectively. Banks and insurance companies (ranked together as financial services industry) have consistently accounted for 19 of the top 20 companies by turnover volume. Banks alone represent 15 of the top 20 companies in terms of market capitalisation. This demonstrates banks' dominance in the Nigerian equity market and the financial system.[22] The debt market is dominated mostly by trading in bonds. The market has grown steadily since the issuance of Federal Government (FGN) bonds was resuscitated in 2003 after an 18-year hiatus. As of October 2014, the Nigerian

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20 M. Fuchs and I. Radwan, *Making Finance Work for Nigeria* (Washington D.C.: World Bank Group, 2009) 147.

21 A. Elesin, 'AP Shares: Otedola Sues Dangote for N117 billion,' available at: <http://www.nairaland.com/257428/ap-shares-scandal-otedola-sues> accessed on 26 August 2013.

22 Fuchs and Radwan (n 20) 31 – 44. See also the *Stock Market Report* for 09 May 2014, which shows that the financial services industry (measured by volume) led the activity chart with 1.345 billion shares valued at N9.334 billion traded in 12,384 deals; thus contributing 79.22% and 53.57% to the total equity turnover volume and value respectively. The report is available online at, <http://www.nse.com.ng/MarketNews/Downloads/Weekly/Weekly%20%20Report%20for%20the%20week%20Ended%2009-05-2014.pdf> accessed on 13 May 2014.

bond market capitalisation is about ₦5.90 trillion ($36.42 billion USD) comprising FGN, State and corporate bonds.[23]

Institutional investors in Nigeria comprise mostly insurance companies, pension funds, and unit trusts. Altogether, they account for 14.7 percent of the total assets in the financial system at year end-2011.[24] Also at year end-2011, the breakdown of local investment on the NSE shows that institutional investors accounted for about 91 percent or N1.13 trillion ($7.43 billion USD) of the trading activities.[25] While it can be surmised from these figures that the financial services industry would have attracted a considerable percentage of the investment, official confirmation is not available. Also not publicly available, is information on the depth and extent of corporate governance influence (if any at all) that is exercised by institutional investors in the financial services industry.

1.3.2 The Nigerian Financial Crisis of 2008-09

This crisis affected nearly all the key sectors of the financial system. The stock market crashed with a loss of $60 billion in capitalisation and the resulting liquidity contraction in the banking sector owing largely to marginal loan exposures, forced the CBN to inject N620 billion (about $4.1 billion USD) into

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23 A. Oteh, 'Building a Vibrant Domestic Bond Market in Nigeria' (2014) available online at: http://www.africanbondmarkets.org/en/news-events/african-bond-market-review/article/building-a-vibrant-domestic-bond-market-in-nigeria-61665/ accessed on 20 December 2014. The writer is the incumbent Director General of the Nigerian Securities and Exchange Commission.

24 CBN (n 15).

25 O. Onyema, 'Opening Remarks at the NSE Institutional Investors' Clinic' 26 September 2012.

eight insolvent banks which were either later sold, liquidated, or rationalised and kept as going concerns.[26] The debilitating reverberations of the crisis, both in terms of its immediate unprecedented and enormous demand on the Nigerian treasury and the contraction in money supply, redundancies, lay-offs and loss of investments, were and are still being felt beyond the financial system and in the country's wider socio-economic life.

The crisis aftermath has spawn scholarly commentaries, which mostly attempt to dissect its causes and proffer reform proposals. These commentaries have made worthy and quality contributions to the debate on the strategies and policy options for reforming the Nigerian financial regulatory system to forestall a recrudescence of the crisis. But questions on the legal and institutional framework required to address the fundamental causes of regulatory deficiencies and supervisory failure have not been addressed with profound detail in existing literature.[27]

Precursor scholarly studies and prescriptions have not also exhaustively addressed if and how the emerging objectives-based approach to the structuring of financial regulatory architecture that have been adopted with some measure of success elsewhere conjoined with other regulatory strategies, including the

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[26] See generally: D. Alford, 'Nigerian Banking Reform: Recent Actions and Future Prospects' 5, < http://ssrn.com/abstract=1592599 > accessed on 22 May 2012; C. Nwude, 'The Crash of the Nigerian Stock Market: What Went Wrong, the Consequences and the Panacea' (2012) Vol. 2, No. 9, *Developing Country Studies*, 105 – 6 < http://www.iiste.org/Journals/index.php/DCS/article/view/2973 > accessed 10 January 2013.

[27] The research conceives regulatory failure in terms of a deficiency in norms, principles and rules, conjoined with lack of the requisite enforcement power(s), which creates vulnerabilities for a financial crisis. Supervisory failure is defined in terms of sub-optimal enforcement of regulatory principles and rules, which creates vulnerabilities for a financial crisis.

imposition of liability for negligent financial regulation can spur reform in Nigeria. The research aims to fill this gap in the literature. It examines the potentials and paradoxes of adopting an objectives-based triple peaks financial regulation as a normative framework for the reform of Nigerian financial regulatory system.

1.3.3 The Anatomy of 'Financial Regulatory Crisis' in Nigeria

Long before the Nigerian financial crisis of 2008-09 there arguably had been an older but no less debilitating crisis—a financial regulatory crisis. The crisis is in terms of a perceived inability of the financial regulatory system to effectively address the issues that characterised the previous cases of insolvencies of financial institutions in Nigeria, the regulatory deficiencies and supervisory failure that substantially induced the crisis of 2008 – 09 and the new regulatory issues thrown up by that crisis. On this view, this crisis has three causal manifestations. *First*, the crisis manifested in those general issues that have perennially impeded the emergence of an effective financial regulatory system in Nigeria. These issues are not solely legal in that they encompass matters political; matters socio-economic; and matters ethno-religious. *Second* and in the regulatory space between the implementation of Nigerian financial consolidation programme in 2005 and the financial crisis of 2008-09, the crisis manifested in regulatory deficiencies and supervisory failure. *Third* and post

2009 the crisis has manifested in new regulatory issues which the crisis of 2008-09 threw up. In what follows, we shall focus on the first and third causal manifestations of the crisis. Chapter 2 would focus extensively on the second causal manifestation.

1.3.3.1 General Issues

After the Nigerian financial crisis of 2008-9 and drawing from the country's past experience with banking insolvencies, commentaries on the causes of the crisis and insolvencies coalesce around the notion that the regulatory framework is infested with issues, which have generally and perennially impeded the emergence of a safe, sound and resilient financial system. These include: capture and perversion of the financial regulatory system;[28] lack of regulatory accountability;[29] abuse and (or) misuse of regulatory powers;[30] conflict between short-term tenure pressure on senior regulatory officials to demonstrate action and long-term safety of the financial system;[31] lopsided enforcement of regulatory sanctions;[32] regulatory favouritism;[33] lack of effective regulatory governance and inter-agency

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28 S. Apati, *The Nigerian Banking Sector Reforms: Power and Politics*, (Basingstoke: Palgrave Macmillan, 2012) 28 – 34, 104 (discussing this practice under the heading, 'Financial Terrorism and the Games Banks Play').

29 *ibid,* 132.

30 T. Ogowewo and C. Uche, '[Mis]Using Bank Share Capital as a Regulatory Tool to Force Bank Consolidation in Nigeria' (2006) vol. 50, 2 *Journal of African Law*, 161, 166 – 70; Apati (n 28) 115 – 28.

31 *ibid.*

32 Apati (n 28) 41 – 52.

33 *ibid,* 78 – 86.

coordination;[34] excessive political influence and the lack of operational independence of regulatory institutions and their officials;[35] endemic and destructive corporate governance abuses in financial institutions; and the fact that the financial system is bereft of a substantive consumer financial and investor protection institution.[36] We shall in the next five paragraphs discuss five of these issues, which are most commonly mentioned by commentators.

Capture and financial regulatory perversions occur mostly when unscrupulous financial institutions, their officers and officials of regulatory institutions exploit regulatory gaps in the financial system to make arbitrage profits. For instance, the foreign exchange deregulation which followed the implementation of the Structural Adjustment Programme in Nigeria in 1986 was perverted for excessive financial gains by banks and their officials through 'round tripping' of foreign exchange purchased at the official low rate from the CBN and sold at high rates in the 'black market.'[37] Indeed the explosion in the number of Nigerian banks from 40 in 1985 to 107 in 1990 and the insolvencies of some of these banks, is attributable largely to the huge margins derived from foreign exchange round tripping and the eventual

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[34] S. Sanusi, 'The Nigerian Banking Industry: What went wrong and the way forward,' (2010) Research Department, Central Bank of Nigeria, 7, available online at: < http://www.bis.org/review/r100419c.pdf?frames=0 > 9 – 10, accessed on 15 May 2012.

[35] Apati (n 28) 125 – 27.

[36] *ibid,* 141 – 156. Sanusi (n 32) 6 – 8.

[37] Apati (n 28) 28 – 34.

insolvencies of some these banks is traceable in large part to the eventual suppression of the practice by the CBN.[38]

Abuse and (or) misuse of regulatory powers arise from lack of due process in financial regulation, disregard of legitimate expectation of financial market operators, and occasional highhandedness of regulatory institutions and their officials. In some cases, abuse and (or) misuse of regulatory powers are used to mask ineffective performance on the part of the regulators.[39]

Linked to the abuse and (or) misuse of financial regulatory powers, is the absence of a strong accountability mechanism to check ineffective or in some cases compromised financial supervision. Generally, accountability in public administration speaks to at least three basic things: the need for public officials to demonstrate that oversight functions have been conducted in accordance with statutory rules and standards; to report fairly and accurately on performance results vis-à-vis mandated roles and plans; and to answer for the performance of their functions and use of regulatory powers and resources.[40] The CBN has on many occasions arguably failed to meet these three measures of accountability as shown in its inability to perform its oversight functions thoroughly to prevent or anticipate crisis in the financial system. For instance, the CBN had a capital verification

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38 *ibid*.

39 Ogowewo and Uche (n 30).

40 This is an adaption of public sector accountability definition by the Organisation for Economic Co-operation and Development (OECD) in *Public Sector Transparency and Accountability: Making it Happen* (OECD Publishing, 2002) 7.

process at the beginning of the banking consolidation exercise of 2005 to avoid bubble capital. The process was ineffectively carried out because the crisis of 2008 to 2009 that resulted in the loss of 'hundreds of billions of naira' in depositors' funds exposed the fact that some banks did not actually raise the capital they claimed.[41] Notably, while the CBN officials who conducted the incomplete capital verification exercise remain in service or have since retired, no one has thus far been held accountable for the failure of the exercise to fulfil its clearly strategic purpose of preventing bubble assets from unravelling the banking consolidation exercise, which could and did result in a financial crisis.

Further, the appointment, conduct and operations of regulatory officials are most often fraught with undue geo-political and ethno-religious considerations and influence. For instance, while there are no explicit provisions in the *CBN Act* and the *BOFIA,* in support of the practice, the Governorship of the CBN tends to rotate among the three major ethnic groups in the country, namely: Hausa, Igbo and Yoruba and between Christian and Muslim candidates. Notably, the appointment of the incumbent Governor from the Igbo ethnic group for a tenure that going by practice should be served by a candidate from the Yoruba ethnic group questions the validity of the practice. At any rate, one implication of this practice is that merit and fit are not

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41 Sanusi (n 32) 7.

so much the key determinants of who heads the CBN, as are ethnic and religious considerations.[42] Another implication is lack of continuity in financial regulatory policies and sometimes the introduction of policies that undermine those formerly implemented by a predecessor Governor, who is perceived to have favoured one section of the country and to the detriment of the section to which the incumbent belongs.[43]

Lastly and in relation to operational independence, the Executive branch of the Federal Government of Nigeria sometimes summarily overrules financial regulatory decisions and policies without engaging with the fundamentals of such policies. For instance, in 2007 and 2012, the CBN announced currency redenomination and standardisation policies respectively. The Government overruled these policies much more for superficial than for sound reasons including, in the case of the redenomination policy, the allegation that the Presidency was only notified of the policy and not consulted.[44] This incident questions the operational independence of the CBN as a key financial regulator in Nigeria.[45] It also suggests the need to re-examine the requirements for operational independence of

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42 *ibid* 41 – 52.

43 *ibid* 125 – 27.

44 *ibid* 78 – 86.

45 Admittedly, *section 1(3)* of the *Central Bank of Nigeria Act No. 7 of 2007,* provides that in order to facilitate the achievement of its mandate under the Act and the *Banks and Other Financial Institutions Act,* and in line with the objective of promoting stability and continuity in economic management the CBN shall be independent in the discharge of its functions. The practice however appears to be that the operations of the CBN are subject to the intrusive influence of the Federal Government of Nigeria: Apati (n 28).

Nigerian financial regulators and to ensure that sectional and political considerations do not overly influence the abilities of regulators to perform their assigned tasks in the Nigerian financial system.

1.3.3.2 Issues Accentuated By The Crisis of 2008-09

The crisis of financial regulation in Nigeria equally manifests itself in those issues that the crisis of 2008-09 accentuates. Four of these issues are worth noting. The first is the *legality* of the post crisis framework for supervision and early intervention in problem banks. While the Prompt Corrective Action (PCA) framework and Supervisory Intervention Framework (SIF) introduced post 2009 appear to be fairly structured, with increasingly intrusive actions taken as the bank's Capital Adequacy Ratio (CAR) or other prudential indicators fall, they are unsupported by *BOFIA*.[46] This is because *section 37* of the Act only provides—in the case of a significantly under-capitalised bank whose CAR falls between 2 per cent and 5 per cent and even—that the NDIC shall request the bank to submit a recapitalisation plan; prohibit the bank from extending further credit and incurring additional capital expenditure; and with approval of the CBN remove or appoint director(s) of the bank. On the contrary, the regulatory powers exercisable in respect of

[46] *Sections 35 – 38 of BOFIA 1991* (as amended by Acts Nos. 38 of 1999 and 40 of 1999) provide the basic statutory framework resolution and regulatory intervention in failing banks. Pursuant to these provisions the CBN introduced the PCA framework and SIF in a single document in 2011: CBN, *Supervisory Intervention Framework for Nigerian Banks* (Abuja: Banking Supervision Department/Financial Policy & Regulation Department, 2011) 7 – 21.

an under-capitalised bank in the SIF are wholly reserved for the CBN and are far more extensive that those sanctioned by the Act. They include CBN's power to request for a business plan from the bank; review the plan; make a final capital call on the bank within four months from the time of acceptance of the business plan; and to take over the management and control of the bank within two months after the final capital call.[47] Equally, *BOFIA* does not provide for PCA framework based on liquidity, asset quality, and earnings triggers among others as contained in the SIF.[48] These statutory inconsistencies could give rise to a legal challenge of the PCA and SIF.

The second issue relates to the *regulatory gap* in liquidity assistance to insolvent banks. The *CBN Act* provides that the CBN may exercise its power as a lender of last resort by granting temporary advances to banks at such interest rate and under such terms as it may determine to any bank having liquidity problems.[49] But the CBN currently has no longer term Emergency Liquidity Assistance (ELA) available to assist individual banks facing liquidity problems and banks therefore currently resort to the interbank market for longer-term liquidity needs. This increases the risk of systemic crisis, if the borrowing bank runs into unresolvable financial difficulties.

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47 CBN (n 15) 8.

48 *ibid,* 9 – 15.

49 *Sections 29(1) and 42(2) of the CBN Act 2007.*

The third issue is whether regulatory institutions (CBN and NDIC) in Nigeria have the requisite *powers and legal basis* to speedily rescue and where necessary wind up insolvent banks. Generally, it is hardly possible to find a financial regulatory system where statutory schemes of arrangement can be done in less time even for insolvent financial institutions. Still, one impression from the crisis of 2008-09 is that the Nigerian financial system requires a robust and bespoke insolvency resolution, winding up and scheme of arrangement framework that specifies clearly how to speedily and effectively resolve, wind up, merge or sell insolvent financial institutions. For instance, the absence of this framework during the crisis meant that in the case of schemes of arrangement implemented for some ailing banks, the CBN and NDIC followed general company law requirements under the *Companies and Allied Matters Act* relating to shareholders' right to vote (adhering to the 21 day notice period for convening a general meeting of shareholders) and a requirement for court sanction, all of which added to the duration of scheme of arrangement. During this process, there were also several legal actions which mostly challenged the authorities' powers and the legal basis for certain intervention measures. Most common were challenges by individual directors on the power of CBN and NDIC to sanction their removal from the intervened banks and challenges by shareholders in relation to the measures adopted by the CBN in the recapitalisation of banks.

The fourth and arguably most poignant issue relates to the *moral hazard* question in Nigeria's current approach to systemic crisis management, in terms of resolution of non-performing loans (NPLs). The Asset Management Corporation of Nigeria (AMCON) was set up to resolve the problem of NPLs, but without clear timelines and cut-off date as though it will exist *ad infinitum*. The absence of a cut-off date for AMCON appears to have created a moral hazard issue that public solvency support will always be available for imprudent banking operations.[50]

1.3.4 The Problem of Piecemeal Reforms

The foregoing amply demonstrates that Nigeria's extant financial regulatory framework exhibits significant deficiencies and thus is unable to address the root causes of the country's financial system collapse. As such, if Nigeria is to effectively anticipate and prevent future financial system collapse, a starting point would be a holistic reform of extant legal and institutional framework to make them more proactive, anticipatory and effective. Previous scholarly studies have taken a piecemeal approach to this question.[51] These studies are of course to be

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[50] S. Omanufeme, 'IMF Recommends AMCON's Liquidation to Curb Moral Hazard' 2 April 2013, BUSINESSDAY, 1.

[51] Ogowewo and Uche (n 30) 161 (arguing for a Nigerian version of the UK FSA and the reform of CBN's power to raise banks' minimum capital requirements); Apati (n 28) Chapter 8 (focussing on more on governance reforms); Nwude (n 26); Ikebudu, 'Mismanagement of Emerging Stock Markets: Analysis of the Role Played by "Legislative Infidelity" – a Norm of Int'l Economic Jurisprudence – in the N 8.1trilion ($60bn) Crash of Nigerian Stock Market'

commended for their independent analytical inquiries into the causes of and solutions to perceived issues in the Nigerian financial regulatory system; and even more commendable is the fact that they provide a helpful starting point for the present effort. Nevertheless, the danger in the piecemeal approach is that focus on discrete regulatory issues (i.e. bank capital, 'legislative fidelity' and regulatory politics among others) alone may distract us from appreciating the broader (particularly legal) context of the regulatory crisis which has for long confronted the financial system.

This research discusses the pathways to 'effective regulation' of the Nigerian financial system. It argues that 'effective regulation' does not emerge from piecemeal 'tide-the system-over' reforms, not from an academic 'pitch and toss' of principles, rules and institutions in the guise of modernisation. Nor does it emerge from a parochial focus on a seeming illusory comparative and descriptive 'importation' of institutional models, which overlooks the deep and often irreconcilable experiential divergences that exist across national financial regulatory contexts, including specifically, the undeniable differences in the level of financial market sophistication that exists across the advanced and developing countries divide. It adopts an approach that conceives 'effective regulation' for

(PhD thesis, Golden Gate University 2011) 240 - 44 (focusing on the reform of statutory provisions which regulate the capital market).

Nigeria in terms of structuring new and sound regulatory principles and institutions that would have a nuanced awareness of the country's practical realities, developmental stage and with the benefit of pertinent regulatory lessons from comparator jurisdictions. It focuses on how the proposed reforms could avoid the problem of regulatory lapses falling between 'two stools' and how to imbue the new dichotomised regulators with operational independence.

In all, the ultimate contribution of this thesis will be to answer the question of how? That is, how can legal and institutional frameworks be reformed and reinforced in Nigeria to anticipate and prevent financial system collapse. To answer this we would discuss the pre-requisites, paradoxes, pitfalls and prospects of adopting of an objectives-based triple peaks financial regulatory model as a normative framework for reforming extant legal and institutional frameworks in Nigeria to make them more anticipatory, robust and effective.

The next section presents the research questions.

1.4 RESEARCH QUESTIONS

Generally and within the framework of the points articulated in sections 1.2 and 1.3 four broad questions shall guide the narrative and analytical framework of this thesis—narrative in terms of presenting the research's justificatory and causal arguments and analytical in terms of a critical appraisal of the prophylactic strategies to be propounded herein. The four research questions are as follows:

1. What are the financial regulatory issues responsible for and accentuated by the Nigerian financial crisis of 2008-09?

2. How can the Nigerian financial regulatory framework be reformed to address these issues, including the question of supervisory negligence implicated in the crisis of 2008 – 09, through the adoption of an objectives-based triple peaks financial regulation?

3. How could comparative financial regulatory and reform lessons from jurisdictions such as Canada, Malaysia, United States of America and United Kingdom feed into the reforms anticipated for Nigeria?

4. What are the benefits, paradoxes and pitfalls of adopting an objectives-based triple peaks financial regulation; and how should they be addressed?

Four reasons explain why we have chosen to focus on these four questions? Question 1 establishes the factual context of the research and builds on the narrative in section 1.3 above.

Question 2 links the factual context to the reform proposals and strategies to be canvassed later in the thesis, and in particular the advocacy for the implementation of an objectives-based triple peaks financial regulatory architecture in Nigeria. Question 3 places the research in a comparative context and provides a framework to draw from financial regulatory reforms and lessons from countries with shared economic, legal, linguistic, political and regulatory affinities with Nigeria. Question 4 provides the framework for a critique of the reforms proposals and strategies to be canvassed in the research as well as a platform to present a forward looking strategy to strengthen the responsiveness of Nigerian objectives-based triple peaks financial regulation to the generally acknowledged 'historical inevitability' of financial crises.

The next section discusses the methodologies to be used in the research.

1.5 RESEARCH METHODOLOGY

Three research methodologies are proposed for this research: historiography, content analysis, and comparative analysis. Historiography is used for the study of written history.[52] It will be used to analyse the history of the Nigerian financial system and relevant historical facts relating to the financial system of comparator countries. Content analysis is used for the study of human communications, books and laws.[53] In this thesis, a thematic content analysis will be used to evaluate relevant materials (i.e. laws, rules, polices, and textual sources). Comparative legal analysis is used for the study of legal systems. It will be used to evaluate the effectiveness of the financial regulatory framework in Nigeria and the comparator countries: including in particular how Nigeria can learn from the Canadian and Malaysian financial regulatory experience, and the recent financial crises and subsequent regulatory reforms in the United States of America and United Kingdom.

Canada, Malaysia, the United States of America and United Kingdom have been selected as comparator countries for seven reasons. First, Malaysia and Nigeria are generally acknowledged to be developing economies.[54] Second, Malaysia implemented a financial sector consolidation post 1998, which was not followed by a financial

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52 M Bentley, *Modern Historiography, An Introduction* (London: Routledge, 1999) ix – x.

53 E Babbie, *The Practice of Social Research,* 10th Edition (Thomas Learning Inc., 2010) 3.

54 See World Bank, *List of Economies* (July 2014) available online at: http//www.lawp.org/joinlawp/countrylist.htm accessed on 10 March 2015.

crisis.[55] In comparison, Nigeria implemented a financial sector consolidation in 2005 which was followed by a financial crisis in 2008, though we do not propose to blame the consolidation totally for the crisis. Third and relatedly, the Canadian and Malaysian financial systems are generally acknowledged to have withstood the 'shock wave' of the 2007 GFC. The GFC as it is generally acknowledged 'critically battered' the UK and US financial regulatory systems. The two countries have since instituted regulatory reforms which are in most respect specific to their national contexts, but some of which could be modified to guide similar reforms in a developing country such as Nigeria. Moreover and arguably as a form of shared economic adversity, the GFC is viewed as one of the causes of the Nigerian financial crisis of 2008 to 2009.[56] Fourth, Nigeria has since adopted the Malaysian model of an asset management corporation.[57] Fifth, functional regulation as practised in Nigeria is considerably influenced by a similar approach in United States of America. For instance, the Nigerian CBN, SEC, and NDIC are modelled after the US Federal Reserve System, the Securities and Exchange Commission and Federal Deposit Insurance Corporation. Sixth and following the GFC, functional financial regulation is now adjudged to be ineffective

[55] U. Kama, 'Bank Post-Consolidation Issues and Challenges in Malaysia and India: Lessons of Experience for Nigeria' (2007) vol. 31, No. 4 *Bullion* 35.

[56] Nwude, (n 26) 109 – 10.

[57] D. Alford, 'Reform of the Nigerian Banking System—Asset Management Corporation of Nigeria (AMCON) and the Recent Developments [2011] 3 – 5, available at: http://ssrn.com/abstract=2006057 accessed on 15 May 2012.

for the prevention and anticipation of financial crises.[58] The US financial regulators are to be restructured in accordance with the goals of financial regulation.[59] As a seventh reason, Canada, Malaysia, Nigerian, and the US, are Anglophone federal states, which together with the UK are members of the common law legal system.[60]

The next section examines the academic context and presents aspects of the literature that are relevant to this research.

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58 J. Coffee, Jr. and H. Sale, 'Redesigning the SEC: Does the Treasury have a Better Idea? (2009) 95 *Va. L. Rev.* 707, 717 – 21.

59 The US Department of the Treasury, *The Blueprint for a Modernised Financial Regulatory Structure* (2008) Chapter VI, 137 – 82.

60 The common law legal systems under reference are those countries within the Anglo-American common law family, which is larger than and incorporates both the American common law and the English common law jurisdictions. See for classification of legal systems in the context of regulatory comparison: P. Wood, 'How to Compare Regulatory Regimes,' (2007) vol. 2, No 4, *Capital Markets Law Journal* 333 – 335.

1.6 Academic Context and Aspects of Relevant Literature

This research situates itself within the debate on what the ideal or effective financial regulatory model is—the question on whether a functional financial regulation,[61] consolidated financial regulator,[62] or twin peaks financial regulation,[63] provides the most effective regulatory model. Essentially, the debate is between the proponents of a single financial regulator and the proponents of multiple financial regulators. The research aligns with the latter.

Briefly, the proponents of a single financial regulator rely on five aggregate arguments. The first is the *convergence argument* according to which a blurring of the distinctions among banks, investment firms, insurance companies and other financial services providers has added to the complexity of financial regulation, increased the cost and reduced the effectiveness of supervision, thus necessitating a single regulator.[64] The second is the *overlap argument*, which argues that overlap of prudential and conduct of business regulatory objectives supports the case for a single regulator in resolving, efficiently and effectively

61 The institutional segregation of financial regulation according to the branches of the financial system i.e. banking, insurance and securities, as practised in Nigeria and United States of America.

62 The consolidation of financial regulation in one agency in the United Kingdom was abolished in April 2013.

63 The establishment of two financial regulators in accordance with the goals of financial regulation, such as now practised in the UK from April 2013.

64 C. Briault, 'The Rationale for a Single Financial Service Regulator,' (1999) FSA *Occasional Paper Series, No. 2,* 25.

situations in which objectives could come into conflict.[65] The third is the *competition in laxity argument.* This argues that a multiple regulators model could encourage financial intermediaries to exploit the competition among regulatory and cherry pick regulators with the most accommodating approach.[66] The fourth is the *administrative convenience argument,* which states that a single regulator would result in a single administrative entry point, for regulated financial services providers, where information submitted for one purpose would not be duplicated, but serve all regulatory purposes.[67] The fifth is the *holistic regulation argument*, according to which the emergence of financial conglomerates requires a regulatory oversight because '[m]any of the threats to solvency of the institution can be addressed on group-wide basis.'[68]

The proponents of multiple financial regulators rely on six major arguments. The first is the *objectives oriented argument,* which posits that to enhance effective regulation, financial regulatory institutions should be designed in accordance with the

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65 E. Ferran, 'Examining the United Kingdom's Experience in Adopting the Single Regulator Model,' (2002-2003) 28 *Brook. J. Int'l L.* 257, 277-301.

66 'Competition in laxity' was coined by former US Federal Reserve Chairman, Arthur Burns, in the 1970s: C. Felsenfeld and D. Glass, *Banking Regulation in the United States'* Third Edition, (New York: Juris Publishing, 2011) 49; E. Ferran, 'The Break-up of Financial Services Authority,' (2011) *OJLS* 1, 11 (she argues further that information flows between the multiple regulators could be sub-optimal and the model merely externalises rather than eradicate the potential for conflict between different regulatory objectives).

67 E. Wymeersch, 'The Structure of Financial Supervision in Europe about Single Twin Peaks and Multiple Financial Supervisors,' 20 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=946695> accessed on 15 May 2012.

68 Briault (n 64) 14.

goals of financial regulation.[69] The second is the *economy of scale argument,* which contends that savings in resources would result from the limited regulatory consolidation than having a fragmented structure.[70] The third is the *conflict argument,* which states that the combination of supervision with lender of last resort in a central bank can be misused to cover up regulatory failure.[71] The fourth is the *mismatch argument* according to which the combination of prudential regulation, consumer protection and market conduct in a single regulator is not practicable because the three require different skills set and approach.[72] The fifth is the *inefficiency argument,* which is to the effect that a single regulator model would strain the resources available to one organisation and generate inefficiencies.[73] The sixth is the *competition argument*. This contends that multiple regulators create opportunities for competition in ideas.[74] This thesis aligns with the arguments of the proponents of multiple financial regulators. It also aligns itself with the post 2007 GFC assessment by the Organisation for Economic Corporation and

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[69] The US Department of the Treasury, *Blueprint for a Modernised Financial Regulatory Structure* (March, 2008) 143.

[70] M. Taylor, 'The Road from "Twin Peaks" – And The Way back' (2009) 16 *Connecticut Insurance Journal* 61, 74.

[71] J. Norton, *Financial Sector Law Reform in Emerging Economies* (London, 2002) p. 102; C. Goodhart and D. Schoenmaker, 'The Institutional Separation Between Supervisory and Monetary Agencies,' in *The Central Bank and Financial System* (1995) 341.

[72] Sir Mervyn King, speech at Lord Mayor's Banquet, (2010) <http://www.bankofengland.co.uk/publications/speeches/2010/speech437pdf> accessed on 15 May 2012; Taylor (n 70) 89 – 90.

[73] Taylor (n 70) 88 – 9.

[74] J. Barth, D. Nolle, T. Phumiwasana and G. Yago, 'A Cross-country Analysis of the Bank Supervisory Framework and Bank Performance,' (2003) 12 *Financial Markets Institutions & Instruments,* 70 – 3.

Development (OECD), which adjudges a multiple regulators approach as the sound model for financial market supervision.[75]

Further and in considering the desirability or otherwise of drawing best practices from comparator countries that have had more stable or efficient financial systems, this thesis will examine the logic of legal transplants as propounded in the legal transplant theory of international comparative law. This theory discusses the borrowing or transfer of legal models, laws and best practices from one country to another. It will examine the contentions of the three schools—the Watson School ('the transferists');[76] Pierre Legrand School ('the culturalists');[77] and Otto Khan-Freund School ('the middle ground theorists').[78]

The next section presents the structure of the thesis.

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[75] OECD, *The Financial Crisis: Reform and Exit Strategies* (Paris: OECD, 2009) p.18. Notably, the OECD is against central bank involvement in supervision because of conflict of interest.

[76] A. Watson, 'Legal Transplants and Law Reform,' (1976) 92 *LQR* 94.

[77] P. Legrand, 'Against a European Civil Code,' (1997) 60 *MLR* 44.

[78] O. Kahn-Freund, 'Uses and Misuses of Comparative Law,' (1974) 37 *MLR* 1; G. Teubner, 'Legal Irritants: Good Faith in British Law or How Unifying Law Ends up in New Divergences,' (1998) 61 *MLR* 11.

1.7 STRUCTURE

This research is structured into eight chapters inclusive of this introductory chapter. Each of the remaining seven chapters shall focus on the separate sub-themes comprised in the research, but they are all part of a linked narrative on the problems and reform of financial regulation in Nigeria. A summary of each of the remaining seven chapters is provided below.

1.7.1 Chapter Two

This chapter articulates the factual justification for embarking on this research, as a crucially prefatory task before a closer analysis, in succeeding chapters, of the institutions and strategies comprised in the proposed objectives-based triple peaks financial regulatory structure. The chapter discusses the perceived regulatory issues, in terms of how the relevant statutory provisions in the *BOFIA, NAICOM Act, ISA, Insurance Act, CBN Act* and *NDIC Act,* relating to financial system stability, consumer protection, market integrity and financial market competition are structured and implemented. Second, the chapter considers how best to respond to these issues in terms of the pros and cons of a piecemeal regulatory reform or a complete redesign of the regulatory architecture combined with the implementation of certain regulatory principles and strategies, which are consistent with an objectives-based triple peaks financial regulatory approach.

1.7.2 Chapter Three

This chapter presents the theoretical underpinning of the objectives-based triple peaks financial regulatory approach. First, it situates the research within a public interest theory of financial regulation. Second, it connects public interest theory with four financial regulatory objectives, which are: financial system stability, consumer protection, financial market integrity, and financial market competition. Third, it examines the recognised regulatory approaches for the implementation of these objectives (i.e. functional and (or) institutional financial regulation, integrated and or consolidated financial regulation and twin peaks financial regulation). It shows that why none of the approaches provides the best fit for the Nigerian regulatory context. Fourth, the chapter articulates the reasons why an objectives-based triple peaks financial regulation best fits the Nigerian context.

1.7.3 Chapter Four

This chapter draws regulatory lessons from the US (2007-08), UK (2007-08), Canadian (2007-08) and Malaysian (1997-98) financial crises. The lessons are meant to strengthen the advocacy for the implementation of an objectives-based triple peaks financial regulatory structure in Nigeria. The lessons discussed here include the need to position the Finance Minister as the chief regulatory coordinator for the financial system; the need to prevent regulatory competition among the proposed triple peaks regulators; the need for an effective framework to regulate financial innovation; a policy on how Nigeria's treaty commitments can impact domestic financial regulation; and the need to regulate the flow of short term foreign speculative capital which can induce currency crisis and (or) stock market crash.

1.7.4 Chapter Five

This chapter continues the thread of strengthening the implementation of an objectives-based triple peaks financial regulation in Nigeria. It focuses on the question of how best to devise an effective regulatory accountability mechanism to forestall and (or) remedy, the recrudescence of supervisory negligence, such as was implicated in the crisis of 2008-09. The chapter's analysis is sequenced under four rubrics. The first rubric considers the effectiveness of four accountability control instruments (parliamentary accountability, ministerial accountability, market based accountability, financial accountability, and judicial accountability) in the Nigerian context and argues for the use of judicial accountability. The second demonstrates the absence of a universal consensus to preclude imposition of negligence liability on financial regulators and shows the position under Malaysian, Nigerian, UK and US law. The third interrogates the arguments against the imposition of this liability. The fourth defends its imposition in the Nigerian context.

1.7.5 Chapter Six

This chapter presents the first in the two levels of the reform proposals under the objectives-based triple peaks financial regulation.[79] It articulates the normative regulatory framework, which underpins the advocacy for the adoption of an objectives-based triple peaks financial regulation in Nigeria. This is in terms of how the principles and institutional configuration comprised in the proposed financial regulatory architecture can and should be implemented, to achieve a more effective approach to financial system stability, financial consumer protection, market integrity and financial market competition. It proposes prophylactic countermeasures to the regulatory issues discussed in chapters 1 and 2. These countermeasures in turn operationalise the theoretical framework constructed in chapter 3 and move the research closer to its conclusion.

1.7.6 Chapter Seven

This chapter presents the second and complementary level of the reform proposals and strategies comprised in the advocacy for the adoption of an objectives-based triple peaks financial regulation in Nigeria. First, it addresses the potential pitfalls and paradoxes in the reforms, ideas and strategies canvassed in chapters 4, 5 and 6. Second and to enhance the prospects of the proposed regulatory framework, it engages with three arguably universal

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[79] The two levels of the reforms are, the normative principles, strategies and institutional regulatory structure (chapter 6), and the strategies for strengthening the proposed regulatory framework (chapter (chapter 7).

concerns in financial regulatory reform, regardless of whether the context of the reform is an emerging or an advanced market namely: (a) the inherent fragility of the financial system (the perpetually risk prone business operations—asset and liability mismatch—of financial intermediaries; (b) the political economy of financial regulation and a regulatory sine curve under which a period of rigorous regulatory scrutiny after a financial crisis is followed by increasing relaxation of the rules and typically capture of the regulator (or at least to some degree) by the industry and (or) vested interests outside the industry; and (c) the cognitive limitations on the ability of both private gatekeepers (i.e. the financial press) and public regulators to perceive new financial system risks accurately, before it is demonstrably too late.

1.7.7 Chapter Eight

This chapter concludes the advocacy for the implementation of an objectives-based triple peaks financial regulation in Nigeria. It summarises the proposals canvassed in the thesis, in terms of the normative principles and strategies for the actualisation of this regulatory framework. It also identifies issues, which can form the basis of further research.

1.8 CONCLUSION

This introductory chapter has laid out the thesis' contextual and structural framework, in terms of its Nigerian factual background; guiding questions; methodology; academic context and relevant literature; significance and contribution; and structure. The succeeding seven chapters would add flesh to the framework laid out herein. They shall develop, defend and close the advocacy that objectives-based triple peaks financial regulation matched with other sound regulatory principles and strategies is a viable and more effective financial regulatory framework for Nigeria.

CHAPTER TWO

THE CASE FOR FINANCIAL REGULATORY REFORM IN NIGERIA

2.1 INTRODUCTION

This chapter articulates the case for financial regulatory reform in Nigeria. It discusses extensively the second of the three causal manifestations of financial regulatory crisis in Nigeria that we analysed in Chapter 1. In so doing, the chapter completes the discussion on the factual justification for embarking on this research. Equally, and seen within the chain of sub-themes comprised in the research, the reform case this chapter articulates prefaces the discussion (in chapters 3, 4, 5, 6 and 7) of the theoretical, comparative, accountability and normative regulatory underpinnings of the advocacy for the implementation of an objectives-based triple peaks financial regulation in Nigeria.

The chapter uses a cause-effect approach. It argues that *regulatory* (structural and statutory) *deficiencies* in Nigerian functional financial regulation and financial *supervisory failure* are two primary reasons for the inability of the financial regulatory system to effectively address past cases of banking insolvencies and collapse of financial institutions in Nigeria and to detect and prevent the crisis of 2008-09. It argues that the two causalities can be addressed effectively by a holistic reform of the financial regulatory framework and a redesign of the regulatory architecture and not by piecemeal reforms.[1] To develop

[1] Deficiencies describe the ineffectiveness and inefficiencies in the implementation of financial regulatory objectives. Supervisory failure is an incidence of ineffective enforcement and (or) non-enforcement of regulatory norms attributable substantially to weak regulatory

and defend this argument this chapter first discusses the deficiencies and failure in the implementation and enforcement of financial system stability, consumer protection, market integrity and financial market competition. Second, the chapter considers how best to respond to these issues in terms of the pros and cons of a piecemeal regulatory reform or a complete reform of the regulatory architecture.

The foregoing discussion is organised into three sections. This introduction is the first. The second section discusses the deficiencies in the current functional regulatory framework in Nigeria. The third section concludes the chapter.

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accountability. The financial regulatory framework describes the statutory aspect and financial regulatory architecture describes the institutional aspect of the financial regulatory system.

2.2 STRUCTURAL DEFICIENCIES AND SUPERVISORY FAILURE IN NIGERIAN FINANCIAL SYSTEM

The general and specific financial regulatory issues discussed in chapter 1 are the first and third levels of the 'crisis' of financial regulation in Nigeria. The second level and the focus of this section is how regulatory deficiencies and supervisory failure have substantially impeded the emergence of an effective financial regulatory system in the country. The arguments and evidence that we would present demonstrate that this second causal manifestation occurred prominently in the regulatory space between the implementation of the Nigerian financial consolidation programme in 2005 and the financial crisis of 2008-09.

It is generally acknowledged that financial regulation aims to accomplish four connected objectives namely: financial system stability; financial market integrity; a fair financial market competition; and consumer financial and investor protection. Depending to a large extent on the national regulatory context, financial regulation can also accomplish other objectives such as the prevention of financial crimes and enhancement of economic development. However, in this chapter and generally in this thesis we would focus on the four objectives for two reasons. Most financial systems tend to focus on these four objectives.[2] A

[2] See generally on this: *Chapter 1B(3)(b) and 1D of the Financial Services and Markets Act* (FSMA) 2000 of the United Kingdom (as amended by *Financial Services Act of 2012*); *Directive 2003/71/EC* recital (10) and *Directive 2004/39/EC* ('MiFID'), recital 44 of the European Union; *Sections 33, 34 and 40, National Securities Market Act 1996* of the United

focus on the four objectives would enhance the clarity of the thesis' overall framework. The four sub-sections that follow immediately below develop this argument in a four-step analysis namely: what are the justifications for the four objectives of financial regulation; how are they implemented in Nigeria; what are the perceived deficiencies in their implementation; and, what could be done to remedy these deficiencies?

2.2.1 Financial System Stability Regulation In Nigeria

In general, financial system stability regulation focuses on the safety and soundness of the financial system particularly with regards to the monitoring of those factors that can impair the well functioning of a country's financial services industry. As an objective of financial regulation, it has two key justifications. The first is micro prudential financial stability: to ensure the health, safety and soundness of a financial intermediary; to prevent its collapse; and to prevent bank runs in the case of deposit money institutions. The second is macro prudential financial stability with focus on the health, safety and soundness of the entire financial system to prevent the risk that the collapse of one financial intermediary could precipitate the collapse of others. Most countries use prudential rules, systemic risk

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States of America; *Section 13 (n), (aa) of the Nigerian Investment and Securities Act, 2007*; D. Llewellyn, 'The Economic Rationale for Financial Regulation' (FSA Occasional Paper, April 1999) 32-33; K. Spong, *Banking Regulation: Its Purposes, Implementation and Effects,* Fifth Edition, (Kansas City: Division of Banking Supervision and Risk Management, Federal Reserve Bank of Kansas City, 2006) 5 – 10; G. Benston, *Regulating Financial Markets: A Critique and Some Proposals* (Institute of Economic Affairs, 1998) 6; R. Dodd, 'The Economic Rationale of Financial Market Regulation,' (2002) *Special Policy Report 12* of the Financial Policy Forum available online at: <http://www.financialpolicy.org/fpfspr12.pdf> accessed on 24 August 2012.

countermeasures and deposit insurance among other regulatory measures to stabilise their financial systems. [3]

The implementation of financial system stability in Nigeria is partly *centralised* and partly *functionally fragmented*. We would argue later in this chapter that this arrangement creates deficiencies in the sense of a *duplicative* financial regulation and *a regulatory blindside* in which systemic risks might spillover across banking, insurance and securities sectors might be difficult to perceive early. For now and in terms of centralisation, one of CBN's statutory objects is to promote a sound financial system in Nigeria. [4] Whether the CBN has performed this object effectively is questionable not least because the recurring incidents of banking insolvencies in Nigeria before the crisis of 2008-09 and the occurrence of the crisis itself arguably speak to a deficiency in the safety and soundness of the Nigerian financial system.[5]

Notably (and indeed commendably) the CBN has since 2010 been publishing twice yearly a Financial Stability Report (FSR). This is meant to enhance systemic stability surveillance.

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3 See generally the sources cited in (n 2) *ibid*. Macro prudential stability should be distinguished from macro economic stability which relates to the concern for the stability of a country's economy. Central banks fulfill this objective through control over currency supply, interest rates, and settlement systems.

4 The other objects are to: ensure monetary and price stability; issue legal tender currency in Nigeria; maintain external reserves to safeguard the international value of the legal tender currency; and act as a banker and provide economic and financial advice to the Federal Government: *section 2* of the *CBN Act, 2007.*

5 For a concise background on banking insolvencies in Nigeria before 2008, see: T. Ogowewo and C. Uche, '[Mis]Using Bank Share Capital as a Regulatory Tool to Force Bank Consolidation in Nigeria' (2006) 50(2) *Journal of African Law*, 161 at 166 – 70.

Assuming *arguendo* that this is the case; it is a measure that has at least three weaknesses. *First*, the FSR coverage is limited to banking, securities and insurance. It does not cover the pension system. Yet this system and the private pension industry in financial size and business volume ought to be categorised as *systemically significant* and thus included in the FSR's coverage.[6] *Second* and given that securities and insurance regulation are outside CBN's remit, the quality and depth of the information on these sectors that are included in the FSR depend largely on what the other regulators (SEC and NAICOM) are willing to share with the CBN. They would conceivably, be less willing to release information that would expose their supervisory shortcomings. *Third*, the FSR's approach to macro prudential stability is *narrow and descriptive* in that it relies on five qualitative measures of systemic risk (credit risk; liquidity risk; interest rate risk;

6 There is evidence to support this view. Before the crisis of 2008 – 09 which spurred the publication of the FSR: the total pension fund assets under the contributory pension scheme stood at N1.098 trillion out of which it exposed ₦430.98 billion or 39.22 per cent to the banking sector, in both equities and money market instruments. These assets are mostly managed by licensed Pension Funds Administrators (PFA, which are 26 in total and administering 26 retirement saving accounts, RSA). In the public sector, the annual pension contributions grew from ₦70.25 billion in 2007 to N99.28 billion in 2008, which represented a growth of 41.32 percent. Similarly, private sector contributions grew from ₦68.34 billion in 2007 to ₦80.81 billion in 2008, representing an increase of 18.25 percent. Approximately, ₦10 – 12 billion of new contributions flow into the system every month. At the end of 2011, the PFA assets account for 22 percent of the market capitalisation of the Nigerian Stock Exchange, 62 percent of banks capitalisation and 1357 percent of the insurance sector capitalisation: See generally, IBRD, *Making Finance Work for Nigeria* (Washington D.C.: World Bank, 2009) 92 – 103; See also T. Omilani, 'PenCom Asset Hits Over ₦4.5trillion In 2014,' available online at: <http://leadership.ng/business/388762/pencom-asset-hits-n4-5trillion-2014> accessed on 18 November 2014; O. Ugochukwu, 'Nigerian: Pension Funds, Insurance Companies and the Changed Equity Markets,' available online at: < http://www.afigfunds.com/sites/default/files/Panel3_Obi_Ugochuku(VA).pdf> accessed on 12 July 2014.

exchange rate risk; and foreign exchange trading risk) that are designed majorly for banks.[7]

CBN' financial system stability remit is further reflected in its management of systemic stability.[8] Even here, there are perceived deficiencies. For instance and due to the fact that monetization of the country's crude oil export and other oil-related inflows are the primary sources of liquidity in the Nigerian financial system; the CBN has often relied heavily on foreign exchange sales to sterilize systemic liquidity.[9] This approach still constitutes a veritable avenue for illicit arbitrage profits for some financial intermediaries through foreign exchange malpractices.[10] CPR, the other instrument the CBN uses for systemic liquidity management, has in the past created regulatory confusion.[11] For instance, the market misread CBN's

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7 CBN, *Financial Stability Report December 2013* (Lagos: CBN Research Department, 2013) 35 – 45.

8 *Section 2* of the *CBN Act, 2007.*

9 Most of the forex operations are conducted through the bi-weekly auctions offered via the Wholesale Dutch Auction System (WDAS) with published quarterly indicative targets: See the CBN website, available at: < http://www.cenbank.org> accessed on 12 July 2014.

10 See for support, the following online news reports: <http://www.nigerianbulletin.com/threads/cbn-releases-names-of-20-sanctioned-forex-operators.8297/> accessed on 13 November 2014; B. Komolafe, '3 banks face CBN sanctions over forex scams,' *Vanguard,* 3 August 2009 available online at: < http://www.vanguardngr.com/2009/08/3-banks-face-cbns-sanctions-over-forex-scam/ > accessed on 13 November 2014.

11 The CPR uses the Monetary Policy Rate (MPR) as the target for monetary policy. The CBN Monetary Policy Committee, sets an interest rate corridor of MPR ± 2 percent points as the tolerable margin for the Open Buy Back rate. At times, the CBN uses asymmetric corridor around the MPR, particularly in the aftermath of the 2008 – 09 Nigerian financial crisis. Other instruments are in use as well either to manage structural or short-term liquidity. Four instruments are used for structural liquidity namely: Cash Reserve Requirements (CRR), which is mostly unremunerated and measured on a daily average of reservable liabilities over a two-week period; quarterly auction of Federal Government Treasury Bills (NTBs) and bonds, by the Debt Management Office (DMO) and the CBN; sale of CBN Bills when additional sterilization is required; and sale and purchase of foreign exchange. Four instruments are similarly used for short-term liquidity namely: the Standing Deposit Facility (SDF) with which the CBN accepts

signal on the changeover from the MPR to the SDF rate in 2011, while the CBN later confirmed the MPR as the applicable rate.[12] These issues point to the need for a streamlined systemic liquidity management and for a clear and prompt communication of related regulatory changes to the market. Of course given the different timeframes there is an arguable case for a flexible systemic liquidity management and the use of mixed systemic toolkits for this purpose. Still, our case is that this flexibility needs to be communicated to the market clearly.

Functional fragmentation of financial system stability regulation is reflected in the provisions of *BOFIA, ISA, Insurance Act* and *NAICOM Act*. These laws are *duplicative* when they are reduced to the ultimate prerequisite tools (such as regulatory intervention, financial stabilization powers and liquidation of insolvent intermediaries) for systemic stability. For instance, *BOFIA;*[13] *NAICOM Act;*[14] and *ISA*[15] contain identically worded provisions which empower the CBN, SEC and NAICOM to stabilize; control; manage; liquidate; and where necessary merge

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an unlimited amount from banks on an overnight basis; the standing lending facility, which is available to all banks and discount houses upon application; repos/reverse repos, which are used to manage liquidity for a few months (repos are used to mop up liquidity and reverse repos are used to inject liquidity; and lastly, deposit auctions, where banks can bid for deposits at the CBN. See generally CBN (n 9).

12 *ibid*.

13 *Sections 35 – 42, BOFIA*. In practice, and with respect to insured banks, the CBN exercises its powers under these provisions in conjunction with NDIC, which is usually appointed as the liquidator of a failed bank. See generally, *sections 38 – 44* of the *NDIC Act*. It is worth noting that the Act also empowers the NDIC to administer the deposit insurance fund whose main goal is to prevent bank runs.

14 *Sections 41 – 46, NAICOM Act.*

15 *Sections 48 – 53, ISA 2007.*

failing financial institutions. These powers we argue can more efficiently and effectively be assigned to and exercised by a regulatory institution that focuses solely on systemic stability.

The existence of a dedicated systemic stability institution would eliminate duplicative regulation in this context. It would also imbue systemic stability regulation with a broader and truly systemic focus which could in turn engender a better appreciation of what regulatory intervention in one sector of the financial system might cause for other sectors. For instance, when the CBN forcibly assumed the management of the eight insolvent banks in 2009, it effectively and no less controversially assumed control of (at least in the case of Oceanic Bank Plc., Union Bank Plc., Afribank Plc., and Intercontinental Bank Plc.) investment banking conglomerates whose securities and insurance subsidiaries were subject respectively to SEC's and NAICOM's regulatory remits. Thus far, we were unable to establish the extent to which the CBN coordinated the intervention with SEC and NAICOM at the planning stage. Of course, the absence of this evidence does not necessarily mean that there was no coordination, but anecdotal evidence obtained from commentators on the intervention and from CBN, SEC and NAICOM officials suggests that the intervention was entirely a CBN affair with support from the NDIC and EFCC.

Another deficiency and a critical indictment of the current approach to systemic stability relates to *regulatory 'blindside'* and the related complication in perceiving, measuring and preventing risks spillovers across the entire financial system. It is a critical indictment because it is one key reason why the CBN failed to see the crisis of 2008-09 coming;[16] and if not effectively remedied could constitute a creeping vulnerability for another systemic financial crisis. To regulate financial system stability as we presently do in Nigeria, in terms of functional designation of a financial intermediary (as a bank, insurer, or capital market operator) creates 'regulatory silos;' it 'blinds' a functional regulator from risks that may arise from outside its remit; it creates opportunities for risks to spill from one functional sector to others; it requires constant but almost always wasteful regulatory duplication and coordination to mount an effective response to the systemic risks; and, what is more, it is now seen as an ineffective regulatory approach under international best practices.[17]

It can of course be argued that with the regulatory developments post 2009 (reflected particularly in the

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16 S. Sanusi, 'The Nigerian Banking Industry: What went wrong and the way forward,' (2010) Research Department, Central Bank of Nigeria, 9, available online at: < http://www.bis.org/review/r100419c.pdf?frames=0 > 9 – 10, accessed on 15 May 2012 (providing an insider account that the CBN's inability to receive reports from the SEC which regulates banks' capital market subsidiaries before the crisis of 2008 – 09 impaired its perception and response to the subsequent risks spill over from the capital market to the banking system).

17 We shall discuss and apply the current best practice in this area in chapter 6, but for a preview see M. Brunnermeier et al, *The Fundamental Principles of Financial Regulation: Geneva Reports on the World Economy 11* (Geneva: International Centre for Monetary and Banking Studies, 2009) 25 – 8.

rejuvenation of the FSRCC)[18] that a regulatory blindside of systemic stability is less likely to recur.[19] This we argue is a beguiling invitation to a risky regulatory complacency. It is risky and complacent because this argument invites us to rely on ad-hoc and piecemeal reforms—motley of 'knee jerk' and token redresses of perceived regulatory lapses—for long-term financial system stability in Nigeria. It should be stressed here that a reliance on these reforms constitutes in reality a reliance on the current regulatory model—a model that has failed in the past; and whose future effectiveness, measured from this past failure is doubtful.

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18 This is the committee that is meant to facilitate inter-agency coordination under the auspices of the CBN for the purposes of systemic stability. It exists pursuant to *sections 43 and 44* of the *CBN Act*. The FSRCC did not meet for two years before the crisis of 2008 - 09; and the eventual resolution of the crisis was largely done by the CBN: Sanusi (n 16). Moves have since been made to rejuvenate and strengthen the committee. It now has a separate website that is web-linked to the CBN website. It has issued new rules on margin trading. See, CBN, 'Press Release: Financial Services Regulation and Coordination Committee Issues New Rules on Margin Trading' (2010) available online at: < http://www.fsrcc.gov.ng/the-cbn-and-sec-agree-to-jointly-issue-rules-on-margin-lending.html> accessed on 19 July 2013.

19 These developments include: intervention in eight insolvent banks and injection of N620 billion ($4.1 USD) as unsecured and unsubordinated debt; a guarantee of interbank and foreign credit lines of banks until the end of 2011; a public commitment by the CBN to protect all depositors and foreign creditors against loss; the establishment of AMCON to support the insolvent banks by purchasing their NPLs and to support the banking industry broadly; the abolition of the universal banking model in favour of a 'back-to-basics' model and introduction of a new bank license regime; issuance of new regulatory guidelines on capital adequacy, related parties and large exposure limits, risk and risk management, and internal control and auditing; and the placing of resident examiners in banks. The CBN now publishes annually a list of banks considered to be systemically important (styled as Systemically Important Financial Institutions, SIFI). The bank also issued a supervisory intervention framework (SIF), which sets out general and specific triggers for a range of corrective actions as well as a PCA regime, with corrective actions tied to prudential thresholds relating to capital adequacy ratios (CAR), asset quality, liquidity, earnings, risk management, internal control and system failures. See for an extensive discussion of these regulatory developments: IMF and IBRD: *Financial Sector Assessment Program Nigeria: Crisis Management and Crisis Preparedness Frameworks* (Washington D.C.: IMF and IBRD, 2013) 13; IMF, *Nigeria: Financial Sector Stability Assessment Country Report No. 13/140* (Washington D.C.: IMF, 2013) 21; *Prudential Guidelines for Deposit Money Banks in Nigeria* (effective from 1 May 2010)*; Supervisory Intervention Framework for the Nigerian Banking System* (effective from 1 February 2011); *and Revised Guidelines for Finance Companies in Nigeria* (effective from 1 April 2014); CBN Circular to all banks and discount houses dated 30 March 2010: *BSD/DIR/GEN/CIR/04/012-Review of Universal Banking Model.*

How then can and should we reform financial system stability regulation in Nigeria? The choice, we reason, is between two alternatives: to continue with the use of ad-hoc regulatory belt and braces to sustain the current failed approach or to implement a financial regulatory model that gives a highly nuanced attention to the stability of the Nigerian financial system—highly nuanced in terms of expanding the perimeter of financial stability; using an analytical method to measure systemic risks spillovers; establishing a dedicated financial system stability agency; and having a streamlined systemic liquidity management framework among others.[20] We strongly contends for the second, because it offers a pathway to better and more effective financial regulation in Nigeria.

2.2.2 Consumer Financial Protection in Nigeria

Consumer financial protection generally relates to the State's regulatory intervention in the financial system to ensure that dealings between financial intermediaries and users of financial services are conducted fairly and lawfully. As an objective of financial regulation, it justified on the need to induce the public to take financial risks in terms of investing in the financial market and (or) placing deposits with financial institutions. Most national financial systems use six key measures for consumer financial protection: information disclosure; direct regulation of financial intermediaries and organised exchanges operating in

[20] We shall discuss these and other reform proposals relating to financial system stability in chapter 6.

their financial markets; enforcement of anti-financial fraud rules; judicial recognition and enforcement of private financial contracts; deposit insurance and investor compensation schemes; and the establishment of a financial ombudsman and imposition of sanctions for violations of consumer rights.[21]

Consumer financial protection regulation in Nigeria is equally functional and *duplicative* in that the CBN, the SEC and NAICOM have individual but identical consumer protection remits.[22] However, the major consumer protection body in Nigeria is the Consumer Protection Council (CPC). Its functions include 'providing speedy redress to consumers complaints through negotiation, mediation and conciliation.'[23] But the definition of consumers under *CPC Act* extends only to individuals and not legal entities. The Council's activities are also mostly concerned with consumer protection in the context of household goods and monitoring of sales promotion of such goods.[24] Again while the CBN recognises the authority of the *CPC Act* over the provision of financial services,[25] in practice the protection of financial consumers is rarely addressed by the CPC. It is even doubtful if

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21 J. Burke, 'Re-examining Investor Protection in Europe and the US,' (2009) 16(2), *Murdoch University Electronic Journal of Law,* 6 - 10.

22 *Section 13 (k)* of the *ISA, 2007*; *Sections 7(h) and 8 (a)* of the *National Insurance Commission Act, No. 1 of 1997.*

23 *Section 2* of the *Consumer Protection Council Act, No. 66 of 1992.* See also CPC website at: <http://cpc.gov.ng/?page_id=868> accessed on 13 May 2014.

24 *ibid.*

25 This was done via paragraph 3.0(f) of the *Guidelines on Electronic Banking in Nigeria* (issued in August 2003) available online at: < http://www.cenbank.org/OUT/PUBLICATIONS/BSD/2003/E-BANKING.PDF > accessed on 13 May 2014.

the Council has the technical competence and capacity to play such a role effectively. However it is worth noting that the Council recently signed a memorandum of understanding with the Nigerian Economic and Financial Crimes Commission to jointly prosecute perpetrators of fraudulent loan schemes and on-line foreign exchange trading, questionable mortgage and other deceptive business practices.[26]

In any event, consumer financial protection rules are as mentioned, structured along functional regulatory lines. In relation to the banking sector, every bank is obligated to display at its offices and branches, its lending and deposit rates and publish its financial accounts in a daily newspaper.[27] The Governor of the CBN is empowered to order a special examination or investigation of the books and affairs of a bank where he is satisfied that the bank has been carrying on its business in a manner detrimental to the interest of its depositors.[28] Every bank is also obligated to keep proper books of accounts of all its transactions that give a true and fair view of the state of affairs of the bank and comply with the accounting standards as may be prescribed for banks. The accounts must be kept at the principal administrative office of a bank and at the

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26 See CPC, 'CPC, EFCC sign MoU to Bring Mortgage, On-line Forex, other Scammers of Consumers to Book,' 15 February 2015, available online at: <http://cpc.gov.ng/?p=1386> accessed on 17 March 2015.

27 *Sections 23 and 27* of the *BOFIA*.

28 *ibid*, *section 33(1) (b)*.

branches of each bank in English language or any other language approved by the Federal Government of Nigeria.[29]

Further, every bank must submit to the NDIC such returns, and information as may be required, by the Corporation from time to time.[30] The Corporation may also require persons having access thereto, to supply to it information, in such manner or form as it may from time to time direct, relating or touching on or concerning matters affecting the interests of depositors of an insured institution.[31] NDIC's bank Examiners may also request information from an insured institution ostensibly for the purposes of depositors' protection.[32] The Corporation may take prompt corrective action in consultation with the CBN against an insured institution to protect the institution's depositors.[33]

In the securities sector, the SEC is empowered to act in the public interest, particularly with respect to investors' protection, maintenance of fair and orderly securities markets and the promotion of investors' education.[34] It may order special examination of the books and affairs of a capital market operator, where it is satisfied that it is in the public interest to do so and pertinently where the market operator has been carrying on business in a manner detrimental to the interest of its clients,

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29 *ibid, section 24(2) (3).*

30 *Section 27 (1), NDIC Act No. 16 of 2006.*

31 *ibid, section 27 (3).*

32 *ibid, sections 28 and 29.*

33 *ibid, section 32.*

34 *Section 13(k) and (s) of the ISA 2007.*

beneficiaries and creditors.[35] There are civil and criminal liabilities for misstatements in a prospectus or any document offering securities to the public.[36] A shareholder may bring an action against a company, to rescind an allotment of shares made pursuant to a false, deceptive or misleading forecast contained in a prospectus.[37]

Lastly, before the manager of a collective investment scheme, enters into a transaction with an investor, he shall disclose information about the investment objectives of the scheme, the calculation of the net asset value, dealing prices, charges, risk factors and distribution of income accruals, to the investor, including information that is necessary to enable the investor to make an informed decision, which shall be disclosed timeously and in a comprehensible manner.[38]

In the insurance sector, the Commissioner for Insurance (the head of NAICOM) may order a special inspection or investigation of the books and affairs of an insurance institution where among other grounds, he suspects, or is satisfied that the insurance institution has been carrying on its business in a manner detrimental to the interest of its policy holders.[39] The Commissioner may intervene in the running of an insurance institution, if, among other grounds, he considers the exercise

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35 *ibid*, *section 46.*

36 *ibid, 85, 86* and *87.*

37 *ibid, section 94.*

38 *ibid*, *section 156.*

39 *Section 35*, of the *National Insurance Commission Act, No. 1 of 1997.*

desirable to protect policy holders or potential policy holders of an insurance institution against the risk that the insurance institution may be unable to meet its liabilities or fulfil the reasonable expectations of policy-holders or potential policy holders.[40] Further, NAICOM may require an insurance institution to take such action as appears to it to be appropriate for the purpose of protecting policy-holders or potential policy holders of an insurance institution against the risk that the insurance institution may be unable to meet its liabilities or fulfil the reasonable expectation of policy holders or potential policy-holders.[41] There are civil and criminal liabilities for inducing a policyholder to enter into an insurance contract with misleading statements.[42]

Where a claim is made by the insured or any other party entitled to do so under an insurance policy, the insurer shall: (a) where he accepts liability, settle the claim not later than 90 days after the issuance of discharge voucher; (b) where any claim remains unpaid as provided, the insured may request NAICOM to effect payment from the statutory deposit of the insurer and NAICOM shall have power to do so; or (c) where the insurer does not accept liability, he shall deliver a statement in writing stating the reason for disclaiming such liability to the person making the

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[40] *ibid*, *section 37.*

[41] *ibid*, *section 40.*

[42] *Section 75,* of the *Insurance Act No. 1 of 2003.*

claim or his authorised representative not later than 90 days from the date on which the person delivered his claim to the insurer.[43]

It is worth noting also that post 2009 the CBN initiated a commendable consumer protection move by sponsoring a Bill in the National Assembly to establish a Financial Ombudsman.[44] Even this initiative is with respect, potentially deficient in that a critical perusal of the Bill betrays a financial *regulatory despotism* (absolute and encompassing regulatory powers conferred on a single official without effective checks) in which most of the powers contained in the Bill are subject to the overarching influence of the CBN Governor. For instance, the Governor is empowered to recommend persons to be appointed as the ombudsman and adjudicators.[45] Yet these adjudicators are to resolve regulatory disputes in which the CBN might be the Claimant or Defendant. Viewed in the context of the CBN's pre-eminence in terms of its extensive powers in the financial regulatory system, this provision questions the impartiality of the ombudsman adjudicators, as much as it engages a CBN regulatory monopoly that is potentially invidious and virtually *ad hominem,* because the powers are concentrated in the CBN Governor, who

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43 *ibid*, *section 70(1)*. Any insurer who contravenes this section commits an offence and on conviction is liable to a fine of ₦500,000.

44 A Bill to Establish the Office of the Financial Ombudsman, 2011, available online at: <http://www.google.co.uk/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&ved=0CCIQFjAA&url=http%3A%2F%2Fwww.nassnig.org%2Fnass2%2Flegislation.php%3Fid%3D1400&ei=llTWU7_cPPTb7AbspYDIBg&usg=AFQjCNHnNGTfuJlRs1j-wTs35CAYTYMQAA&bvm=bv.71778758,d.ZGU> accessed on 13 July 2014.

45 *ibid*, *Section 6.*

doubles as the Chairman of the CBN Board and that of the FSRCC.

The foregoing apart, and given the extensive financial consumer protection rules cited above, it is strongly argued that the financial consumer protection has remained deficient in Nigeria and poignantly so near to the crisis of 2008 – 09 for two reasons: *structural deficiency* and *supervisory failure*. Structural deficiency arises from the fact that the functional financial regulation with its duplicative consumer financial protection approach has similarly impeded the emergence of a focussed and effective protection framework for Nigerian financial consumers. Supervisory failure is rooted in negligent financial supervision—the inability of the CBN, the SEC and NAICOM to robustly and creatively enforce the statutory provisions cited above in the absence of a financial ombudsman.[46] The CBN's performance in the period supports this last point. According to an influential insider account, banks' reports to the CBN and investors were often inaccurate, incomplete and late, depriving the CBN of accurate and timely information necessary to effectively supervise the industry and in turn depriving investors of information required to make informed investment decisions.[47] Further, that it was common for banks to publicise information on

[46] See for an extensive discussion of the part played by supervisory failure in the Nigerian financial crisis of 2008-09: O. Famuyiwa, 'The Nigeria Financial Crisis of 2008-09: A Reductionist Diagnosis,' (2013) 2(1) *Journal of Sustainable Development Law and Policy*, 1-25.

[47] Sanusi (n 16) 8. Mr. Sanusi was the CBN Governor during the crisis of 2008-09 and up on till February 2014.

their operations on a highly selective basis and investors were unable to make informed decisions on the quality of bank earnings, the strength of their balance sheets or the risks in their businesses.[48] We can infer at least three points from these revelations. First, due largely to inaccurate financial information released by banks, investors made ill-advised decisions regarding bank shares. Second, and with the hope of speculative returns on their investment in shares, more and more unsophisticated retail investors joined the 'doomed gravy train.' Third, the CBN failed in two relevant aspects: it did not act to enforce the data quality of banks to ensure accurate reporting; nor did it strengthen its internal reporting system to provide an effective early warning system for bank surveillance.[49] Against this background, the inevitable supervisory failure came in 2008, when the financial crisis broke.

How do we remedy the foregoing situation? The choice, we again argue, is between two alternatives: to sustain the current approach with the clear danger of perpetuating structural deficiency and supervisory failure; or to adopt a new focused approach that gives a highly nuanced attention to consumer protection in the Nigerian financial system—highly nuanced in terms of a dedicated financial consumer protection agency; aggressive financial consumer activism; imposition of liability

[48] *ibid.*

[49] *ibid.*

for supervisory failure induced by negligent financial supervision; implementation of financial literacy; and the application of the contemporary behavioural economic principles in the formulation of consumer protection policies among others.[50] We strongly contend for the second alternative, because it offers a pathway to better and more effective financial regulation in Nigeria.

2.2.3 Financial Market Integrity Regulation In Nigeria

Financial market integrity regulation in general aims to prevent and where necessary punish practices that could erode public trust in a country's financial market. As a financial regulatory objective, it is justified on the need to create a malpractice free 'level playing field' in which financial intermediaries and users of financial services are able to transact with minimal risk of fraud, exploitation and (or) manipulation. Market integrity regulation often maps unto investor protection and there is a general tendency for rules that are intended for investor protection to serve the dual purpose of enforcing market integrity. For instance, effectively enforced mandatory disclosure rules in capital markets can enhance the transparent trading in shares (market integrity) and simultaneously equip investors with information necessary for investment decisions (investor protection). Market integrity however goes beyond investor protection. It focuses also on issues such as the prevention of

[50] We shall focus extensively on these points in Chapter 6.

abusive market practices such as insider dealing and market manipulation. Regulatory measures to enforce financial market integrity are therefore in the form of rules and sanctions to deter market manipulation; market rigging; insider dealing; fraud and (or) promotion of bubble companies; false trading; publication of inadequate and (or) fraudulent market sensitive information; and unlicensed financial market practices or businesses.[51]

Nigeria's current functional financial regulatory framework necessarily entails that rules which enforce market integrity, including the mandatory disclosure rules discussed above under consumer protection, are crafted along functional lines of banking, securities and insurance. We would again argue that this approach has in large part induced *structural deficiency* and *supervisory failure* that have substantially contributed to the 'crisis' of financial regulation in Nigeria.

In terms of banking sector (money market) integrity, the licencing and entry restrictions and the *BOFIA* disclosure obligations discussed above, operate as the first level (market entry) regulation. The second and core regulatory level enforces integrity in the conduct of banking business. For instance, a bank cannot conduct its business in a manner that is detrimental to the

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51 The points discussed here are garnered from several sources including: G. Akerlof, 'The Market for "Lemons": Quality Uncertainty and the Market Mechanism' (1970) 84 *Quarterly Journal of Economics* 488; D. Morgan, 'Rating Banks: Risk and Uncertainty in an Opaque Industry' (2002) 92 *American Economic Review* 874; R. Bartlett, 'Making Banks Transparent' (2012) 65 *Vanderbilt Law Review* 293; B. Malkiel, 'The Efficient Market Hypothesis and its Critics' (2003) 17 *Journal of Economic Perspectives* 59 at 60; J. Dow and G. Gorton, 'Stock Market Efficiency and Economic Efficiency: Is There a Connection? (1997) 52 *Journal of Finance* 1087; E. Fama, 'Efficient Capital Markets: II' (1991) 46 *Journal of Finance* 1575.

interest of its depositors and creditors.[52] NDIC's power to take prompt corrective action (discussed above) against an erring insured financial institution can similarly be engaged in a case where an insured institution indulges in unsafe market practices. For instance, where an insured financial institution consistently grants excessive and poorly collateralised single obligor loan,[53] this could be regarded as an unsafe market practice to warrant the exercise of this power. However, whether or not the Corporation has thus far used this power effectively and particularly with regards to the banking malpractices that partly induced the crisis of 2008 – 09, is doubtful.

In any event and more direct in terms of protecting the integrity and transparency of the money market, is the requirement for banks to display their lending and deposit interest rates.[54] Also, a bank shall not later than 4 months after the end of its financial year publicise its balance sheet and profit and loss account[55] It is thought that this provision is meant to provide a bank's existing and potential customers, investors and creditors with the information to make business (investment and

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52 *Section 33(b), BOFIA*. The section empowers the CBN Governor to conduct a special examination or investigation of the books and affairs of a bank when this arises and the affected bank shall bear the cost of the investigation: *section 33(4) BOFIA.*

53 *Section 32, NDIC Act, No 16 of 2006*. A single obligor loan is a credit facility granted by a bank to an individual.

54 *Section 23(1), BOFIA,* as amended by Act No. 38 of 1998. Any bank in breach of this requirement is guilty of an offence and liable to a fine not exceeding N5,000 for every day during which the offence continues: *Section 23(2), BOFIA.*

55 *Section 27(1), (2)* of the *BOFIA,* as amended by Act No.40 of 1998. Contravention of these requirements is an offence and a culpable bank is liable to a fine of ₦10,000 each day during which the offence continues: *section 27(5), BOFIA.*

lending) decisions. However, it is questionable whether indeed with the high level of financial illiteracy among retail investors discussed above, such publication is of material assistance to them. For the few who are financially knowledgeable such as institutional investors, it could equip them with information to exert corporate governance pressures during a bank's annual general meeting. But the extent of the pressure would most likely depend on the quality and accuracy of the information and on the interests of the institutional investors. If, for instance, the information is inaccurate and (or) the interests of the institutional investors are aligned with that of the management and board of directors in terms of maximising RoE, institutional investors may just simply 'toe the party line' and not be 'spoilers.'

In relation to curbing insider abuse in the grant of credit, no manager or any other officer of a bank shall have personal interest in any advance, loan or credit facility. If he has any such personal interest, he shall declare his interest to the bank concerned.[56] Nor is it is permissible for an officer of a bank to grant a loan to any person, unless it is authorised in accordance with the bank's rules and regulations; and where adequate security is required by such rules and regulations such security shall, prior to the grant, be obtained for the loan and deposited

[56] *Section 18(1)(a)* of the *BOFIA.*

with the bank.[57] Similarly, a duty is imposed on a director of a bank who is directly or indirectly interested in the grant of a loan with the bank to declare the nature of his interest at a meeting of the board of directors of the bank.[58] A bank shall not also without the prior approval of the CBN permit to be outstanding, unsecured advances, loans or unsecured credit facilities, of an aggregate amount in excess of N50,000 to any of its directors; to any firm partnership or private company in which any one or more of its directors is interested as directors, partner, manager or agent or any individual firm, firm, partnership or private company of which any of its directors is a guarantor; to any company or private company in which the bank, any one or more of its directors jointly or severally maintains shareholding of not less than five per cent either directly or indirectly. [59] One pertinent issue with respect to these money market integrity provisions is how effectively they have been enforced by the CBN thus far.

In the securities sector, *ISA's* registration,[60] licencing,[61] authorisation provisions,[62] and the disclosure obligations,[63] are

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57 *ibid, section 18 (1b), (2).*

58 *ibid, section 18 (3), (11).*

59 *Sections 20(2) and 21 (9)* of the *BOFIA* (as amended by Act No. 4 of 1997).

60 *Sections 13, 28, 29, 38, 54 and 158 of the ISA 2007* empower SEC to register and regulate: securities exchanges; capital trade points; futures; options and derivative exchanges; commodity exchanges; securities of public companies; corporate and individual capital market operators; the workings of venture funds, and collective investment schemes; and securities depository companies, clearing and settlement companies, custodians, of assets and securities, credit rating agencies and such other agencies and intermediaries.

61 *ibid, section 30 (1) (c).*

62 *ibid, sections 67 (1) and 75(1).*

arguably the first level of capital market integrity regulation. The second level comprises the rules which are meant to prevent abusive and potentially anti-capital market integrity practices such as false trading and market rigging transactions;[64] market manipulation;[65] false or misleading statement;[66] fraudulently inducing persons to deal in security;[67] dissemination of illegal information;[68] fraudulent procurement or disposal of securities;[69] insider dealing; and abuse of information obtained in official capacity.

Insurance companies are similarly bound by rules which are meant to protect the integrity of the sector. It is for instance an offence to offer or receive or participate in sharing inducements, (a) for the purposes of acquisition, transfer, merger or consolidation of an insurance business, or (b) to procure the insurance business.[70] It is an offence to induce a potential policyholder to enter into an insurance contract, by means of a misleading statement, deception and concealment of a material

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63 *ibid, sections 85, 86 and 87.*

64 *ibid, section 105.*

65 *ibid, section 106.*

66 *ibid, section 107.*

67 *ibid, section 108.*

68 *ibid, section 109.*

69 *ibid, section 110.*

70 *Section 54* of the *NAICOM Act, 1997*. The offence is punishable by payment of a fine (₦500,000) or imprisonment for three years or to both such fine and imprisonment.

fact.[71] It is prohibited to induce a person to take out or renew or continue an insurance contract.[72]

Clearly from the foregoing, there are extensive market integrity rules across the three sectors comprised in the Nigerian financial system. If this is so, one would logically want to know why were they not enforced to check the series of financial services malpractices that substantially induced the crisis of 2008-09 and those that have always caused the insolvencies of financial institutions in Nigeria.[73] The answer is partly due to the inherent *structural deficiency* of functional regulation in which without effective coordination it would be hardly possible for one regulator to address or deter malpractices that cut across two or more sectors. For instance, if as was the case before the crisis, a bank were to grant margin credit to a stock broker for the concealed objective of manipulating the bank's share price, except the CBN, the SEC and NSE work together, it would be difficult for one of them to know the scale of the scheme for the purposes of regulatory action(s). For instance, regulatory collaboration among the three agencies could have been through an ad hoc tripartite committee to monitor and investigate suspicious dealings in bank shares during the banking consolidation exercise. This existence of the committee would at

71 *Section 75, Insurance Act, No. 1 of 2003.* The offence is punishable by payment of a fine (₦100,000) or imprisonment for a term of 2 years or to both such fine and imprisonment.

72 *ibid, section 76.*

73 See for an extensive discussion of these malpractices and lapses see: Sanusi (n 16); Famuyiwa (n 46); Ogowewo and Uche (n 5).

least have shown a nuanced regulatory stance against share price manipulation.

In comparison and with reference to malpractices that were restricted to one sector, it is hardly convincing to blame structural deficiencies because inter-agency coordination would not be a requisite condition before a 'prompt corrective action.' On this view, one could question the inability of the CBN to discover the extraction of N16 billion from Intercontinental Bank until the new owners of the bank made the discovery and instituted a recovery action against the bank's former chief executive in England? The answer, we argue, speaks more to *supervisory failure* than to any other causality.[74]

The conduct of the banking consolidation of 2005 further supports our position on *structural deficiency* and *supervisory failure*. To comply with the new capital requirement of N25 billion, announced by the CBN in 2004, Nigerian banks raised a total of N406.4 billion from the Nigerian capital market. Out of this sum, N360 billion was verified and accepted by the CBN.[75] The CBN did not verify further capital raised by the banks from the capital market after 2005,[76] but nearly all Nigerian banks as

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74 For more on this, see Famuyiwa (n 46).

75 CBN, *Annual Report and Statement of Accounts 2005*, 37 – 38. The purpose of the verification was to ensure that the sources of the funds were legitimate and the banks did not capitalise with depositors' funds.

76 The CBN *Annual Reports and Statement of Accounts* for 2006, 2007 and 2008, reported no capital verification to have been done in those years by the CBN. This suggests one of three things: that there was no capital verification after 2005; that the verifications carried out after 2005 were not included in the subsequent annual reports; or that the 2007-2008 IPOs were verified mostly by compromised regulatory officials. The third position appears correct because

shown in Table 1 below went to the stock market every year to raise capital after 2005.

Table 1

Stock Market Access Nigerian Banks 2006-8

Bank	**Use of Capital market post 2005**
Access Bank Plc	7 times
Skye Bank Plc	7 times
Sterling Bank Plc	7 times
UBA Plc	7 times
Guaranty Trust Bank Plc	7 times
First City Monument Bank Plc	7 times
Diamond Bank Plc	7 times
Zenith Bank Plc	7 times
Bank PHB Plc	2 times
First Bank Plc	6 times
Union Bank Plc	7 times
Fin Bank Plc	7 times
Eco Bank Plc	6 times
Wema Bank Plc	6 times
Intercontinental Bank Plc	7 times

Source: Report of the Ad-Hoc Committee on the Investigation into the near collapse of the Nigerian Capital Market, p. 67.

There are no statutory restrictions on the number of times a quoted bank can raise capital through the capital market. But what happened in the race to meet the December 2005 N25 billion capitalisation deadline under the CBN's, SEC's and NSE's watch and in relation to most of the capital raised by the banks, was a series of market abuse in the form of 'fake capital financed from

in 2010, the then incumbent Governor of the CBN disclosed that the capital verification exercise was stopped for 'some unexplained reasons:' Sanusi (n 16).

depositors funds' and routed mostly through the capital market.[77] The NSE market data on the banking sector in that period supports this view. The sector consistently accounted for more than 50% of the market capitalisation of the Nigerian Stock Exchange.[78] In the same period, the share prices of four of the banks declared insolvent by the CBN in 2009 (Afribank Plc., Intercontinental Bank Plc., Oceanic Bank Plc., and Union Bank Plc.) rose from an average of N10.27 per share at the end of January 2005 to N37.9 at the end December of 2007. That was the period when trading in shares of banks peaked before the market crash of 2008.[79] The established facts from *Access Bank Plc v Akingbola and 4 Ors;*[80] *SEC v Union Bank Plc and 19 Ors;*[81] and the Report of the Ad-Hoc Committee on the Investigation into the Near Collapse of the Nigerian Capital Market,[82] all speak to the point that the increase in the prices of shares of banks resulted mostly from insider manipulation and market rigging.

It is of course arguable that the sophisticated means and expertise available to financial intermediaries can be deployed to conceal malpractices from regulators for a possible long while

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77 Sanusi (n 16) 7.

78 This percentage is from the cumulative statistics on the capitalisation of the Nigeria Stock Exchange between 2006 and 2009, published in *SEC Quarterly* for the four quarters comprised in each of 2006, 2007, 2008 and 2009.

79 The historical data table on the movement of the share prices of these banks can be found at the end of the thesis as Table 2.

80 [2012] EWHC 2148 (Comm) [82], [85], [87], [95].

81 Case No IST/OA/20/2010, 50 -51.

82 House of Representatives, *Report of the Ad-Hoc Committee on the Investigation into the Near Collapse of the Nigerian Capital Market* (Abuja: National Assembly, 2012) 60 – 61.

before regulators can discover them or until serious damage has been done to the financial system. Even so, we contend that the scale of the securities malpractices in Nigeria in the period under discussion was such that would have been difficult to conceal from a vigilant regulator. For instance in *Union Bank,* the IST found that in 2007, the respondent bank borrowed N30.4 billion from HSBC and Merrill Lynch. The money was transferred as a facility to Union Trustees (a subsidiary of the respondent), which in turn transferred the money to Falcon Securities Ltd to carry out a pre-arranged share price manipulation scheme. In four days in November 2007, Falcon Securities purchased 620.4 million units of Union Bank shares worth ₦30.8 billion ahead of a public offer and rights issue of the shares of the bank. Similarly in *Access Bank v Akingbola,* the court found that between June 2007 and December 2008, Intercontinental Bank and its principal officers bought back 3.4 billion units of the its shares using depositors funds.

After the crisis, some senior officials of the insolvent banks have been prosecuted for the breach of their fiduciary duties and infractions of Nigerian financial crime laws.[83] The SEC has also commenced enforcement actions in respect of capital market manipulations and insider dealings that precipitated the crisis.[84]

[83] One of this is the judgment in Suit No.: FHC/L/CS/12/2012: *Akingbola v The Chairman, EFCC and Etudo*. The judgment was appealed to the Court of the Appeal Lagos Division in Appeal No.: CA/L/105/2013 *Akingbola v The Chairman, EFCC.* The appeal was allowed and the case remitted to another judge.

[84] See I. Nwachukwu, 'SEC Suspends Falcon Securities, Wizetrade Capital,' *BUSINESSDAY,* 17 June 2013 available online at: < http://businessdayonline.com/2013/06/sec-suspends-falcon-

The CBN, the SEC and NSE have also introduced additional and in some instances *identical* rules relating to margin lending;[85] margin trading;[86] false trading;[87] market manipulation and rigging;[88] insider dealing;[89] short selling;[90] securities lending;[91] market making;[92] and over the counter trading in securities.[93] Again we contend that increasing the rules alone without a corresponding improvement in the quality of enforcement would, all else equal, lead to *over regulation*—too many rules with little enforcement. All told, these actions and measures are still commendable because they testify credibly to the seriousness of the regulators to 'correct their mistakes.' But that should not distract us from perceiving the measures and rules for what they are: a motley of reactive and piecemeal reforms that may lure us into a risky complacency, a false sense of

securities-wizetrade-capital/#.VG0LTovVtFI> accessed on 18 November 2014. Also as at March 2011, 27 cases were referred to the Nigerian Police Force and the State Security Services. Information on these cases is available online at: < http://www.sec.gov.ng/cases-referred-to-law-enforcement-agencies.html> accessed on 18 November 2014.

85 The CBN and SEC jointly issued rules on margin lending in March 2010, as referenced (n 18). In 2013, SEC introduced its own margin lending rules: *Part G2: Margin Lending, Rules 352 – 87, SEC Rules 2013.*

86 *Rules 356 - 387, SEC Rules 2013.*

87 *Schedule IX: Code of Conduct for Capital Market Operators and their Employees, SEC Rules 2013*. In November 2013, NSE issued *Rules and Regulations Governing Dealing Members (Amendments and Additions Part I)* which substantially mirror the SEC Rules. See *Article 104A* of the *Rules and Regulations Governing Dealing Members (Amendments and Additions Part I).*

88 SEC (n 93); *Articles 104* and *105* of the NSE's *Rules and Regulations Governing Dealing Members* as amended on 30 March 2013.

89 *Article 104,* of the NSE's *Rules and Regulations Governing Dealing Members* as amended on 30 March 2013.

90 NSE, *Short Selling Rules of the Nigerian Stock Exchange, February 2012.*

91 *Rules 388 – 394, SEC Rules 2013; NSE, Securities Lending Guidelines of the Nigerian Stock Exchange, March 2012.*

92 *Rules 76 – 82, SEC Rules 2013;* NSE, *Market Making Rules of the Nigerian Stock Exchange, March 2012.*

93 *Rules 243 – 255, SEC Rules 2013.*

security that the monster of market abuse is finally chained even if the chain is fastened on the same deficient regulatory model which has failed in the past and which given this past failure may yet fail again and let the monster loose in the market as before.

There is an alternative to the foregoing chronicle of failure, the 'crisis' of financial regulation in Nigeria and the current deficient financial regulatory framework. The alternative holds out the prospect of a better and more effective approach to financial market integrity regulation in Nigeria in terms of consolidating existing market integrity rules in banking, securities and insurance sectors into a coherent financial market integrity rulebook; establishing a specialist regulatory agency for market integrity that closes the integrity gaps induced by functional financial regulation and with powers to enforce the rulebook; the enactment of rules to empower the market integrity regulator to administratively adjudicate market integrity infractions whether they engage civil liability or crime; and the formulation and implementation of organisational market conduct risk management framework by financial intermediaries.[94]

2.2.4 Market Competition Regulation In Nigeria

Generally, financial market competition regulation encompasses regulatory measures that enhance choice, variety and 'healthy rivalry' in the provision of financial services. As an objective of financial regulation it is justified on mainly two grounds: on the

[94] We would discuss each of these proposals in chapter 6.

need to prevent business practices that limit the choices available to users of financial services; and the need to deter those practices which unlawfully harm the interests of rival intermediaries.[95]

The objective can be implemented through a specialist competition (antitrust) law and regulator, with a mandate to regulate competition in the financial services industry, or by assigning the task of promoting competition to a financial regulator.[96] In banking, competition can be promoted by relaxing entry barriers such as for instance lowering regulatory capital. In securities trading, the abolition of ties between brokers, dealers and exchanges creates greater possibilities for competition between venues for trading securities. Each of these initiatives is clearly motivated by the desire to increase the penetration of the relevant financial services through removing anticompetitive practices.[97]

Currently, Nigeria does not have a specialist competition law and enforcement agency. Nor is the promotion of competition in the financial system assigned to any of the three functional regulators (CBN, SEC, and NAICOM). From experience, the promotion of competition in the provision of financial services

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95 *Part 1E(1), Financial Services Act 2012* (UK).

96 This is the current UK approach, in which the FCA is assigned the task of promoting competition in the financial system: ibid. Similarly, the *National Securities Improvement Act 1996,* (US) requires SEC, when exercising rule making powers to consider 'in addition to the protection of investors, whether the action will promote efficiency, *competition,* and capital formation.'[96]

97 See generally the sources cited in (n 2).

has been through financial regulatory policies with wider economic implications such as increase in minimum regulatory capital of financial intermediaries in part response to rising inflation and in part 'to squeeze out' underperforming financial intermediaries.

In the banking sector, for instance, the first major economic policy that induced competition in the provision of banking services was the economic liberalisation policy, which was part of the Structural Adjustment Programme (SAP) introduced in 1985. The policy thrust was to reduce government's heavy presence in the economy; eliminate financial repression; and introduce competition through privatisation, commercialisation, and relaxation of approval to operate certain businesses including banking.[98] With the policy, the number of banks increased from 40 in 1985 to 120 in 1992. Some of the banks were however anything but banks in that they were heavily involved in money laundering, foreign exchange racketeering, and insider abuses including the grant of huge and mostly unsecured credits to their directors and senior management.[99] The last practice has been identified as one of the factors, which induced excessive NPLs and insolvencies in the Nigerian banking system at the time before the Federal Government intervened through CBN to check

98 For extensive discussion of the effect of liberalization policy on the Nigerian financial system, see A. Adeeko, *The Law and Policy of Financial Regulation and Deregulation of Nigerian Banking System* (1998) PhD thesis, University of Warwick, available online at: <http://wrap.warwick.ac.uk/4258/> accessed on 24 May 2012.

99 S. Apati, *The Nigerian Banking Sector Reforms: Power and Politics* (Basingstoke: Palgrave Macmillan, 2012) 9 – 24.

the trend in 1998.[100] In that year alone, 26 of these banks were declared insolvent and their banking licences revoked by the CBN.[101]

Prudential regulation has also been used to enhance banking competition. For instance, in 2005 and after the introduction of universal banking in 2001, the CBN increased the minimum capital of banks from N2 billion to N25 billion. The increased capitalisation arguably spurred a business necessity to generate higher RoE for shareholders. The banks thus expanded very rapidly. This in turn increased competition, pushing banks to expand into new geographic areas; to open new branches; to offer new products and to start operating in new areas of activity such as retail loans, insurance and brokerage services. In addition, about half of the 25 banks which met the minimum capital requirement, established subsidiaries in Benin Republic, Gambia, Ghana, Kenya, Sierra Leone, South Africa, Zambia, among other countries.[102]

It is worth noting however that the period after the banking consolidation exposed a regulatory deficiency—the absence of a

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100 G. Ogunleye, 'A Review of Banking Activities and its Regulatory Framework in Nigeria: The Past, Present and Future' (1999) 9 (4) *NDIC Quarterly,* 25 at 30.

101 Ogowewo and Uche (n 5) 169.

102 The expansion in the banking sector started as early as 2003, but the impact of the consolidation and increased capital resulted in explosive growth between June 2006 and June 2008. Banks assets expanded from approximately ₦4.4 trillion in 2005 to over ₦10.4 trillion in 2007 and reached ₦15.8 trillion in the last quarter of 2008. The year-on-year growth in bank credit to the private sector accelerated from 25 percent in July 2006 to over 92 percent in 2007, decelerating to 59.4 percent in 2008: IBRD (n 6) 33. See also, D. Alford, 'Nigerian Banking Sector Reform: Recent Actions and Future Prospects,' (2010) 8, available online at: <http://ssrn.com/abstract=1592599. For the articulation of the regional expansion drive behind the minimum capital increase, see C. Soludo, 'Consolidating the Nigerian Banking Industry To Meet the Development Challenges of the 21st Century,' (CBN Research Department, 2004) 2.

clear and robust regulation against *de-marketing* among banks. This practice entails one bank spreading false and harmful rumours concerning its competitors' solvency in order chiefly to induce depositors of those 'insolvent' banks to move their deposits to the 'solvent' rumourmonger. Most often the originators and conduits of the rumours are bank officers. The CBN issued two circulars in 2006 and 2008 to caution banks to desist from the practice.[103] Other than these circulars, no law has been introduced to penalise the practice. Yet, it is a potentially dangerous practice not least because it could harm the safety and soundness of the banking sector in terms inducing retail bank runs.

In March 2010 the CBN announced the discontinuation of the universal banking as the model for the conduct of banking business in Nigeria. It introduced a new licencing regime that categorises banks by function and allows a variety of banks to operate in Nigeria with varying minimum capital requirements depending on the bank's function as opposed to the single minimum capital requirement.[104] By introducing a varied licensing regime and entry requirements, the intent, it can be surmised, is

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103 See the CBN Circular BSD/08/2006 titled 'The Unethical and Unprofessional Practice of De-Marketing Colleagues/Other Banks in the Industry by Spreading False Rumours dated 12 April 2006 and the Circular BSD/DR/CIR/07/Vol.2/016 titled 'De-marketing of Banks by other Banks,' titled 21 October 2008, available at: < http://www.cenbank.org/OUT/CIRCULARS/BSD/2008/CIRCULAR%20ON%20DE-MARKETING%20BY%20BANKS-21-10-2008.PDF> accessed on 25 July 2013.

104 Under the new model, banks are authourised to operate the following types of business: commercial banking (with either regional, national and international licence); merchant (investment) banks; specialised banking (microfinance, mortgage; non-interest banking (regional and national); and development finance institutions: S. Sanusi, *Banking Reform and Its Impact on the Nigerian Economy* (Abuja: CBN Research Department, 2012) 8.

to allow the creation of banks that would serve different market segments, such as small and medium-sized enterprises, and to phase out the 'one-size fits all' approach under universal banking. To work effectively however the new licensing regime requires that the CBN have the requisite regulatory capacity (human and material resources) to supervise the different types of banks. The specialist banks licenced under the new regime (such as Islamic banks) would also need the relevant specialist business capacity to provide the types of financial services they offer. Whether the CBN and the banking industry have the requisite capacities for non-interest banking is a question that requires in depth research and is outside the scope of this thesis. It is noteworthy that the CBN has thus far licensed three non-interest banks: Jaiz Bank Plc., Stanbic IBTC Plc. and Sterling Bank Plc.[105]

In the insurance sector, the use of prudential regulation (in terms of minimum capital requirements) as a competition toolkit has not achieved the same effect as witnessed in the banking sector. It has made the insurance industry the least competitive sector of the Nigerian financial system. For instance, countries with comparable emerging market status as Nigeria usually require for insurers a minimum capital of between $4 million and

105 See the online source: < http://blog.thomsonreuters.com/index.php/islamic-banking-in-nigeria-progress-and-prospects/> accessed on 24 November 2014. The legal basis for non-interest banking in Nigeria can be found under *Section 33 (1) (b) of the CBN Act 2007*; *Sections 23(1) 52, 55(2), 59(1)(a) and 61* of the *BOFIA* (as amended); *Section 4(1)(c)* of the *Regulation on the Scope of Banking Activities and Ancillary Matters, No. 3, 2010.*

$10 million USD.[106] The current Nigerian minimum capital requirements are three to six times higher.[107] Given the existing premium volume,[108] the high capital requirements present a challenge to the competitiveness of the sector and thus require reconsideration to make the sector attractive and competitive.

The uncompetitive state of the insurance sector induced by the high minimum capital requirements has in turn contributed to the underdevelopment of the sector, in terms of market penetration. For instance, non-life penetration is around one-half per cent or only one-seventh of the average penetration of the OECD countries in 2010.[109] Life insurance penetration is even lower at around 0.2 per cent. This comparison does not again improve if we use measurement of insurance utilisation that takes the country's level of economic development into consideration and its Benchmarked Insurance Penetration (BMIP) against the world

106 This figure represents the average for countries whose insurance minimum capital requirements mirror those under the EU Solvency I regime. Solvency I, is due to phased out in the EU and Solvency II Directive 2009/138/EC, which reflects new risk management practices to define required capital and manage risk is scheduled to come into effect on 1 January 2016.

107 In 2007, NAICOM raised the minimum capital of insurance companies, as follows: non-life insurance companies: from ₦200 million to ₦3 billion ($19.14 million USD); life insurance companies: from ₦150 million to ₦2 billion ($12.76 million USD); composite insurance companies: from ₦350 million to N10 billion ($31.9 million USD); and reinsurance companies: from ₦350 million to ₦10 billion ($63.8 million USD). See IBRD (n 6). The minimum capital increase reduced the number of insurers from 104 in 2007 to 60 in 2008. Further insurance market consolidation should be expected in the coming years, as banks comply with one of CBN's post 2009 directive to divest from their non-banking activities including insurance.

108 In terms of gross written premium, the total sector grew at an average rate of 23 percent from 2001 to 2010, but remains very small, with total premium income of ₦192 billion, representing 0.7 percent of GDP in 2010. The gross written premium was ₦232 billion in 2011: NAICOM, *Nigerian Insurance Digest, 2011.*

109 IBRD (n 6).

insurance penetration average for the non-life sector.[110] The Nigerian BMIP value indicates that the insurance industry is underdeveloped with only 43 per cent of the world average insurance penetration at the Nigerian 2010 GDP per capita level. This places Nigeria at the bottom of comparator countries with the exception of Egypt as shown in Table 3 below.

Table 3

Insurance Penetration in Six African Countries

Country	Non-life Insurance Penetration	Penetration as a Percentage of OECD average penetration	BMIP
Angola	0.91	27%	58.99
Egypt	0.39	12%	30.18
Ghana	0.56	17%	47.75
Kenya	1.58	46%	142.75
Morocco	1.62	48%	124.09
Nigeria	0.51	15%	42.88
South Africa	1.87	55%	96.82

Source: IMF, *Country Report No. 13/145* (May 2013) p.12.

In the securities sector, the SEC has similarly used prudential regulation to enhance competition and pointedly to

110 BMIP is the insurance penetration benchmark against the world average insurance penetration. The benchmark was developed by the average of the world insurance penetration calculated using data from 1980 to 2006 for 95 countries. See generally for the information presented here IMF, *Country Report No. 13/145* with the full title: IMF, *Nigeria: Publication of Financial Sector Assessment Program Documentation—Detailed Assessment of Observance of Insurance Core Principles* (Washington DC: IMF, May 2013).

remove poorly capitalised and constantly erring operators from the capital market. This view is supported by the official justification for the new minimum capital requirements for capital market operators the Commission announced in December 2013.[111] According to the Commission, the presence of undercapitalized and hollow shell CMOs undermines market integrity, erodes investor confidence and hikes regulatory cost, which is incurred through investor complaints management and other remedial undertakings.[112]

It is hardly disputable that the increase in minimum capital requirements in banking, insurance and securities sectors as the foregoing shows, can generate at least two competitive effects: increase the market share of well capitalised and soundly managed financial intermediaries when the poorly capitalised financial intermediaries exit the market; and compel the soundly managed ones to offer better services so as to retain their increased market share. Whether the second effect would always happen is doubtful because the eventual emergence of a few big financial intermediaries can generate a third but adverse effect:

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111 *Section 313(6)*, *ISA 2007,* empowers SEC to prescribe minimum capital requirements from capital market operators namely, brokers-dealers, registrars, issuing houses, underwriters, trustees, investment advisers, and rating agencies. The minimum capital regime announced in December 2013, is as follows: (i) for broker dealers from ₦70 million to ₦300 million; (ii) for a stand alone broker, from ₦40 million to ₦200 million; (iii) for a stand alone dealer, from ₦30 million to ₦100 million; (iv) for issuing houses, from ₦150 million to ₦200 million; (v) for an underwriter, from ₦100 million to ₦200 million; (vi) for a registrar, from ₦50 million to ₦500 million; (vii) for trustees, from ₦40 million to ₦300 million; (viii) for a rating agency, from ₦20 million to ₦150 million; (ix) for corporate investment advisers, from ₦20 million to ₦150 million; and (x) for individual investment advisers, from ₦500,000 to ₦2 million. The compliance date for the minimum capital increase is 31 December 2014: I. Nwachukwu, 'Minimum Capital Requirements for Market Operators...Matters Arising,' *BUSINESSDAY,* 9 January 2014.

112 *ibid.*

monopolistic competition in the provision of financial services. This would be the case where big and highly capitalised financial intermediaries use their business might to dictate the choices available to users of financial services and make entry by new intermediaries almost impossible. Thus, the potential for the current approach to financial market competition regulation to lead to the emergence of monopolistic competition ought to be noted as a regulatory deficiency. There are at least four other deficiencies that ought to be equally noted.

First, the current approach limits the interplay of market forces as objective and less controversial determinants of which intermediary stays in business. Market forces—the forces of demand and supply—are objective and less controversial because with them the survival of each intermediary is tied to its performance. They remove the criticism of regulatory high-handedness and poor consultation that often plague minimum capital increase.[113] If the regulatory aim is to oversee a market, which provides minimally disruptive exit routes for weak and non-performing intermediaries, then the regulators can stipulate that intermediaries which have consistently proved to be weak and non-performing over a stipulated period of time should submit a business improvement plan or exit the market.

[113] Not unlike past trends, the new increase announced by SEC is already the subject of controversy. See Nwachukwu (n 110); O. Adindu, 'The New Minimum Capital Requirement for Capital Market Operators (CMOS) was the Outcome of Extensive Consultations,' (March, 2014) available online at: <http://www.sec.gov.ng/articles/the-new-minimum-capital-requirement-for-capital-market-operators- (cmos)-was-the-outcome-of-extensive-consultations.html> accessed on 28 July 2014. Mr. Adindu is the Communications Adviser to the Director-General of the SEC.

Second, increasing minimum capital to spur competition, as the crisis of 2008 – 09 shows, can be counter-productive and ultimately deleterious. This is because the excess liquidity that tends to follow such capital increase, as the experience from the banking sector shows, may not necessarily increase credit to sectors such as manufacturing, agriculture and for infrastructural development. It can, for instance, be the herald of another desperate competition and speculative business by intermediaries as they explore profitable means to secure higher return on capital to justify the new increase. Of course we could argue that since measures have been introduced to regulate margin trading, there is no point anticipating new problems in this area. But excessive speculative business fueled by margin credit is not the only quick and dangerous profit avenue for financial intermediaries. For instance, excessive credit could be funneled into the real estate market; the importation of consumer goods; loans to politicians for electioneering campaigns; and loans to States and local governments. It may even be the case that all of these are currently taking place only that they are yet to reach crisis proportion. Thus the possibility that for regulatory capital increase to lead to another systemic crisis should always be considered seriously whenever regulators elect to order a new round of recapitalisation.[114]

[114] Ogowewo and Uche (n 5) have indeed cogently questioned the logic of regulating banks into existence in Nigeria without a corresponding improvement in the country's economic fortunes including the expansion of non-banking Nigerian business beyond the shores of Nigeria.

Third, to force small but not necessarily weak intermediaries out of the market could destroy or limit the opportunities available for different operators and users of financial services to create niche markets. Generally a niche market is a subset of the market on which a product or service is focused. In a country such as Nigeria with preponderant retail investors, petty traders, small savers, artisans and tradesmen, squeezing out small banks, insurers and brokers, would most likely prevent the emergence of a niche market in financial services for this segment of the public and may even increase the price they pay to use financial services. It can of course be countered that effective consumer protection should protect them from exploitation. Still, effective consumer protection should not be seen as a credible substitute for a variegated competition regulation in which opportunities are created for different operators to find and grow their niche markets. This could be in terms of catering for the interests of varying clientele at a quality and cost that is mutually satisfactory to the users and providers of financial services. This thinking perhaps influenced the CBN's policy shift from a monolithic minimum capital requirement and banking licence regime to a variegated approach.

Fourth, using minimum capital to spur competition is susceptible to an inflation induced 'vicious circle' of future increases to play catch up, as inflationary trends erode the capital base of financial intermediaries. It has been persuasively argued that the CBN has often used banks' minimum capital increase to mask its inability to devise an effective monetary policy approach to control inflation.[115] If the current approach is sustained, therefore, the circle of 'inflation-increase-inflation-increase' is most likely to persist for long in the entire financial system.

There is again an alternative to this chronicle of deficiencies in financial market competition regulation. The alternative contends that while high minimum capital requirement can strengthen the financial system, there is a foundational need to study the appropriateness of the capital requirement, to balance risk; returns on capital; and market development. In chapter 6, we shall demonstrate how this alternative thinking under an objectives-based financial regulatory approach can be used to craft regulatory principles that promote financial market competition in a coherent, consistent, dynamic and minimally counter-productive way.

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115 *ibid.*

2.3 CONCLUSION

This chapter has articulated the case for financial regulatory reform in Nigeria. It has used a caused-effect approach to show that structural and statutory deficiencies as well as supervisory failure in the enforcement of financial system stability, consumer financial protection, market integrity and competition, are causal manifestations of the crisis of financial regulation in Nigeria, a discussion that we started in Chapter 1. The chapter argued that there are two alternatives for financial regulatory reform in Nigeria: through piecemeal reforms or a holistic regulatory reform. It strongly contended for the second alternative not least because it offers us an opportunity to propel effective and enduring financial regulatory reform in Nigeria.

Overall this chapter is prefatory in that it is intended to open up the reform issues that would dominate our discussions in subsequent chapters of this thesis and with specific reference to the theoretical and normative regulatory contents of our advocacy for the adoption of an objectives-based triple peaks financial regulation in Nigeria. In chapter 3 that follows next, we shall discuss the theoretical underpinning of this advocacy.

CHAPTER THREE

Objectives-Based Triple Peaks Financial Regulation: The Theoretical Underpinnings

3.1 Introduction

This chapter presents the theoretical assumptions that underpin our advocacy for the adoption of objectives-based triple peaks financial regulation in Nigeria. It addresses a self-imposed theoretical standard according to which a research (such as our current endeavour) to design a new financial regulatory system, should aim for an approach which fits the regulatory context of the subject country and mirror relevant contemporary regulatory best practices. To attain this standard we would demonstrate in this chapter that financial regulatory theories, objectives and models could be used in principle to design an effective financial regulatory framework for Nigeria.

This chapter is divided into five sections. This introduction is the first. The second section evaluates the theories of financial regulation; the remedial foundations of the law of obligations; and espouses a public interest account for this thesis. The third section highlights the four financial regulatory objectives and evaluates extant regulatory models. The fourth justifies the appropriateness of an objectives-based triple peaks financial regulatory framework for Nigeria. The fifth section concludes the chapter.

3.2 PUBLIC INTEREST AND CORRECTIVE JUSTICE IN FINANCIAL REGULATION

In the three sub-sections that follow below we would review and critique the 'public interest' and 'private interest' theories of regulation; situate the thesis within the public interest theories; characterise the public interest theories as creating a primary public regulatory obligation and that a breach of this obligation (i.e. through financial supervisory failure) induces a secondary remedial obligation to atone for the breach on the basis of corrective justice.

3.2.1 Public Interest Theories

Public interest theories explain regulation in terms of a general societal necessity for the State's regulatory intervention to rectify perceived imperfections of the market system so as to achieve the collective public interest. The State's regulatory intervention, on this view, promotes behaviours that in the absence of such intervention are believed not to occur. [1] Implicitly, regulation is mainly intended to defend the interests of the general public and thereby attain the common good; that is the society's socio-economic well-being as a whole.[2]

Applied to financial regulation, public interest theorists perceive markets as extremely fragile and prone to operate very

1 A. Ogus, *Regulation: Legal Form and Economic Theory* (Oxford: Hart Publishing, 2004) 1 – 2; R. Posner, 'Theories of Economic Regulation' [1974] *The Bell Journal of Economics and Management Sciences,* 335.

2 C. Uche, 'The Theory of Regulation: A Review Article,' (2000) *Journal of Financial Regulation and Compliance,* 68.

inefficiently or inequitably if left alone.[3] Financial markets regulation thus takes the form of an indispensable application of communal power through government, with the purpose of overcoming possible failures of the assumptions which support the market system,[4] such as the Efficient Market Hypothesis (EMH) that we shall discuss later under private interest theories. Although the public interest theorists conceive regulation as instrumental for the correction of market failures and as a means to advance the general welfare and society's common economic interests, they do not define the common good in a restricted sense of ensuring a safe and sound financial market. Rather, they take a broader approach according to which the State's regulatory intervention is directed towards socially efficient use and allocation of scarce public resources as well as to protect vulnerable members of the society, who in the absence of regulation would be subject to social injustice.[5] The efficiency, egalitarian and humanitarian persuasions of the public interest theorists notwithstanding, their theoretical assumptions arguably provoke at least three questions.

First, it is debatable whether we can easily separate public interest theories of regulation from *regulatory paternalism*—the

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3 Posner (n 1) 336. For a more recent and extensive discussion of this point see generally: C. Calomiris and S. Haber, *Fragile By Design: The Political Origins of Banking Crises and Scarce Credit* (Princeton: Princeton University Press, 2014).

4 R. Baldwin and M. Cave, *Understanding Regulation: Theory, Strategy and Practice* (Oxford: OUP, 1999) 19.

5 A. Ogus, 'Whither the Economic Theory of Regulation? What Economic Theory of Regulation?' Chapter 2 in J. Jordana and D. Levi-Faur, *Handbook on The Politics of Regulation* (Cheltenham: Edward Elgar Publishing Ltd, 2004) 35.

idea that the State as the contemporary *parens patriae* should always be ready to protect the weak and intervene on behalf of the feeble through regulatory intervention.[6] The assumption that the Sate's regulatory intervention is essential and would always be justified to protect the weak, feeble and vulnerable is not necessarily true in all cases and in some cases could even become an unreasonable paternalism. This would be the case, for instance, where the vulnerability of the person to be protected is self-induced; such as where an investor in disdain of obvious risk and without availing herself of professional advice invests in a high-risk investment scheme with the hope of reaping high short-term returns but ended up losing her investment. Equally, the State's regulatory intervention may also engage unreasonable paternalism in situations where those to be protected—such as institutional investors—ought to be financially knowledgeable enough to look after their interests. Unreasonable paternalism is also engaged by the assumption that the State's regulatory intervention is necessary in cases where those to be protected are well able to regulate themselves such as we have in the case of self-regulatory organisations in most financial markets who thus

6 *Parens patriae* is the Latin for 'parent of the country.' As a legal doctrine, it has its roots in English common law. In feudal times various obligations and powers, collectively referred to as the 'royal prerogative,' were reserved for the king. The king exercised these functions in his role as father of the country. In modern times, the doctrine supports the inherent power and authority of the State to protect persons who are legally unable to act on their own behalf. For more on this doctrine see the online resource available at: < http://legal-dictionary.thefreedictionary.com/Parens+Patriae> accessed on 2 December 2014.

far have satisfactorily run stock markets and commodities exchanges.

We can indeed question whether the State's regulatory intervention as argued by the public interests theorists is necessary in all cases and in all aspects of the financial markets. Assuming *arguendo* that there might be situations that require the State's regulatory intervention in the financial system, we can still question how and to what extent is the intervention justifiable. It is submitted consistently with the overall approach adopted in this research that the State's regulatory intervention in this respect ought be justifiable on five key grounds: to establish the parameters of financial regulation; set up and maintain the rules and institutions essential for the implementation of regulatory objectives; to 're-balance' the foundational asymmetries of power, means and information between financial intermediaries and their customers; to ensure that financial regulation is performed accountably, efficiently and effectively; and to ensure that remedial consequences attach to losses that members of the society may suffer from the aforementioned asymmetries in the financial services industry and from negligent performance of financial regulation.[7]

Closely connected to the foregoing is the second question according to which, the public interest theorists do not provide us with a complementary mechanism albeit in theory through which

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7 We would debate the pros and cons of the four area of intervention extensively in chapter 5.

the monopoly of regulatory power reserved for the State can be made subject to public interrogation and scrutiny to ensure that the power is exercised accountably, efficiently and effectively. It can of course be countered that the existence of public law judicial review processes and public service administrative disciplinary procedures should serve this purpose. But this argument is debatable because in a considerable number of jurisdictions, financial regulators are clothed with statutory immunity which is usually in terms of protection from liability to pay damages or other pecuniary compensation in cases where they have acted with 'gross negligence' or in bad faith.[8] Similarly, a public service reprimand of negligent regulatory officials may not necessarily follow a case of supervisory failure if the disciplinary procedures are weak or poorly administered. Even if the reprimand does follow, it does not necessarily translate to material recompense for the losses that may have been suffered by third party users of financial services in that context. Given these concerns, we argue that there is an accountability gap in the public interest regulatory account that should be filled.

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8 See for instance *Section 114 of the Banking and Financial Institutions Act of 1989* of Malaysia; *section 87 of the Central Bank of Malaysia Act of 2009*; *section 55 of the Capital Markets and Services Act of 2007; Section 53 of the Banks and Other Financial Institutions Act of 1991 as amended; section 52 of the Central Bank of Nigeria Act of 2007; section 302 of the Investment and Securities Act No 29 of 2007; Schedule 1, section 19 of the Financial Services and Markets Act (FSMA) 2000 (as amended by the Financial Services Act of 2012) and section 244 of the Banking Act of 2009* of United Kingdom*; Article 79(8) of the Law on Credit Institutions of 2006,* Bulgaria; *Part XII, Article 32(1*), *Cyprus Banking Law No 66(1) of 1997.* We shall discuss similar legal provisions in other countries in chapter 5.

The third question relates to the implicit assumption of the public interest theorists that government regulation is effective and that it can be implemented without cost. Government regulation can sometimes prove to be unsuccessful in reaching its objectives and even costly. It can be unsuccessful for instance and as we demonstrated in Chapter 2, where the administrative regulatory agencies are requested to fulfill overlapping and (or) 'underlapping' functions in a manner that distorts efficient financial regulation and the efficient functioning of the financial markets.[9] Government regulation can also be costly if, for instance effective and efficient regulation is conflated with an increase in the *quantity of regulation* (more rules and compliance standards) and not as an increase in the *quality of regulation* (focus on better regulation). Increase in the quantity of regulation through the introduction of more and more rules, compliance measures and regulatory inspections without a corresponding consideration of the effect these might have on the cost of compliance for financial intermediaries can lead to burdensome compliance costs.[10]

The foregoing questions do not necessarily suggest the irrelevance of the public interests theories for this thesis. Rather, they point to the need to rework their basic assumptions to address the concerns about unreasonable regulatory paternalism,

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9 Posner (n 1) 339.

10 I. Ehrlich and R. Posner, 'An Economic Analysis of Legal Rules-Making (1974) *Journal of Legal Studies,* 260.

regulatory accountability, regulatory overlap and ‘underlap’ and the cost implications of an emphasis on the quantity of regulation. Later in this chapter, we would address the regulatory accountability gap preliminarily with the application of corrective justice theory of the private law of obligations and more extensively in chapter 5 when we debate the *pro et contra* of imposing liability for negligent financial supervision. The concerns about regulatory paternalism, regulatory overlap and ‘underlap,’ and cost would be addressed through the normative principles and institutional architecture comprised in our advocacy for the implementation of an objectives-based triple peaks financial regulation in chapters 6 and 7.

The thesis aligns with the public interests theorists on five grounds. The public interest account generally speaks to what governments and administrative regulatory agencies should do; and satisfactorily explains what they actually do in the wider context of public administration. The public interest theorists’ assumptions persuasively justify contemporary manifestations of financial regulation across jurisdictions. The rationale behind regulation as propounded by the public interest theorists provides a convincing theoretical basis for the comprehension of the objectives which financial regulations aim to accomplish in practice. The public interest account supplies a polemical basis to interrogate the relevance of the private interest theories of regulation for this research.

3.2.2 Private Interest Theories of Financial Regulation

Centrally, private interest theorists assume that as a consequence of the high-stakes and the interests in the outcome of policy or regulatory decisions, interest groups affected by regulation will focus their resources and energies to promote the policy outcomes they prefer. The result of interest group influence is that the positive aims of regulation are weakened and regulatory effectiveness and efficiency are compromised with the advantages of regulatory reform ending up being unequally distributed and benefitting those involved in lobbying the legislators at the expense of the society at large.[11]

Applied to financial regulation, private interest theorists hold that the financial services industry controls governmental institutions including particularly the administrative regulatory agencies that are responsible for supervising the economy.[12] Through such control, the industry influences the financial regulatory and supervisory processes in a manner that is exclusively to its own benefit. The influence thus exercised by the financial services industry speaks to *regulatory capture.* On the private interests account this occurs when regulation that are initially meant to serve the public good eventually serve that of

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11 Posner (n 1) 335; Baldwin and Cave (n 4) 21; A. Estache and D. Martimort, 'Politics, Transaction Costs, and Design of Regulatory Institutions,' (1999) *World Bank Policy Research Paper 2073,* 9 – 10, 16 – 18.

12 Posner (n 1) 341.

powerful and influential private interests who are able to influence policy-makers and regulatory officials.[13]

Further, a chequered and refined adaption of the private interest theories in finance and financial regulation is the Efficient Market Hypothesis (EMH) according to which financial markets are 'informationally efficient' and work not necessarily because of law, the State's regulatory intervention or the threat of liability, but because market information is provided, collected, verified and disseminated by private reputational intermediaries (investment banks, auditors, securities analysts and credit rating agencies) who impliedly pledge their reputational capital behind their opinions and judgments.[14] Hence, these intermediaries would have little incentive to misrepresent or distort.[15] Regulatory intervention on this account is thus justified when the market is 'informationally inefficient' where intermediaries misrepresent or distort market information.

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13 J. Hertog, 'General Theories of Regulation,' (1999) 225 available online at: <http://www.scribd.com/doc/239491/General-Theories-of-Regulation> accessed on 26 February 2013.

14 EMH's history is remarkably chequered and refined because it has been the subject of scholarly discussion since 1863 and its contemporary signification appears to play down the undertone of financial markets regulatory manipulation that is apparent from a cursory appraisal of the private interest account. For an extensive background on EMH with its roots in the work of Jules Regnault, a French stock broker, published in 1863, see the online resource available at: <http://en.wikipedia.org/wiki/Efficient-market_hypothesis#cite_note-desai-4> accessed on 16 November 2014.

15 For more on this point and the related Efficient Capital Market Hypothesis (ECHM) see generally: E. Fama, 'The Behaviour of Stock Market Prices,' (1965) 38 *Journal of Business,* 35 – 105; --, 'Efficient Capital Markets: A Review of Theory and Empirical Work,' (1970) 25(2) *Journal of Finance,* 383 – 417; R. Gilson and R. Kraakman, 'The Mechanisms of Market Efficiency,' (1984) 70 *Va. L. Rev.,* 549, 619 – 21; G. Cooper, *The Origin of Financial Crises: Central Banks, Credit Bubbles and the Efficient Market Fallacy* (Petersfield: Harriman House Ltd, 2008) 25 – 7.

The private interest account does not supply a convincing theoretical foundation for this thesis on three grounds. First, this account is not sufficiently distinguishable from the public interest account given that both accounts base themselves on the assumption that the public interest is the basis for the initiation of regulation. Second, it is totally unconvincing to say that the financial services industry uses its influence over regulators selfishly always and without a consideration of what is good for a country's economic and the stability of its financial system. This is because the industry can and has often provided helpful inputs into new regulation such as was the case in the UK in the consultations leading to the enactment of the *Financial Services Act 2013*. Third, investors and researchers have disputed both empirically and theoretically the validity of EMH or ECMH. Theoretically, behavioural economists attribute the imperfections in financial markets to a combination of cognitive biases such as overconfidence, overreaction, representative bias, information bias and various other predictable human errors in reasoning and information processing. Psychologists have studied and confirmed the existence of these errors.[16] In the US for instance, these errors in reasoning lead most investors to avoid value stocks and buy growth stocks at expensive prices, which allow those who

[16] See for instance the recent leading work in this area by D. Kahneman, *Thinking, Fast and Slow* (London: Penguin Books, 2012) 109 – 198 (Part II. Heuristics and Biases); 199 – 268 (Part III. Overconfidence); 269 – 376 (choices).

reason correctly to profit from bargains in neglected value stocks and the overreacted selling of growth stocks.

Similarly while empirical evidence has been mixed, it has not generally supported EMH.[17] For instance, while a strong form of the EMH claims that market prices instantly change to reflect new public information and even hidden 'insider' information; a study of low price-earnings ratio stocks in United States found that these stocks have greater returns which are not correlated with either publicly available or insider information on their prices.[18] It is debatable also if EMH convincingly explains the workings of emerging financial markets which have been empirically shown to be inefficient in that they exhibit considerable serial correlation (price-trends),[19] non-random walk and evidence of manipulation.[20] This argument finds support in the evidence of market manipulation on the NSE in 2006 – 2008 that we presented in chapter 2.

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17 For empirical studies that question EMH see F. Nicholson, 'Price-Earning Ratios in Relation to Investment Results,' (1968) *Financial Analysts Journal,* 105 – 109; S. Basu, 'Investment Performance of Common Stocks in Relation to Their Price-Earnings Ratios: A Test of the Efficient Market Hypothesis,' (1977) 32 *Journal of Finance,* 663 – 682; B. Rosenberg, K. Reid, R. Lanstein, 'Persuasive Evidence of Market Inefficiency,' (1985) 13 *Journal of Portfolio Management,* 9 – 17; C. Chan, E. Gup, and M. Pan, 'International Stock Market Efficiency and Integration: A Study of Eighteen Nations,' (2003) 24 (6) *Journal of Business Finance & Accounting,* 803 – 813.

18 N. Dreman and A. Berry, 'Overreaction, Underreaction, and the Low-P/E Effect,' (1995) 51(4), *Financial Analysts Journal,* 21 – 30.

19 In finance, serial correlation is used by technical analysts to determine how well the past price of a security predicts the future price, because technical analysis is based entirely on a stock's price movement and the associated volume, rather than the company's fundamentals. See the online information resource available at: <http://www.investopedia.com/terms/s/serial-correlation.asp#ixzz3gSNJZbwG> accessed on 18 July 2015.

20 B. Malkiel, 'Investment Opportunities in China' (2007) referenced in the EMH online resource in (n 16).

Although the private interest theories of financial regulation do not provide a convincing foundation for this thesis in terms of the three grounds argued above, private interests can still play salutary roles in the financial regulatory process. These roles should be objectively recognised. For instance, financial services industry lobby groups can share their expertise with legislators and policy-makers which all else being the same should allow for more informed laws and policies to me made. Indeed, it reflects best practice and a process driven financial regulation to formally consult the industry about draft regulatory measures in order to give those who fall within the scope of the planned legislation the opportunity to express their views on the proposal. What is objectionable is when financial services industry lobbyists have extensive privileged access to policy-makers and exercise unwholesome influence on the legislative process and in relation to matters that affect their collective interests.[21]

[21] This phenomenon is arguably pervasive in western developed markets as evidenced by the following mass media revelations: SpinWatch, 'Doing God's Work: How Goldman Sachs Rigs the Game' March 2011 available online at: <http://www.spinwatch.org/-articles-by-category-mainmenu-8/48-lobbying/5426-the-power-offinancial-lobbyists-must-be-curtailed > accessed 9 September 2012; A. Rowell, 'The Power of Financial Lobbyists Must be Curtailed' SpinWatch 20 March 2011, available online at: <http://www.spinwatch.org/-articles-by-category-mainmenu-8/48-lobbying/5426-the-power-offinancial-lobbyists-must-be-curtailed > accessed 9 September 2012. In March 2011 a report by an undercover team from the UK's Sunday Times newspaper alleged that the MEPs had accepted offers of cash in exchange for influencing laws. As reported in the Sunday Times, four members of the European Parliament accepted a bribe from journalists, pretending to be lobbyists, in return for the watering down of a proposal for the reform of financial regulation.

3.2.3 The Public Financial Regulatory Obligation and Corrective Justice

The idea expressed above that the public interest account of financial regulation philosophically justifies this research, invites several questions. We would here focus on three of these questions that we consider to be pertinent to the overall analytical framework of this research. The first question relates to whether the public interest in the regulation of financial services necessarily imposes a *normative regulatory duty* on the State to ensure that the pursuit of value by financial intermediaries does not occasion harm to the economy and users of their services. Second and assuming *arguendo* that a financial normative regulatory duty is imposed on the State, whether this duty creates a correlative *normative regulatory right* for the users of financial services to request the State to account for the performance of this duty. Third and assuming *arguendo* the public interest account of financial regulation contemplates a bipolar normative regulatory duty and right, how do we characterise this remedial bipolarity?

In relation to the first question, it is hardly debatable that the very existence of the State does not justify the imposition of a duty to regulate financial services, because there are areas of human life that are not strictly speaking provinces for the State's regulatory intrusion. The State for instance, does not and ought not to regulate all aspects of our family life and the private relations of consenting adults especially those which the society regards as sexually immoral. Nor does the public interest in financial regulation translate to an implied statutory duty incumbent on the State to regulate financial intermediaries. This is because it is hardly convincing to impose (in the absence of a clear statutory provision) an implied statutory duty on the State to regulate financial services. The State's duty to regulate financial services it is submitted is conceptually rooted in the strategic indispensability of the roles played by financial intermediaries conjoined with the limited powers of users of financial services to mount an effective monitoring and regulation.

The strategic indispensability of financial intermediaries is evident in many respects. They run the payments system; provide credit for the economy and act as deposit custodians. They provide liquidity to the economy, by transforming liquid deposits into large illiquid loans. They provide loan commitments; letters of credit; financial guarantees that assist business counterparties to transact; advisory services that help investors plan future investments; and facilitate access to alternative sources of external finance (e.g. commercial paper market). They also provide derivative contracts that enable counterparties to hedge their market risk.[22] They are indispensable to financial maturity transformation because they garner deposits and raise funds in

[22] Allen N. Berger, Philip Molyneux and John O. S. Wilson, 'Banking: An Overview' in Allen Berger *et al* eds., *The Oxford Handbook of Banking* (Oxford: OUP, 2010) 1.

the short term money markets, which they invest in long term capital markets—a maturity mismatch allowing them to offer risk sharing to depositors—but which also exposes them to bank runs.[23] In bank-based economies such as Japan and Germany, banks play corporate governance roles as outside or delegated monitors of large corporations.[24] Thus they assist to overcome possible asymmetric information problems by forming long-term relationships with the firms to which they provide funding.[25]

Given the foregoing roles and the implicit trust that heterogeneous users of financial services often repose in financial intermediaries, it is strongly argued that even if the very existence of the State does not invite a financial regulatory duty and if no express statutory duty to do so can be referenced; the duty should arise nonetheless from a conceptual norm

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23 Bank runs can involve the withdrawal of funds by depositors (retail runs) or the drying of liquidity in the short-term capital markets (wholesale runs). In the case of the run on the Northern Rock in the UK, in late 2007, both occurred. These runs can occur spontaneously as a panic resulting from 'mob psychology' or 'mass hysteria.' See generally, C. Kindleberger and R. Aliber, 5th edition, *Manias, Panics and Crashes: A History of Financial Crises* (Hoboken: Wiley and Sons, 2005). They may also arise from fundamental causes that are part of the financial intermediary's business cycle. See generally on causal explanations of financial business cycles: W. Mitchell, *Business Cycles and Their Causes* (Berkeley: University of California Press, 1941).

24 In Japan, this system of monitoring is referred to as *main bank* system, characterised by long-term relationship between a bank and its client firm, debt and equity holding in the client and active intervention should the client become financially distressed. In Germany, it is known as *hausbank system,* wherein banks tend to have very close ties with firms, for the loans they provide, direct shareholding and the proxies they are able to exercise: Franklin Allen and Elena Carletti, 'The Role of Banks in Financial Systems' in Allen N. Berger et al eds. (n 21) 37 – 57; T. Hoshi, A Kashyap and D. Scharfstein, 'The Role of Banks in Reducing the Cost of Financial Distress in Japan' (1990) 27 *Journal of Financial Economics,* 67 – 68; M. Aoki and H Patrick (eds) *The Japanese Main Bank System: Its Relevance for Development and Transforming Economics* (Oxford: Oxford University Press, 1994) 592 – 633; G. Gorton and F. Schmid, 'Universal Banking and the Performance of German Firms,' 58 *Journal of Financial Economics,* 29 – 80.

25 A. Boot, 'Relationship Banking: What do we know?' (2008) 9 *Journal of Financial Intermediation,* 7 – 25.

according to which the strategically indispensable roles of financial intermediaries and the implicit trust reposed in them by their heterogeneous customers—who are not practically well resourced and whose dispersed contractual monitoring powers may not be easily aggregated and deployed to detect or prevent abusive practices by financial intermediaries—necessitate a State regulatory duty to ensure that their (financial intermediaries') pursuit of value is done in a safe and sound manner that creates a minimal risk of harm to the economy and users of their services. Accordingly and in answer to the first question, the State's duty to regulate financial services could be conceptually characterised as *normative*.

It follows from the foregoing and in answer to the second question that to the extent that the State has a conceptually normative financial regulatory duty, this duty engages a jural correlative,[26] a *normative civic right* for the users of financial services to request the State to account for the performance of this duty. The correlativity of the normative financial regulatory duty and right does not exist *in vacuo* (i.e. lacking in context) any more than we can contend that the State's duty to expend public resources for the general welfare of the citizenry is devoid of an accountability context. For the purposes of conceptual

[26] For an extensive discussion of the jural relations in each of these cases right and duty; privilege and no right; power and liability; immunity and disability; right and no-right; privilege and duty; power and disability; and immunity and disability, see: A. Kocourek, 'The Hohfeld System of Fundamental Legal Concepts,' (1920) 15(1) *Illinois Law Review,* 24 – 39.

soundness,[27] the State's normative duty to regulate financial services, as with its duty to expend public resources for the welfare of the general citizenry, ought to have an accountability context to enable the beneficiaries (the financial public and the general body of citizens) challenge the discharge of this duty. Two arguments, one general and the other specific, support this proposition. Generally, the citizens as the electorates are the ultimate sources of the State's sovereign delegated regulatory power and thus to whom the State at all times in its existence remains *rightfully* accountable. Specifically and to prevent a descent into regulatory excesses (high-handed regulation) or the ascent of regulatory negligence, the State's power to regulate financial services ought to be circumscribed by a mechanism through which its performance is measured against the normative *rightful entitlement* of users of financial services to *diligent regulation*.

If the foregoing provides a conceptual context for a normative bipolar duty—right relation between the State and users of financial services, how do we—in relation to our third question—characterise this bipolarity for the purposes of accountability and for a remedial response to an established breach of this duty? It is submitted that corrective justice theory of the private law of obligations, is applicable for the

[27] Conceptual soundness as used here, references a self imposed requirement for our argument on the correlativity of duty and right in financial regulation to have a convincing basis in principle.

characterization of this bipolarity.[28] Generally in the private law of obligations, corrective justice reflects in a three-stage sequence of right-duty, wrong and civil recourse: (a) a claimant's injury must be something, which embodies a right;[29] (b) the defendant's act must violate a duty incumbent upon the defendant as to be regarded as a wrong;[30] and (c) the duty breached must concern the right, the infringement of which supplies the claimant's cause of action. That is the claimant must sue to enforce her right and not as a vicarious beneficiary of another's right.[31]

Applied in a modified form to financial regulation and consistently with our analysis thus far in this chapter, the corrective justice sequence translates to: (a) a normative primary

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28 For an extensive and superb analysis of the corrective justice account of private law of obligations see E. Weinrib, *The Idea of Private Law,* (Cambridge-Massachusetts: Harvard University Press, 1995). A part of this book can be read in an earlier article: E. Weinrib, 'Corrective Justice', (*1991*-1992) 77 *Iowa L. Rev., 403.*

29 Judicial authorities support this point. In *Fontainebleau Hotel Corp. v Forty-Five Twenty-Five, Inc.,* 114 So. 2d 357 (Fla. C.A., 1959), the plaintiff hotelier filed a claim against the defendant owner of a neighbouring premises, for building a structure that cast an afternoon shadow on its bathing area. The court, in dismissing the action, held at 358, that the maxim *sic utere tuo ut alienum non leadas* 'does not mean that one must never use its property in such a way as to do any injury to his neighbor . . . It means only that one must use his property so as not to injure the lawful rights of another.' Similar issues arose when defendant caused economic loss through negligent damage to some facility: a tunnel in *Cattle v Stockton Waterworks* (1875) L.R. 10 Q.B. 453; a power line in *Spartan Steel and Alloys Ltd. v Martin & Co. (Contractors) Ltd.,* [1973] Q.B. 27 (C.A.); a pipeline in *Caltex Oil v The Dredger 'Willemstad,'* 176 Comm. Law Rep. 529 (H.C. Aust., 1976) and a bridge in *Norsk Pacific Steamship Co. Ltd. et al v Canadian National Railway Company,* [1992] 1 Sup. Ct. Rep.1021.

30 In *Bourhill v Young* [1943] A.C. 92 at 106, Lord Wright held that damages which occur from a legitimate exercise of right are not actionable, even if the actor contemplates the damage. It is *damnum absque injuria.* The damage must be attributable to the breach by the defendant of some duty owed to the plaintiff.' Cases such as *Mogul Steamship Co. v McGregor, Gow & Co* [1892] A.C. 25 and the *Bradford Corporation v Pickles* [1895] instanced leading occasions where the court have held damage occurring upon the legitimate exercise of right as *damnum sine injuria.*

31 In *Palsgraf v Long Island Railroad,* 162, N.E. 99 at 100 (N.Y.C.A, 1928) Cardozo J. held *inter alia*, that 'the plaintiff sues in her own right for a wrong personal to her, and not as the vicarious beneficiary of a duty owed to another.'

duty incumbent on the State to regulate financial intermediaries; (c) a normative derivative right of civil recourse by that section of the general citizenry who are beneficiaries of this duty to interrogate its performance where a breach of duty is perceived to have occurred; and (c) a secondary remedial duty of atonement incumbent on the State where such a breach is established. This sequence, we contend, is applicable to close the accountability gap in the public interest account of financial regulation and also provides a theoretical basis for users of financial services to seek private and public law remedies against the State where a breach of duty is perceived. Chapter 5 explores extensively the implications of this contention for the imposition of negligence liability on financial regulators for regulatory accountability and private law remedial purposes.

The next section of this chapter, discusses how the public interest account reflects in financial regulatory objectives. It evaluates the extant models for the pursuit of these objectives and shows why none of these models provides the 'best fit' for the Nigerian context in terms of an effective financial regulatory structure.

3.3 FINANCIAL REGULATORY OBJECTIVES AND MODELS

The public interest account of financial regulation is practically demonstrated in the objectives financial regulation. These objectives can be in terms of prevention of financial crimes or the need to ensure that the conduct of financial services contributes to national economic development and growth. However and in four senses that correspond to the framework of this thesis, these objectives comprise financial system stability, consumer financial protection, financial market integrity, and promotion of competition in the provision of financial services. We have examined the justifications for these objectives and how they are (ineffectively) enforced in Nigeria in chapter 2. This section connects with that initial examination in that it evaluates the extant models for the implementation of these objectives and shows why none of these models provides the 'best fit' for the Nigerian context in terms of an effective financial regulatory structure.

3.3.1 Financial Regulatory Models

There are in general no strict rules that dictate the choice of the applicable model for the implementation of the four objectives discussed in chapter 2; nor is there a consensus on the most practical approach for the regulation and supervision of financial markets. Evidentially, the question of which model provides the best fit in a given national regulatory context is driven largely by country-specific factors. The discussion on the failure of functional financial regulation in Nigeria in chapter 2 partly supports the last point. For our purposes here, we would build on that failure argument and argue further that the failure of functional financial regulation in Nigeria cannot be remedied by merely adopting one of the other existing models. This is mainly because none of them can effectively reform the contextual regulatory issues discussed in chapters 1 and 2. The remaining part of this subsection would develop this argument and our other introductory points here.

There are two views on the nature and forms of financial regulatory models. The first view encapsulated in the Group of Thirty's *The Structure of Financial Supervision* identifies four models of financial regulation.[32] These are: the institutional approach,[33] the functional approach,[34] the integrated approach,[35] and the twin peaks approach.[36] The second view by two leading authorities on financial regulation identifies three basic regulatory models: 'the functional/institutional model, the consolidated financial services regulator model, and the "twin peaks" model.'[37] This thesis adopts the second view because we

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32 Group of Thirty, *The Structure of Financial Supervision, Approaches and Challenges in a Global Marketplace* (Washington, D.C.: Group of Thirty, 2008) 23 – 32.

33 This where the firm's legal status determines which regulator has oversight for the firm: *ibid,* 24.

34 This where the business transacted by the financial intermediary determines the nature of regulatory oversight: *ibid.*

35 This involves a single universal regulator with remit for prudential regulation and market conduct: *ibid.*

36 This model assigns prudential regulation and conduct regulation to two separate agencies: *ibid.*

37 J. Coffee and H. Sale, 'Redesigning the SEC: Does The Treasury Have a Better Idea?' (2009) 95 *Va. L. Rev.* 707 at 717 – 18.

are unable to appreciate a fundamental difference between the legal status of a financial intermediary as a bank and its functional business either as a commercial or an investment bank that arguably supports the distinction between institutional approach and functional approach as adopted by the first view. In the other words, an intermediary's status as a bank and the businesses of commercial and investment banking all exist within the broad category of banking business. Accordingly and in agreement with the second view, we perceive the institutional and functional approaches as the same.

3.3.1.1 The Functional/Institutional Model

Functional and (or) institutional financial regulation is arguably the most instinctive and traditional of all the three known models, because it maintains separate regulatory agencies across segregated ('functional') lines of financial services, such as banking, insurance, securities, and where applicable futures trading, and pension funds regulation. In its institutional form, it is seldom the product of deliberate design, but rather that of historical contingency, piecemeal reform, and gradual evolution, which subjects similar activities to regulation by same regulator, on the premise that no one regulator can have or easily develop expertise in regulating all aspects of financial services. Thus the securities regulator understands securities, while the insurance regulator has expertise with respect to the very different world of insurance.[38] In addition to Nigeria, functional financial regulation is practiced in the US, Malaysia and Italy.[39] In the case of Nigeria and, as we have argued in chapters 1 and 2, this has failed to respond effectively to perennial banking insolvencies which reached a debilitating climax in the crisis of 2008 – 09.[40] For our purposes here, we would use the US experience to analyse the deficiencies of this model in a different national context and to validate our argument that financial regulatory reforms are largely driven by country-specific factors.

Functional financial regulation in the US is fragmented along overlapping institutional and federal-state lines. Both the federal and the state governments regulate some sectors of the financial system (i.e. banking and insurance) and state and federal regulatory institutions often perform overlapping regulatory functions.[41] There are currently nine federal financial regulators, namely, the Federal Reserve,[42] the OCC,[43] the FDIC,[44]

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38 *ibid*; U.S. Department of the Treasury, *Blueprint for a Modernised Financial Regulatory Structure* (Washington D.C.: Dep't of the Treasury, 2008) 4, 27.

39 In Italy, banking supervision is exercised by *Banca d'Italia* while the *Institutio di Vigilanza sulle Assicurazioni Private* (ISVAP) regulates insurance business. The *Commission Nazionale per le Società e le Borse* (Consob) regulates the securities markets. See E. Wymeersch, 'The Structure of Financial Supervision in Europe: About Single, Twin Peaks and Multiple Financial Supervisors,' (2007) 8(2), European Business Organization Law Review, 237 at 292.

40 See also on this point: O. Famuyiwa, 'The Nigerian Financial Crisis: A Reductionist Diagnosis' (2013) 2(1) *Journal of Sustainable Development and Policy*, 1 – 25.

41 For an extensive discussion of the US dual and overlapping functional and institutional regulatory approach, see generally, C. Felsenfeld and D. Glass, *Banking Regulation in the United States* (Huntington: Juris Publishing Inc., Third Edition 2011) 39 – 80.

42 Established in 1913, by *Sections 2, 3 and 4 of the Federal Reserve Act of 1913*, the Federal Reserve System ('the Fed') is effectively the Central Bank of United States. It regulates bank holding companies, financial holding companies, savings and loans holding companies, state banks that are members of the Federal Reserve System, US branches of foreign banks and foreign branches of US banks. Further to the reform under the *Dodd-Frank Wall Street Reform and Consumer Protection Act, 2010,* the Fed now regulates financial firms, which engage in

the NCUA,[45] the SEC,[46] CFTC,[47] FHFA,[48] the BCFP,[49] and the FIO.[50] Each state has its own regulatory agency to charter and supervise state banks. The organisational features of these agencies vary from state to state and in many states the agency supervising state banks also supervises other types of financial institutions. However before the subprime mortgages crisis of 2007-08, Fed, OCC, SEC, CFTC, the Office of Thrift Supervision

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payments, clearing, and settlement systems, designated as systemically significant by the Financial Stability Oversight Council: *Sections 101- 123* of the *Dodd-Frank Wall Street Reform and Consumer Protection Act, 2010.*

43 OCC is an independent bureau within the United States Department of the Treasury that was established by the *National Currency Act of 1863* and strengthened by the *National Bank Act of 1864* to charter and regulate national banks. In the reforms implemented through the *Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010* the OTS has been merged with the OCC and the latter now also regulates federally chartered thrift institutions: *Sections 312 and 313 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.*

44 Established by *Section 101 of the Banking Act 1933*, FDIC regulates federally insured depository institutions, including state banks and thrifts that are not members of the Federal Reserve System.

45 Established by *Section 1752a of the Federal Credit Union Act, 1934*, the NCUA regulates federally chartered or insured credit unions.

46 SEC was established by *Section 4 of the Securities Exchange Act of 1934* to regulate securities exchanges, brokers and dealers; clearing agencies, mutual funds; investments advisers (including lodge funds with assets over $150 million); nationally recognised statistical rating organisations; and security-based-scrap corporations selling securities to the public must register and make financial disclosures to SEC: *Sections 4A - 21 of the Securities Act 1934*.

47 Established by *Section 2* of the *Commodity Futures Trading Commission Act of 1974*, the CFTC, regulates futures exchanges, brokers, commodity pool operators, and commodity trading advisors. Since 2010, the CFTC and SEC now have joint remit over regulation of over-the-counter-swaps markets: *Section 712* of the *Dodd-Frank Wall Street Reform and Consumer Protection Act, 2010.*

48 The FHFA was established by *Section 4511 of the Federal Housing Finance Regulatory Reform Act of 2008*, as the successor regulatory agency resulting from the statutory merger of the Federal Housing Finance Board (FHFB), the Office of Federal Housing Enterprise Oversight (OFHEO) and the US Department of Housing and Urban Development government-sponsored enterprise mission team, absorbing the powers and regulatory remits of these entities, with expended legal and regulatory authority, including the ability to place government sponsored enterprises (GSE's) into receivership or conservatorship. *Section 1102* of the *Housing Economic Recovery Act of 2008*.

49 Established by *Section 1011* of the *Dodd-Frank Wall Street Reform and Consumer Protection Act*, the BCFP, inter-regulates nonbank mortgage-related firms, private student lenders, payday lenders, and larger 'consumer financial entities' to be determined by the Bureau.

50 Established post 2008 under *Section 502* of the *Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010,* the FIO has the remit among other things, to monitor all aspects of the insurance industry, including identifying issues or gaps in the insurance industry that could contribute to a systemic crisis.

(OTS), and state banking regulators regulated the US financial system.

The US financial regulatory experience speaks to two key deficiencies of functional financial regulation. The first is how to coordinate the functional and (or) institutional divide of the regulatory architecture; the second is the associated opportunities for regulatory arbitrage by financial intermediaries. The coordination deficiency is illustrated by the need within the fragmented regulatory system for close contact and cooperation between banking, securities, and insurance regulators in order to achieve effective supervision of financial conglomerates whose businesses straddle the boundaries between those sectors. This deficiency is partly responsible for the Nigerian financial crisis of 2008 – 09.[51] Regulatory arbitrage is more common in the US than Nigeria and it arises partly from the tendency of functionally regulated financial institutions to position their operations to fall within the jurisdiction of the most accommodating regulator. This was pronounced before the crisis of sub-prime mortgage crisis of 2007 – 08 where, for instance, investment banks designed new financial products so as to encounter the least regulatory oversight.[52]

Financial regulatory developments in the US after 2008 validate our argument that reforms in this area tend to be driven

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51 S. Sanusi, 'The Nigerian Banking Industry: What Went Wrong and the Way Forward,' (2010) 5,available online at < http://www.bis.org/review/r100419c.pdf? frames=0 > accessed 15 May 2012.

52 Coffee and Sale (n 36) 726.

largely by country specific-factors. These factors in the US context are regulatory arbitrage facilitated by ineffective regulatory coordination and in the case of the regulation of Over-the-Counter financial products (OTCs) lack of effective regulation. To reform these factors, the structure of financial regulation in the US is now constructed around two building blocks (macro-prudential and micro-prudential supervision) that should operate in an integrated and cooperative way, but with distinct responsibility and accountability under a clear guidance of the Treasury. The Financial Stability Oversight Council (FSOC) is created and tasked with macro-prudential supervision in the sense of (a) identifying risks to the financial stability of United States, (b) promoting market discipline and information, notably by eliminating expectations that financial and non-financial organisations will be shielded from losses in the event of failure and (iii) responding to emerging and systemic threats to financial stability.[53] Micro-prudential supervision is still fragmented along overlapping institutional and federal-state lines as indicated above.

3.3.1.2 The Consolidated Financial Regulator Model

The consolidated financial regulator model unifies the responsibilities for regulation of banking, securities, and insurance in one agency. Norway was the first country to

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[53] See, Title I—FINANCIAL STABILITY, Subtitle A—Financial Stability Oversight Council, *Dodd-Frank Wall Street Reform and Consumer Protection Act, 2010.*

establish a consolidated regulator in 1986,[54] followed by Denmark in 1988,[55] and Sweden in 1991.[56] However as the first the major international financial centre to adopt the single regulator model, the United Kingdom creation of the defunct Financial Services Authority (FSA) between 1997 and 2000 is arguably the most famous.[57]

One argument in favour of the single regulator model is that it matches the convergence of financial services, and enhances a more holistic regulatory approach to the emergence of financial conglomerates whose businesses often straddle the entire financial system and thus breakdown the orthodox distinctions among banking, insurance and securities businesses.[58] However, the UK's adoption of the single regulator was not solely premised

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54 A single regulator, the *Finanstilsynet* (the Financial Supervisory Authority of Norway), regulates banks, finance companies, mortgage companies, insurance companies, pension funds, investment firms, securities fund management and market conduct in the securities market, stock exchanges and authourised market places, settlement centers and securities registers, estate agencies, debt collection agencies, external accountants and auditors: Wymeersch (n 38).

55 A single regulator, the Danish Financial Supervisory Authority (DFSA), regulates the Danish financial system. See generally: R. Dijikstra, 'Liability of Financial Supervisory Authorities in the European Union,' (2012) 3 *JETL* 346 at 352 – 3.

56 Since 1991, the Swedish Financial Supervisory Authority (SFSA), or *Finan-sinspektionen*, has been the sole regulator of the Swedish financial sector. The SFSA is a government central administrative authority that falls under the Swedish Ministry of Finance: *ibid*, 362.

57 The FSA started as a company limited by guarantee following the renaming of the Securities and Investments Board (SIB), itself a private company limited by guarantee in 1997 formerly responsible for the delegated regulation of the UK securities market. The FSA later received statutory backing in the *Bank of England Act 1998* and the *Financial Services and Markets Act*, 2000. See generally, E. Ferran, 'Examining the United Kingdom's Experience in Adopting the Single Financial Regulator Model,' (2003) 28, *Brook. J. Int'l L.* 257 at 260 – 276. Since 1 April 2013, and in consequence of the regulatory reform under UK *Financial Services Act of 2012*, the FSA has been reformed into regulatory agencies, the Financial Conduct Authority and the Prudential Regulatory Authority.

58 For this argument and other merits of this model, see generally, C. Briault, 'The Rationale for a Single Financial Service Regulator' (FSA Occasional Paper Series, No. 2, May 1999) 25; Ferran (n 56) 277 – 301; Wymeersch (n 38). T. Ogowewo and C. Uche, in '[Mis]Using Bank Share Capital as a Regulatory Tool to Force Bank Consolidation in Nigeria' (2006) vol. 50, 2 *Journal of African Law*, 161 align with this view and that Nigeria needs a financial regulator that mirrors the defunct UK FSA.

on this argument.[59] There were 'country specific' considerations including the dismal failure of a prior regulatory system that relied heavily on self-regulatory bodies, but which became a political liability because of its inability to cope with a succession of serious market scandals.[60]

After the UK financial crisis of 2007 – 08, a separate set of factors including the failure of prudential regulation which substantially resulted in the collapse of Northern Rock and the nationalisation of Bradford & Bingley, exposed two key deficiencies of a single regulator model as adopted in the UK under the FSA.[61] The first deficiency is the likelihood that the consolidated regulator would concentrate on one regulatory objective while paying less or ineffective attention to the pursuit of other objectives. The second deficiency is the difficulty of having a practically ambidextrous consolidated regulator who is

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59 Ferran (n 56) 259. Instructively, the then Chancellor of the Exchequer, premised the creation of the FSA, on three key reasons: (1) the existing structure was failing to deliver the standards of investor protection and supervision that industry and the public had the right to expect; (2) the two tier structure under the *Financial Services Act, 1986*, was inefficient, confusing, and lacked accountability and a clear allocation of responsibilities; (3) the need for a regulatory structure that would reflect the nature of the markets where the old distinctions between banks, securities and insurance companies had become increasingly blurred. See generally, G. Brown, 'The Chancellor's Statement to the House of Commons on the Bank of England (20 May 1997) available at: http://www.hm-treasury.gov.uk/Newsroom_and_Speeches/speeches/statement/speech accessed on 23 July 2012.

60 The UK experienced two major banking failures, the Bank of Credit and Commerce International (BCCI) in 1991, and Barings in 1995. Each prompted an official inquiry that found lax supervision at least a partial cause. Securities regulation in the UK at the time also came under persistent criticism focused on the inability of the SROs to protect consumers from fraud and misconduct. Two scandals particularly stood out: the Robert Maxwell affair in which a prominent financier effectively embezzled the pension funds of his companies and a 'pension mis-selling' controversy in which risky financial products were inappropriately sold to pension funds without supervision or disclosure: Ferran (n 56) 261 – 62, 267 – 68.

61 See generally on this: FSA (now defunct) *The Turner Review; A Regulatory Response to the Global Banking Crisis* (London: FSA, 2009) 11 – 50. . See also K. Keasey and G. Veronesi, 'Lessons from the Northern Rock Affair,' (2008) 16(1) *Journal of Financial Regulation and Compliance,* 8 – 18.

able to combine and deploy the dissimilar skills sets required for prudential regulation, market integrity regulation and consumer financial protection. We reason that in the Nigerian context and in view of the need for a more effective approach to financial regulatory objectives, consolidated financial regulation should not be seen as a reform option. Of course the fact that this model failed in the UK does not mean that it will not work in Nigeria. Still we argue against the adoption of this model because it requires the combination of at least three objectives (market integrity, consumer protection and financial system stability) in a single agency which for instance does give a much needed enhanced profile to consumer financial protection in Nigeria. Another objection and one from our appraisal of CBN and SEC performance in Chapter 2, is that there is no guarantee that the new consolidated regulator will not mask its ineffective implementation of one objective by overusing its powers under one of the other two objectives. It might for instance impose high fines for market integrity violations where it should have effectively implemented strong financial system stability rules early to check the risky prudential practices by intermediaries that could be the veritable causes of the violations.

3.3.1.3 The 'Twin Peaks' Model

The twin peaks model places responsibility for prudential supervision of financial intermediaries in one agency and the responsibility for business conduct supervision and consumer protection in another.[62] The ‘twin peaks’ derives from the work of a leading British academic and former Bank of England (BoE) official, who in 1995 argued that financial regulation had two separate basic aims (or ‘twin peaks’) namely, ‘to ensure the soundness of the financial system,’ and ‘to protect consumers from unscrupulous operators.’[63] However, this argument was less original in its proposal to separate prudential supervision from business conduct supervision, than in its insistence upon the need to consolidate ‘responsibility for the financial soundness of all financial intermediaries in a single agency.[64] This is because the foundation of the twin peaks advocacy arguably arises from a concern that if the BoE remained responsible for the prudential supervision of banks, its independence in setting interest rates might be compromised by its fear that raising the rates might cause bank failures for which it would be complicit. Partly for this reason, the eventual reform legislation (*Financial Services and Markets Act* 2000), shifted responsibility for banking supervision from the BoE to the defunct FSA.

At any rate, even if as it is now clear that the twin peaks advocacy has won in the UK in that the FSA has now been

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62 Australia and the UK are classic examples of the jurisdictions, which have embraced this model. The transition to the twin peaks model in Australia began in 1996 and thus preceded UK’s. The Australian Securities and Investments Commission (ASIC) is the ‘consumer protection’ agency under this ‘twin peaks’ approach, and the Australian Prudential Regulatory Authority (APRA) supervises banking ‘safety and soundness.’ Coffee and Sale (n 36) 723 – 24.

63 M. Taylor, *‘Twin Peaks’: A New Regulatory Structure for the New Century* (London: Centre for the Study of Financial Innovation, 1995) 4. For a review of Taylor’s early formulation of the twin peaks approach, see C. Lichtenstein, ‘The Fed’s New Model of Supervision for “Large Complex Banking Organisations:” Coordinated Risk-Based Supervision of Financial Multinationals for International Financial Stability,’ (2005) 18 *Transnat’l Law* 283 at 295 – 96.

64 Lichtenstein (n 62) 295 (quoting Taylor, n 62).

reformed into the PRA and FCA,[65] the current UK financial regulatory theory and practice still expose the deficiencies of the twin peaks approach. First, it approaches the self-evident to argue as the proponent of the twin peaks model did that a conflict exists between the consumer protection role of a universal regulator and its role as a 'prudential' regulator intent on protecting the safety and soundness of the financial institution. The goal of consumer protection is most obviously advanced through deterrence and financial sanctions, but these can deplete assets and ultimately put a bank solvency at risk. Nevertheless, in a jurisdiction such as Nigeria where relatively modest financial penalties are imposed,[66] the conflict and risk to the solvency of the bank subject to a penalty may sound more superficial than real. Even in a jurisdiction such as the US where regulators are known to impose heavy fines on erring financial intermediaries the fact still needs to be established as to whether these penalties do significantly threaten the solvency of the intermediaries that are compelled to pay or whether the threat is overstated.

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65 There is indeed a hint of triumphalism in Taylor's assessment of the initial rejection and subsequent adoption of the twin peaks approach in the UK in his, 'The Road from "Twin Peaks" and the Way Back' (2009) 16 *Conn. Ins. L. J.* 61 – 96.

66 In December 2013, the SEC announced that the agency's enforcement actions in fiscal year 2013 resulted in a record $3.4 billion in monetary sanctions ordered against wrongdoers. See the press release titled, 'SEC Announces Enforcement Results for FY 2013,' available online at: <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540503617> accessed on 23 January 2014. See also the LSE *Conduct Costs Results for 2009 - 2013*, which shows that banks in the UK paid £99.53 billion as fines and penalties in the for year period. The results are available online at: <http://blogs.lse.ac.uk/conductcosts/files/2014/07/CCP4-Summary-Table-and-Results.pdf > accessed on 2 July 2014.

Second, it is open to question to what extent the twin peaks approach serves as an effective model for the supervision of the so-called conduct of business without the complement of a nuanced enforcement regime based on rules with clearly defined sanctions; and not based on principles which lack detailed implementation rules and disciplinary prescriptions. Illustratively, the current UK approach to conduct of business regulation is based on a set of four obligations according to which FCA regulated entities are to act honestly, fairly and professionally, disclose information to clients before they provide services, not to offer or accept inducements in relation to any business or service and to know whether their client(s) is a principal or an agent.[67] These obligations are expressed as principles without prescriptive implementation and disciplinary rules which state how and what will happen in a case where an infraction of the obligations is established. The form and substance of the obligations indeed mirror the principles-based regulation under the defunct FSA.[68] The principles-based approach in turn, is premised on the facility it offers the FSA (read FCA) to move away from dictating through detailed rules

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[67] See FCA, *Conduct of Business Sourcebook* (COBS) Chapter 2: Conduct of Business Obligations (London: FCA, May 2014) sections 2.1 – 2.4. The current COBS builds and simplifies the version introduced in 2007 by the defunct FSA and under the old consolidated regulatory regime.

[68] The FCA itself a mutation of the FSA, supports this view on its website, to the effect that '[t]he review of the conduct of business regime is a significant milestone for us in our move towards more outcomes-focused regulation and away from detailed prescriptive rules. Our April 2007 publication "Principles-based regulation - Focusing on the outcomes that matter" sets out our thinking on our move towards a more principles-based regulatory regime. See information posted on FCA website, <http://www.fca.org.uk/firms/being-regulated/meeting-your-obligations/cobs> accessed on 23 January 2014.

and supervisory actions how firms should operate their business.[69] The FCA by this approach aims ‘to give firms the responsibility to decide how best to align business objectives and process with the regulatory outcomes’ it specifies.[70] But this approach can be faulted for its tendency to relocate the margin of appreciation of what is right or wrong and what best aligns with regulatory objectives from the regulator to the regulated financial intermediary.

Third, implementation and disciplinary rules, when clearly crafted, can promote certainty, transparency, and fairness in that regulated entities know exactly what they can expect from the regulator. This knowledge in turn facilitates a more nuanced enforcement and an accelerated resolution of regulatory disputes. This is because where the rules and the applicable sanctions are known, cases of infractions are most likely to be deterred. Further, and given the complexity of financial markets, rules are needed to explain the principles and direct implementation. The UK approach means that the twin peaks model is practised in a form that disavows these salutary qualities of a rules-based approach. It provides opportunities for regulated firms to ‘capture’ a critical stage in the regulatory process—the implementation stage. It means that in spite of the change over to the new model, something vestigial of the failed old order

69 See FSA (now FCA), *Principles Based Regulation – Focusing on the Outcome that Matters* (London: FCA, April, 2007) 4 – 5.

70 *ibid*, 4.

remains. One question that can indeed be asked, as to why in the twilight and after the transition to a new model, which has a pronounced emphasis on conduct of business regulation, the UK has been visited with two major financial scandals—the London Interbank Offer Rate (LIBOR) fixing scandal and the investment advice mis-selling in which a total of six UK banks were implicated.[71] The answer, we argue, can be found partly in the principles-based approach.[72] The argument finds support in the Wheatley Review's conclusion that while attempts to manipulate LIBOR could potentially constitute a criminal offence under legislation other than the *Financial Services and Markets Act* (FSMA) *2000,* the FSA at the time had no power to investigate and prosecute such conduct.[73]

Fourth, the current UK approach locates the PRA within the BoE.[74] It makes sense to have this arrangement for an effective prudential regulation of banks. But we should also appreciate that it is susceptible to distortion and conflict. Generally, the most strongly emphasised argument in favour of assigning prudential regulation to a central bank such as the BoE is that as banking

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71 See Her Majesty Treasury Department, *The Wheatley Review of LIBOR: Final Report* (London: HM Treasury, September 2012); D. O'Loughlin and A. Wassall, 'HSBC estimates £96 million bill for investment advice mis-selling,' *Financial Times Adviser*, 24 February 2014.

72 *ibid,* 18. Indeed an almost identical point is argued by a commentator with respect to the regulatory reform in the US after the subprime mortgage crisis of 2007 – 8: J. Coffee, 'The Political Economy of the Dodd-Frank: Why Financial Reform Tends to be Frustrated and Systemic Risk Perpetuated,' (2012) 97, *Cornell Law Review*, 1019 at 1065 – 1075.

73 HM Treasury (n 71) 18. The Wheatley Review thus recommended that the FSMA, 2000 (at section 397) be amended to include as an offence, the making of a false or misleading statement in order to manipulate LIBOR.

74 Part 2 of the UK, *Financial Services Act*, 2012, amending *sections 1 – 18 of the FSMA 2000*.

supervisor (for micro-prudential supervision mostly) it will have first-hand knowledge of the condition of and performance of banks. This in turn can help it identify and respond to the emergence of systemic problem in a timely manner. But this argument is open to criticisms at two levels. At the first level, to locate prudential regulation within the BoE can, theoretically speaking, distort the macro-prudential regulation of the entire UK financial system. This could be the case where the focus on macro-prudential regulation is mostly on banks and without commensurate focus on insurers and securities market operators.

At the second level, the UK approach can exacerbate the theoretical conflict between prudential regulation and monetary policy regulation. Prudential regulation as we mentioned in chapter 2 addresses the safety and soundness of an individual financial intermediary (micro-prudential regulation) and the stability of the entire financial system (macro-prudential regulation); monetary policy regulation, on the other hand, involves inflation targeting most often through contraction or expansion of money supply. The conflict between the two arises where a central bank's attempt to revamp a depressed economy through lower interest rates to increase liquidity supply turns into a less tightly regulated monetary policy to avoid adverse effects on banks' earnings and credit quality; and (or) where a central bank encourages banks to extend credits more liberally to complement an expansionary monetary policy. In either case, there is a potential that at some stage a liberal monetary policy can lead to excess liquidity which can in turn feed into another ‘boom and bust cycle.’ All of this of course is theoretical and built on an assumption that links a liberal monetary policy to the risk of deleterious credit expansion. Nonetheless, this scenario argues against the location of prudential regulation of the banking sector and even the entire financial system in a central bank as the current UK twin peaks approach shows. For this and other reasons canvassed above, we submit that the twin peaks approach only offers a template on which we can craft an effective financial regulatory model for Nigeria; it cannot be applied to address the crisis of financial regulation in Nigeria, which in this context is reflected in the view that the CBN sometimes pursues a liberal monetary policy to mask its deficient prudential supervision of banks.[75]

The next section presents and justifies (albeit preliminarily) our advocacy for the adoption of objectives-based triple peaks architecture as an effective financial regulatory model for the Nigerian context.

[75] A. Teriba, ‘Clarification on Recent CBN Proposals’ 12 available online at: <SSRN: http://ssrn.com/abstract= 587966> accessed on 12 December 2013.

3.4 Objectives-Based Triple Peaks Financial Regulation

In the last two preceding sections, we situated this research within public interest theories of (financial) regulation and argued that these theories are manifested in the four financial regulatory objectives of financial system stability, consumer financial protection, market integrity and market competition. We also argue that the question of which financial regulatory model a country adopts is driven largely by contextual factors; and that the extant (functional financial regulation, consolidated financial regulation and twin peaks financial regulation) models are deficient and thus ineffective for the Nigerian context. Given these arguments, a logical question would be to ask which model effectively—at least in theory—fits the Nigerian context. The answer we strongly argue lies in an objectives-based triple peaks financial regulation. In support, we would in this section focus on three questions: what is objectives-based triple peaks financial regulation; what are its theoretical and practical appeals in the Nigerian context; and how does it improve upon extant models.

3.4.1 What is Objectives-Based Triple Peaks Financial Regulation?

It is a financial regulatory model according to which the agencies that supervise financial intermediaries ought to consist of three institutional bodies that are designed to focus on the implementation of four main objectives of financial system stability, consumer financial protection, and market integrity together with market competition. The model is objectives-based because it gives a more pronounced regulatory manifestation to the four objectives of financial regulation discussed in chapter 2 and highlighted above. It is triple peaks because it advocates three coordinate financial supervisory agencies, namely a financial system stability regulator, a consumer financial protection agency and market integrity regulator. We would in Chapter 6 suggest tentative names for three agencies and discuss more fully the normative regulatory architecture under which they should operate including their respective remits and applicable regulatory principles.

3.4.2 Objectives-Based Triple Peaks Financial Regulation and the Nigerian Context

The appeal, in terms of effectiveness, of objective-based triple peaks financial regulation for the Nigerian context is approachable in theoretical and practical terms.

Theoretically, the objectives-based approach potentially maximises financial regulatory synergies on five levels: the policy objectives level, the policy instrument level, in the use of regulatory information, at the expertise level and the administrative level. Generally, regulatory synergy occurs where beneficial outcomes achieved in the pursuit of one objective support the achievement of one or more objectives.[76] Applied to the objectives-based approach, it can be expected in principle and in terms of *synergy of policy objectives* that the successful pursuit of systemic stability will lead to conditions favourable to the safety and soundness of Nigerian financial institutions. Illustratively, the work of a Nigerian systemic stability regulator in terms of effective prudential regulation would feed into the safety and soundness of the country's financial system and thus assist the work of the market integrity regulator. In terms of *synergy of policy instruments* it can be expected in principle for instance that the benefits of systemic surveillance carried out by the financial system stability regulator will feed into coterminous functions of the other regulators and thus eliminate the need for duplicative systemic surveillance. In terms of *information synergy* it can be expected for instance that business conduct problems linked to a financial institution may throw up red flags regarding the corporate governance practices of the institution and thus raise questions about its safety and soundness, given in particular and as demonstrated in Chapter 2 the importance of corporate governance in the Nigerian financial system. In relation to *synergy of expertise* it can be expected that, for instance, the supervisory expertise in asset-liability management in the banking sector may be applicable to the insurance sector. *Administrative synergy* is enhanced in principle by combining

[76] OECD, *Policy Framework for Effective and Efficient Financial Regulation* (Paris, Organisation for Economic Cooperation and Development, 2010) 37.

consumer financial protection of bank customers, insurance policy holders and capital market investors in one consumer financial protection agency. Another theoretical appeal of the objectives-based approach for the Nigerian context include its potentials to enhance consistent and coherent implementation of financial regulatory objectives.

In practical terms, the objectives-based approach provides an effective model for Nigeria in several key respects which are articulated extensively in chapters 6 and 7. For our present purposes, it is worth noting that the objectives-based approach to regulatory capital to be canvassed in chapter 7 provides a practical solution to the persistent and debilitating scenario of abusive corporate governance practices in the Nigerian financial services sector. Its focus on regulatory objectives and not on legal status of financial intermediaries eliminates the manifest need for constant inter-agency coordination among Nigeria's current functional financial regulators. It gives an unprecedented focus and nuanced attention to consumer financial protection in Nigeria by assigning an independent seat to consumer protection at the financial regulatory table. It minimises regulatory duplication and provides a single administrative entry point for financial intermediaries on matters relating to the four regulatory objectives. Finally it aligns financial regulation in Nigeria with the emerging international best practice according to which the first step in developing a sound institutional system for government's regulatory intervention in the financial services industry is to assign regulatory objectives and instruments to key separate institutions.[77]

3.4.3 What Does Objectives-Based Approach Add to Extant Models?

As canvassed, the objectives-based approach builds on functional financial regulation in that it limits the opportunities for regulatory arbitrage created by lack of effective coordination among functional regulators. It improves upon the functional financial regulation's approach to systemic stability by focussing less on the legal status of a financial intermediary but more on how its size and business operations affect the safety and soundness of the financial system.

Further, the objectives-based approach improves upon consolidated financial regulation because it eliminates the possibility that unequal supervisory attention would be given to four regulatory objectives. It also enhances the development and deployment of the necessary supervisory skills sets for financial system stability, consumer protection, market integrity and market competition.

The objectives-based approach does more than merely adding another peak to the twin peaks approach, in that it provides a clearer separation and minimises the inherent conflict in the financial system stability and monetary policy regulatory

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77 *ibid.*

functions of a central bank. By focussing separately on consumer financial protection and market integrity, the objectives-based approach eliminates the potential for the twin peaks approach to conflate regulation of the two objectives. Where, as would be canvassed for Nigeria, the objectives-based approach is based on clearly articulated implementation rules and not on exhortatory principles, it reduces the possibility that the decision on the margin of appreciation of what constitutes proper regulatory conduct would be relocated from the regulators to regulated financial intermediaries.

3.5 CONCLUSION

This chapter has articulated the theoretical justifications for this research. It has addressed a self-imposed standard according to which a project such as the instant to design a new financial regulatory system should aim for an approach which fits the regulatory context of the subject country and mirror relevant contemporary regulatory best practices. To address this standard, the chapter set for itself and accomplished four theoretical tasks. It situated this research within a public interest account of financial regulation and corrective justice theory. It connected the public interest account with the four financial regulatory objectives discussed in chapter 2 (financial system stability, consumer financial protection, financial market integrity and financial market competition). It evaluated the four recognised models for the implementation of these objectives and argued that none provides the best fit for the Nigerian financial regulatory context. The fourth articulated the reasons why an objectives-based triple peaks financial regulatory architecture fits the Nigerian context.

Overall, the discussion in this chapter was partly intended to preface a closer analysis in chapter 4 of the reasons why financial regulatory systems fail or succeed and what comparative lessons can be drawn therefrom for the reform of financial regulation in Nigeria. It was equally meant to preface the debate on the pros and cons of imposing tort law negligent liability financial regulators in Nigeria in chapter 5. It similarly serves as the philosophical foundation of a full discussion (in chapters 6 and 7) of the normative regulatory principles, institutional architecture and reform strategies that are comprised in our advocacy for the adoption of an objectives-based triple peaks financial regulation in Nigeria.

CHAPTER FOUR

WHY DO FINANCIAL REGULATORY SYSTEMS OFTEN FAIL OR SUCCEED? WHAT CAN A NIGERIAN OBJECTIVES-BASED TRIPLE PEAKS APPROACH LEARN?

4.1 INTRODUCTION

This chapter and the next are a two-part analysis which occupies a mid-point in this research. The first part herein discusses the lessons that a Nigerian objectives-based triple peaks approach canvassed in the Chapter 3 can draw from the failure and success of financial regulation in three advanced and one developing comparator jurisdictions: Canada, the UK, US and Malaysia. An analysis of comparative financial regulatory lessons is considered germane to the overall framework of this thesis because countries often learn from one another for law and institutional reform purposes. The form and substance of the 'learning' can vary according to the recipient country's individual circumstances, the regulatory context and nature of the law(s) and (or) institution(s) involved in the reform, as well as the affinities shared by the countries involved. But rarely nowadays, do countries initiate regulatory reforms in isolation of progress and pitfalls recorded elsewhere. This, perhaps, is explicable on the realisation that no country is, or can ever remain isolated in the regulatory reform context; and it is partly by drawing lessons from comparators, that a country enriches and refines its laws and regulatory institutions for a better and more effective exercise of the governmental monopoly of financial regulation.

Thus far, the Nigerian context in large part validates this general view in that its financial regulatory framework often tracks developments in the UK and US; and, following the financial crisis of 2008 – 09, it established the Malaysian model of an Asset Management Company to address the problem of non-performing loans in its financial system.[1] This chapter builds on this regulatory transplant pattern. It opens up and addresses questions which as demonstrated by the recent near universal financial crises, intersect comparative financial regulation, financial legal transplantation and the Nigerian context, namely why do financial regulatory systems often fail or succeed, in terms of a perceived inability to serve a fundamental rationale for their existence—to anticipate or prevent financial system collapse? Is the inability attributable to fit and design of the national regulatory context, or a concatenation of causalities which include deficient rules and legislative failure, weak governance of regulatory agencies, regulatory capture and the conduct of financial intermediaries, the 'shockwave' of externally induced financial meltdown? If so, does a transplant of regulatory system present a credible hope for a crisis-prone financial system such as Nigeria? If not, should failure and

[1] Section 1, *Asset Management Corporation of Nigeria (AMCON) Act No. 4, 2010*; D. Alford, 'Reform of the Nigerian Banking System—Asset Management Corporation of Nigeria (AMCON) and the Recent Developments (2011) 3 – 5, available online at: <http://ssrn.com/abstract=2006057> accessed on 28 July 2012; O. Ajayi, *Troubled Assets Resolution* (London: LexisNexis, 2012) 15 – 34.

reform in other jurisdictions only *suggest lessons* for the reform of financial regulation in Nigeria, other than a literal transplant of the regulatory paths chosen in those jurisdictions? What, in sum, can the proposal for a Nigerian objectives-based triple peaks financial regulation learn, from the perceived successes and pitfalls in the Canadian, Malaysian, UK and US financial regulation during the global financial crisis? This last question, lies at the heart of this chapter.

This chapter is divided into four sections. This introductory part is the first section. The second section analyses the theoretical background to financial legal transplantation and situates this chapter's transplant approach and that of the thesis in general within the *Otto Khan Freud* school of legal transplantation. The third section discusses the causalities of financial regulatory system failure or success in the context of the Canadian, Malaysian, UK, and US experience in the GFC; and draws lessons for the proposed triple peaks financial regulatory framework in Nigeria. The fourth section concludes the paper.

4.2 Theoretical Approaches to Legal and Financial Regulatory Transplant

Legal transplant theorists generally argue for three routes for 'diffusion' of laws and institutions across national jurisdictions. This section examines these routes, first, in terms of their relevance to this chapter's transplant approach and, second, in relation to our overall approach to legal and regulatory transplant in this research. This section situates that approach within the *Otto Khan Freud* school of legal transplant and argues for the *transplant of regulatory lessons*.

4.2.1 The Watson School ('the transferists')

The **first** transplant route which is encapsulated in the postulations of the *Watson school* ('the transferists') involves a direct or literal transfer of laws and institutions from one jurisdiction to another. In the transferists' view, this route is the most fertile source of legal development, 'since changes in most systems are the result of borrowing.'[2] Taken literally, this is a persuasive contention and may well account for the 'transfer' of case law precedents across common law jurisdictions. But it is doubtful if literal transplant of laws as advocated by the transferists can work effectively without a consideration of the social, cultural, economic and political contexts of the 'exporting' jurisdiction and that of the 'importing' jurisdiction.

[2] A. Watson, 'Legal Transplants and Law Reform,' (1976) 92 *LQR* 94.

The comparative case of Nigeria and UK illustrates the foregoing point. Nigeria has legal, linguistic (English language) and colonial affiliations with the UK, but these affiliations alone can hardly support a case for a 'lock, stock and barrel' transplant of the UK model of financial regulation to Nigeria in the guise of modernisation, let alone can such a transplant even work in Nigeria, without a proper study of the experiential factors that informed the UK choice of regulatory approach, and those factors largely responsible for the perceived failure of the Nigeria approach. In part for this reason, it is submitted that the transferists' approach is inapplicable in the context of the present research whose aim is to combine foreign and local factors in its proposal for an objectives-based triple peaks financial regulatory framework for Nigeria. The transferists' postulation does not apply in part also because it represents a practically difficult route to legal transplant among the three established routes. The difficulty relates to the local opposition to reform that might be provoked by a transplant approach that ignores the experiential factors specific to the recipient country. This is supported by the debate among US corporate law and financial regulation commentators on whether the UK financial regulatory should be copied in the reform of US financial regulation.[3]

[3] See generally on this debate: J. Coffee and H. Sale, 'Redesigning the SEC: Does The Treasury Have a Better Idea?' (2009) 95 *Va. L. Rev*. 707.

4.2.2 Pierre Legrand School's ('the culturalists')

The second transplant route, canvassed by *Pierre Legrand* school's ('the culturalists'), arguably in response to the perceived weakness in the transferists' postulation, conceives an effective introduction of foreign legal and political norms into any society as dependent on the incorporation of part of the norms and philosophy of the native society.[4] On this approach, the transplant of foreign laws and institutions goes with the transplant of the contextual belief system (conceived in terms of the 'norms and philosophy of the native society') the laws and institutions of the 'exporting country.' Where the transplant is between jurisdictions with identical belief systems this approach might well apply. But in terms of transplant between jurisdictions with marked dissimilarity in belief systems, it is open to criticisms.

Apart from the lack of a clear definition of what constitutes and can be included in the category of 'norms and philosophy of the native society' in terms of whether the category takes in cultural, political, social and economic norms or philosophy, the approach begs the question of how the norms and philosophy of two or more countries with deeply embedded national idiosyncratic differences can blend. Let us take again the case of Nigeria and the UK. Politically, but not strictly in the context corporate and financial regulation, the former is a federation and

4 P. Legrand, 'Against a European Civil Code,' (1997) 60 *MLR* 44.

presidential democracy; and the latter, a quasi-unitary State and parliamentary democracy.[5] If the culturalists' approach were to be applied *reductio ad absurdum,* it would mean that a transplant, for example, of either consolidated or twin peaks financial regulation from the UK to Nigeria, would necessitate the incorporation of certain aspects of the UK political system in Nigeria. Given the cultural, economic, social and even political differences between the two countries, such incorporation might be difficult to accomplish. This argument can be faulted as an extreme distortion of the culturalists account, but we do not intend to distort. Rather, we are concerned with whether legal and institutional transplant should necessarily proceed on the basis of incorporation of political, social or cultural norms and philosophy? Is it not possible to transplant the *lessons* suggested by the evolution of the laws and the institutions in one jurisdiction? If so and if the culturalists' account does not in principle accommodate a transplant of lessons *sans* socio-political norms and philosophy, can they be categorised as the opposite extreme of the transferists? In answer, we argue that this is so and the culturalists' approach, according to which the incorporation of native norms and philosophy, is 'an irreducible minimum' for an effective legal and institutional transplant fails to advance the approach adopted in this research, namely, to

[5] The UK is a quasi-unitary State, because while the political administration is centralized in London, some measure of self-government powers are devolved to regional parliaments in Scotland and Northern Ireland.

consider how regulatory lessons and best practices from comparator and other relevant jurisdictions can be transplanted to Nigeria.

4.2.3 Otto Khan Freud School ('the middle ground theorists')

The *Otto Khan Freud* school ('the middle ground theorists') advocates the **third** legal transplant route. This approach reconciles the bipolar positions of the transferists and the culturalists. It does this by contending that if legal systems must look to each other for law reform purposes, then the best systems likely to benefit from each other's *experience* are those closely related historically, legally, politically, culturally and legal-culturally.[6] This postulation supplies the theoretical foundation of the transplant approach adopted in the entire thesis and in particular this chapter, for two main reasons. The first reason is that our comparator jurisdictions (Canada, Malaysia, UK, US and Nigeria) are Anglophone countries and members of common law legal system with a historic and shared colonial affiliation.[7] The second relates to our approach according to which legal and financial regulation transplant ought to be conceived *as a method to track the financial regulatory lessons in comparator*

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6 O. Kahn-Freund, 'Uses and Misuses of Comparative Law,' (1974) 37 *MLR* 1; G. Teubner, 'Legal Irritants: Good Faith in British Law or How Unifying Law Ends up in New Divergences,' (1998) 61 *MLR* 11.

7 The common law jurisdictions here referenced, are those within the Anglo-American common law family, which is larger than and incorporates both the American common law and the English common law jurisdictions. See for classification of legal systems in the context of regulatory comparison, P. Wood, 'How to Compare Regulatory Regimes,' (2007) 2(4) *Capital Markets Law Journal* 333 – 335.

jurisdictions including the UK, United States, Malaysia and Canada to spur and enrich reforms within the Nigerian context.[4]

The next section builds on the foregoing transplant analysis; it considers why financial regulatory systems often fail or succeed in relation to the Canadian, Malaysian, UK and US financial regulatory experience before and during the GFC; what comparative lessons can be drawn therefrom and how should these lessons feed into the proposal for the adoption of objectives-based triple peaks financial regulation in Nigeria.

4 Please refer to the our discussion under methodology in Chapter 1 for the other reasons why we have chosen Canada, Malaysia, the UK and US as comparator countries in this research.

4.3 COMPARATIVE FINANCIAL REGULATORY LESSONS FROM CANADA, MALAYSIA, UNITED KINGDOM AND UNITED STATES OF AMERICA

While several causalities can be, and have been adduced for the success and failure of financial regulatory systems across jurisdictions,[5] this section contends that they can be conveniently grouped and discussed under two broad headings: *the financial regulatory design factor* and *the context factor.* Structural issues as shown in Chapter 3 are common with all regulatory models. But other issues are specific to the context in which a model exists, depending on the level of sophistication of the financial system and specifically as between an emerging and an advanced financial market. Illustratively, both Nigeria and US are similarly circumstanced comparatively on the weaknesses of functional regulation, but they do not share issues, which relate to shadow banking, subprime lending and excessive reliance on sophisticated financial modeling and engineering which are specific to the US context. Nor does the US share with Nigeria, the persistent problem of corporate governance abuse in banks. Accordingly, where the major determinant(s) of success or failure of the financial regulatory system arises from its organisational structure, that scenario speaks most likely to a design factor. On the other hand, context factor relates not so much to how the

[5] The term 'financial regulatory system' as used here, describes the legal and institutional framework of financial regulation, including the wider historical, cultural, social and political order in which the laws, the regulators and the regulated intermediaries exist.

financial regulatory system is structured as to the nature of the financial market and the regulators' operating environment.

It should of course be noted that the regulatory design factor and the context factor are not in most cases the only two determinants of the failure or success of financial regulatory systems. For instance, in jurisdictions such as the UK, USA and Malaysia where the then prevailing regulatory system failed to forestall financial crises at different times, this failure has been blamed on a host of factors. These include for UK and USA, the inherent deficiencies of the regulatory model, irrationality of efficient markets, excessive and poorly regulated securitization, ill-advised deregulatory measures, misplaced reliance on sophisticated mathematics, failure of market discipline, failure on the part of regulatory agencies, the enthronement of the 'originate, rate and relocate' business model among investment and mortgage bankers, moral hazard and indulgent regulation reflected in the hackneyed 'too-big-to-fail perception and treatment of some behemoth financial intermediaries, and mispricing in credit default market. For Malaysia, these include, ill-advised financial liberalization, crony capitalism, moral hazard that resulted from a long tradition of public guarantee of private projects, deficient risk management, and deleterious currency speculation. [6] We chose to focus on design and context

6 See generally, E. Ferran, 'The Break-up of the Financial Services Authority' (2011) 31(3) *OJLS*, 455 – 480; M. Taylor, 'The Road from "Twin Peaks" and the Way Back' (2009) 16 *Conn. Ins*. L. J. 61 - 96; K. Keasey and G. Veronessi, 'Lessons from the Northern Rock Affair,' (2008) *Journal of Financial Regulation and Compliance*, 14 – 18; The Financial Services

factors as two broad causal categories for the discussion of these factors and against the background of the experience in four comparator countries whose selection represents failure and success scenarios and covers the advanced markets and the emerging markets divide. A consideration of the lessons for Nigeria follows the discussion of the failure and success scenarios.

4.3.1 The Institutional Regulatory Design Factor as a Measure of Failure or Success

The term 'regulatory design factor' refers to the institutional structuring of financial regulation, the performance of this structure relative to size and sophistication of the financial system, and its susceptibility to financial crises. Financial crises generally refer to situations in which there is a sharp drop in the value of assets (e.g. exchange rate, shares, bonds, and real estate)

Authority (FSA, now defunct) *The Turner Review – A Regulatory Response to the Global Banking Crisis* (London: FSA, 2009) 11 – 50; J. Coffee and H. Sale (n 7); J. Coffee, 'The Political Economy of Dodd-Frank: Why Financial Reform Tends to be Frustrated and Systemic Risk Perpetuated,' (2012) 97 *Cornell Law Review* 1019; —, 'Ratings Reform: The Good, The Bad, and The Ugly,' (2011) 1 *Harv. Bus. L. Rev*., 231; M. Dewatripont, J. Rochet, J. Tirole (eds), *Balancing the Banks: Global Lessons from the Financial Crisis* (Princeton: Princeton University Press, 2010); K. Jomo 'What Can The Developing World Learn From Post-Colonia Malaysia Development Experience?' in A. Radhika and S. Alian (eds), *Readings on Development: Uncommon Voices, Common Aspirations* (Kuala Lumpur: Khazanah Nasional, 2009) 215-232; T. Porter, 'Canadian Banks in the Financial and Economic Crisis,' (2010) Paper presented at the Policy Responses to Unfettered Finance Workshop North-South Institute, Ottawa, Canada, 8 – 9 June 2010; L. Ratnovski and R. Huang, 'Why are Canadian Banks More Resilient?' (2009) *International Monetary Fund (IMF) Working Papers Series*, available online at: <http://ssrn.com/abstract=1442254> accessed on 10 September 2012; M. Bordo, A. Redish, and H. Rockoff, 'Why didn't Canada have a banking crisis in 2008 (or in 1930, or 1907, or...)?' (2011) *National Bureau of Economic Research (NBER) Working Paper No.17312*, available online at: <http://www.nber.org/papers/w17312> accessed on 18 October 2012. C. Calmes and R. Theoret, 'Is the Canadian Banking System Really "Stronger" than the U.S. One?' (2013) *3 Review of Economics & Finance* 1 -18.

an increase in the real interest rate and a massive capital outflow. This can result from a currency crisis,[7] a banking crisis,[8] or a debt crisis,[9] or a combination thereof.

While the regulatory structure is important, it can of course be argued that it is not an end in itself, in that a *good* (well designed) regulatory structure alone, does not guarantee good regulation without, for instance, the complement of effective regulatory enforcement. Even so, a poorly designed financial regulatory structure can make effective regulation almost impossible. This can occur if the structure impedes effective oversight where, for instance, different agencies regulate different subsidiaries of a financial conglomerate. It can also occur if the financial regulatory system substantially creates opportunities for regulatory arbitrage where, for instance, different regulators impose very different regulatory burdens on the same products offered by different intermediaries in a manner

7 In a currency crisis, speculative attacks on a national currency often force a country to devalue its currency. The Malaysian financial crisis (1997 – 98), a sub-plot in the Asian financial and economic crisis of 1997, was triggered by speculative attacks first on the Thai baht, which attacks later spread to Hong Kong dollar, and the Malaysian ringgit. See R. Buckley and D. Arner, *From Crisis to Crisis: The Global Financial System and Regulatory Failure* (Alphen aan den Rijn: Kluwer Law International, 2011) 55 – 72 (Chapter 4: The Asian Financial and Economic Crisis of 1997).

8 In a banking crisis, a widespread situation of bank runs creates difficulties for many banks, which are forced into bankruptcy, subsidized mergers or nationalization. Banks runs are wholesale, when they result from banks calling in their inter-bank loans. They are retail, when they result from overwhelming withdrawal of deposits. The US and UK financial crisis of 2007 – 08, which were precipitated by wholesale and retail runs in mortgage and investment banks can thus be characterised as banking crisis. See generally, V. D'Apice and G. Ferri, Financial Stability: Toolkits for Interpreting Boom and Bust Cycles (Basingstoke: Palgrave Macmillan, 2012) 17 – 24.

9 In a debt crisis, the government declares its inability to pay the interest and repay capital on the terms established through the contract. The Argentinian financial implosion of 2001, which arose largely from the country's excessive indebtedness, exemplifies a debt crisis: *ibid.*

that weakens the balance of regulatory power between regulators and the financial services industry. In what follows, we shall discuss these issues in the context of the US and Canadian financial regulatory systems, which are generally seen as examples of a failed and successful regulatory systems respectively.

4.3.1.1 The United States Regulatory System as a Failure Scenario

Most of the flaws discussed under functional financial regulation in Chapter 3 were evident in the US financial regulatory system in the period leading into the crisis of 2007 – 08. Specifically, there were two particular characteristics of the US financial regulatory architecture that stood out in the context of the crisis.

First, the competitive financial regulatory system in the US had many gaps in regulatory coverage that resulted from the need to ring-fence regulators in order to minimise turf battles. Under this system a largely unregulated *shadow-banking* sector emerged in the US as a direct and lower-cost alternative to the regulated banking system.[10] In particular, the powerful Wall Street

[10] Shadow banking, comprises a diverse set of institutions and markets that, collectively, carry out traditional banking functions--but do so outside, or in ways only loosely linked to, the traditional system of regulated depository institutions. Examples of important components of the shadow banking system include securitization vehicles, asset-backed commercial paper (ABCP) conduits, money market mutual funds, markets for repurchase agreements (repos), investment banks, and mortgage companies. See Ben. Bernanke, 'Some Reflections on the Crisis and the Policy Response,' (2012) remarks at the Conference on 'Rethinking Finance: Perspectives on the Crisis' organised by the Russell Sage Foundation and The Century Foundation, New York, 13 April 2012. See also the The United States Financial Crisis Inquiry Commission, 'Chapter 4: Deregulation Redux' in The Financial Crisis Inquiry Report (January, 2011) 27 – 37. For a detailed account of how shadow-banking products were used fraudulently in the US, see W. Bratton and A. Levitin, 'A Transactional Genealogy of Scandal: From Michael Milken to Enron to Goldman Sachs,' (2013) 86 *Southern California Law Review* 783.

investment banks were regulated by the Securities and Exchange Commission, rather than by any of the many banking regulators, and were regulated to a much lower standard of prudence and corporate governance than by commercial banks.[11] Similarly, insurance companies which were regulated under a fragmented state-based system, were regulated to a lower level of prudence than banks. Under this structure many of the complex products that contributed to the crisis fell outside the scope of the mainstream regulatory agencies.[12] Critical parts of the mortgage lending process for example were unregulated, including the monitoring of corporate governance in the big and systemically significant mortgage finance institutions.[13]

Second, the US structure provided, at best, a fragmented and ineffective framework for regulating financial conglomerates. Illustratively, while the US Federal Reserve Bank regulated bank holding companies, it regulated neither banks nor any of the other financial institutions that operate under bank holding companies. Thus, in regulating conglomerates, the Federal Reserve was completely reliant on the quality of regulation

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11 N. Poser, 'Why the SEC Failed: Regulators Against Regulation,' (2009) 3 *Brook. J. Corp. Fin. & Com. L.* 289, 296 – 324 (that SEC made important regulatory changes that weakened the regulatory system and turned out to be a disaster for investors, significantly contributing to the 2008 financial crisis, namely the SEC exempted the largest investment banks from the minimum capital requirements imposed on broker-dealers; repealed a rule designed to prevent manipulative short selling of securities; limited shareholders access to the proxy voting system; and repeatedly urged the US Supreme Court to limit investors' ability to recover their fraud losses by means of private lawsuits. See also, Coffee and Sale (n 3) 731 – 748; A. Bebchuk, A. Cohen, and H. Spaman, 'The Wages of Failure: Executive Compensation at Bear Stearns and Lehman 2000 – 2008,' (2009) *ECGI Discussion Paper No 657*, available online at: <http://papers.ssrn.com/abstract=153522> accessed on 28 July 2012.

12 Bratton and Levitin (n 10).

13 The United States Financial Crisis Inquiry Commission (n 10) 102 – 126.

implemented by other agencies. Non-bank financial groups were even less tightly regulated. As a direct result of this weak framework for conglomerate regulation, banks were able to shift risky assets off balance sheet into unregulated or under regulated local and offshore affiliates. Regulatory arbitrage also enabled financial institutions to choose the regulator that best suited their appetite for risk.[14] Moreover, there was insufficient systemic (macro-prudential) oversight of the financial sector as a whole. When each regulator is proverbially assigned a small stand of trees it is hardly surprising that none has a good view of the forest. Given this scenario, it is difficult to reach any conclusion other than that the design of financial regulatory system in the US contributed largely to its failure, which failure aided both the emergence and severity of the US subprime mortgage crisis of 2007-08.[15]

4.3.1.2 The Canadian Financial Regulatory System as a Success Scenario

Canada's current financial regulatory structure can be described as a consolidated and functional hybrid, because it has the characteristics of both models. The legislative and regulatory framework for banks is entirely federal. The federal government

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14 One of the great anomalies to emerge from the crisis was the fact that the Office of Thrift Supervision (a renamed version of the agency that had presided over the Savings and Loan failures of the early 1980s) regulated AIG Financial Holding Company, the parent company of the world's largest insurance company AIG, on a consolidated basis.

15 See generally on this conclusion and other related points: J. Carmichael, 'Regulatory Lessons from the Global Financial Crisis,' in M. Ariff, J. Farrar, and A. Khalid, (eds), *Regulatory Failure and the Global Financial Crisis: An Australian Perspective* (Northampton-Massachusetts: Edward Elgar Publishing Limited, 2012) 168 – 187.

through the Department of Finance is responsible for the legislative framework for banks. The Office of the Superintendent of Financial Institutions (OSFI) is the prudential supervisor. The Canada Deposit Insurance Corporation (CDIC) is the deposit insurer. The Bank of Canada is the lender of last resort. The Financial Consumer Agency of Canada (FCAC) enforces the consumer protection provision in the *Banking Act*. The Federal Competition Bureau, an independent agency, regulates mergers among financial institutions.[16]

Six key composite factors support the view that the design of Canadian financial regulatory system represents a success scenario in that unlike the US, and in spite of her proximity to the US, these factors enabled Canada to emerge from the financial crisis of 2007-08 with little damage to its financial system.[17] The first is the presence of a *strong and independent bank regulator*. The Canadian Office of the Superintendent of Financial Institutions (OSFI) is devoted entirely to prudential regulation. The OSFI is generally seen as a forceful regulator, in that its head attends bank board meetings at least once a year, sometimes without the attendance of the bank executives.[18] OSFI also has a reputation for working aggressively but flexibly with

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16 The Group of Thirty, *The Structure of Financial Supervision: Approaches and Challenges in a Global Marketplace* (Washington, D.C.: The Group of Thirty, 2008) 126 – 35.

17 These factors reflect a composite account of earlier studies of the Canadian financial system, including those by the following commentators: Ratnovski and Huang (n 6); Bordo, Redish and Rockoff (n 6).

18 C. Freeland, 'View from the Top: Julie Dickson, Superintendent OSFI,' 21 December 2009, *Financial Times*.

banks to anticipate and mitigate risks. Unlike the defunct FSA in the UK, the OSFI has the power to issue guidance and interpretations of guidance and to bring about compliance with these. The Bank of Canada is responsible for monetary policy, lender of last resort functions, and oversight of payment and settlement systems. Securities markets are regulated provincially, but federally regulated banks play a key role in those markets. In the late 1980s banks were allowed to purchase investment dealers, and this brought those operations under OSFI's strict remit, in contrast to the anemic regulation of US investment banks under the SEC.

The second factor is *capital-asset ratios regulation*. Before the crisis of 2007-08 Canadian bank capital was not necessarily higher than other banks that were more troubled. For instance, the US Wachovia failed with an equity/asset ratio of 16.9, as compared to the highest ratio of the big Canadian banks at 5.7.[19] Nevertheless, Canadian banks overall were required by OSFI to be well capitalised. OSFI required Canadian banks to hold 7% of Tier 1 capital and 10% total capital above the then prevailing Basel II requirements of 4% and 8%.[20] Canadian Tier 1 capital requirements were the highest among the G7 countries. Moreover

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[19] Ratnovski and Haung (n 6) Table 2 on page 7.

[20] C. Northcutt, G. Paulin, and M. White, 'Lessons for Banking Reform: A Canadian Perspective,' (2009) 19(4) *Central Banking* 44 at 46. Tier 1 capital is the core measure of a bank's financial strength from a regulator's point of view. It is composed of core capital, which consists primarily of common stock and disclosed reserves (or retained earnings), but may also include non-redeemable non-cumulative preferred stock. The theoretical reason for holding capital is that it should provide protection against unexpected losses. This is not the same as expected losses, which are covered by provisions, reserves and current year profits.

OSFI insisted on high quality Tier 1 capital: 75% or more must be common equity. Single name exposures are limited to 25% of regulatory capital.[21]

The third factor is the use of *leverage cap.* Among the G7 countries, only Canada and the US regulators impose leverage caps on their banks. However, the OSFI's included some off-balance sheet exposures in its definition of assets that the US did not, including credit derivatives. The Canadian leverage cap was maximum asset to capital (Tier 1 and 2) ratio of 20, while the US ratio (on Tier 1 only) was 33.5% for banks thought to be stronger and more sophisticated and 25% for other banks.[22]

The fourth factor relates to how the structure of the Canadian financial system has overtime shaped the conduct of financial intermediaries. Illustratively, the Canadian banking industry is dominated by five banks; and banks generally are permitted to engage in securities markets and insurance, although the latter must be separated organizationally from the rest of the bank. At the same time Canadian authorities prevented further consolidation. In 1998 and despite enormous pressure from the industry, the government refused to allow mergers. The relatively small number of banks is seen as facilitating effective regulation.[23] Their domination of nation-wide small retail banking

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21 *ibid,* 49.

22 IMF, Canada: Staff Report for 2009 Article IV Consultation, (17 April 2009) Box 1 at 17, available at: <http://www.imf.org/external/pubs/ft/scr/2009/cr09162.pdf> accessed on 18 May 2012.

23 Freeland (n 18).

has shielded them from international competition, as has the rule which traditionally limited the holding of any one shareholder of the main schedule 1 banks to 10% of all shares. In 2006, foreign banks only accounted for 7% of bank assets in Canada.[24] The rule also limits banking concentration. Canadian banks are unusual among OECD banks in the share of depositary funding to total assets.[25] Banks which relied more on the wholesale (inter-bank) loan market such as the UK's Northern Rock experienced 'credit crunch' during crisis of 2007 – 08 due largely to wholesale bank runs.[26] Canadian banks retained a far higher share of mortgages on their books than did US banks, thereby giving them stronger interest in the long-range financial health of the mortgages.

The fifth factor relates to how the regulatory framework has shaped the structure of the *Canadian mortgage market* in terms of encouraging a conservative approach. Illustratively, the Canadian mortgage market concentrates mostly on prime home ownership loans, less than half of which are securitized. For instance, a 2009, IMF Staff Report, noted that only 5% of Canadian mortgages were subprime, and only 25% were securitized. These figures compare, with 25% and 60% respectively in the United States.[27] The Canadian subprime market was terminated in 2008, when the Canadian Mortgage and Housing Corporation (CMHC)

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24 IMF, 'Canada: Financial System Stability Assessment Update,' (2008) *IMF Country Report 08/59*, p. 11.

25 Ratnovski and Huang (n 6) 11.

26 Keasey and Veronessi, (n 6) 9.

27 IMF (n 22) 5.

stopped insuring such mortgages.[28] The CMHC is government owned and provides most mortgage insurance. The government also guarantees most private mortgage insurance, although at 90% rather than the CMHC's 100%. Almost half of residential loans are guaranteed, and mortgages with a modestly high loan to value ratio must be fully insured. Unlike the US mortgage interest is nondeductible, increasing the incentive of homeowners to pay mortgages down quickly.[29]

The sixth factor is *strong institutional approach to consumer protection*. The Financial Consumer Agency of Canada regulates market-conduct issues. It promotes financial education and addresses the type of misleading confusing contract language that contributed to the subprime mortgages crisis in the US.

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28 Northcutt et al (n 20) 47. The credit standing of a borrower may not rise to the level of the generally acceptable mortgage borrower in his/her community. Nevertheless, the borrower may need a mortgage loan and a lender may be willing to give it. The lender may consider a higher interest rate than is customary to compensate for the greater risk being under taken with this borrower. Such a loan is often called 'subprime', as distinguished from 'prime' loans (but not necessarily so called) where the borrower has acceptable credit standing. Applied to mortgage, subprime mortgages are for those borrowers with a credit score below 620 - in a credit score ranging from 300 to 900 - while borrowers with a score above 620 qualify for prime mortgages. The exact notes and terms of subprime mortgages vary based on credit history, size of down payment, income, and other factor; but subprime mortgages generally have higher interest rates and less favourable terms than prime mortgages. Subprime loans/mortgages can shade off into what are called 'predatory loans', which by definition takes in loans which exploit the borrower's low creditworthiness, but as a matter of fact, most predatory loans tend to fall in the subprime category, because they often illegally or improperly disadvantage the subprime borrower: C. Felsenfeld & D. Glass, *Banking Regulation in United States* (Huntington: Juris Publishing Inc., 2011) 104-5; R. Brooks and G. Ford, 'The United States of subprime - Data Show Bad Loans Permeate the Nation; Pain Could Last Years,' Wall Street Journal, 11 October 11, 2007 at A9.

29 Canadian Bankers Association, Canada's Strong Banking System: Benefiting Canadians (2009) 2; K. Richburg, 'Worldwide Financial Crisis Largely Bypasses Canada,' Washington Post, 16 January 2008.

4.3.2 The Regulatory Context as a Measure of Failure or Success

The financial ‘regulatory context’ refers to a combination of historical, cultural, economic, social, and political circumstances in which regulators operate. These circumstances can impact the regulatory process, either positively or negatively, because financial regulation manifests the State’s monopoly of public regulatory power. For this reason, it most often reflects a country’s policy outlook at the relevant time. Even where a measure of self-regulation exists, it does so in reality from a prior implied or expressed (statutory) concession by the State. This can be seen in Chapter 3 with respect to the UK’s financial regulatory approach before the creation of the FSA—an approach that depended partly on direct and delegated (self) regulation.

At any rate and given that regulatory policy often changes in response to the evolving socio-economic, cultural and political circumstances of the State, financial regulation can come under pressures, which originate from outside the legal and institutional context of the regulatory process. The intensity and consequences of the pressure depend in part on policy expediency, and in part on the extent to which the regulator resists or succumbs to these pressures. This is because, while policy expediency can dictate several regulatory choices, the regulator still has to make the call as between those choices which can keep the financial system safe and those which promises short term gains but can have harmful effects on the safety and soundness of financial system in the long term. Thus, where the regulator succumbs, it can emerge that it has exercised a wrong choice, which later exposes the financial system to crisis.

It may also be the case that the regulator operates under a supra-national treaty obligation which restricts its ability to monitor risks to the financial system holistically and effectively. Should a crisis result from such restriction, it can hardly be fair to blame the regulator entirely. This is the approach in which we discuss below, the failure of the UK financial regulatory system in 2007, although an influential commentary attributes the failure to a design defect (the combination of prudential regulation and financial conduct regulation in FSA).[30] Where the regulator resists the pressure to aim for short-term gains at the expense long-term stability which may be due to lessons learnt from a wrong policy choice in the past, the financial system can remain strong and resilient, even in the face of a global financial crisis, whose 'shock waves' may have destabilised comparator financial systems. This is our approach below to the performance of the Malaysian financial system in 2007 – 08.

4.3.2.1 Context Factor in UK Financial Regulatory System Failure

The GFC affected the UK financial regulatory system as much as it did that of the US. This has led some commentators to argue

[30] See generally on this: Taylor (n 6).

that consolidated financial regulation under the UK FSA also failed the test of the crisis.[31] There is some persuasive force in this argument in view of what has been said in Chapter 3 in relation to the inherent weaknesses of consolidated regulation. In the researcher's view, however, the UK failure scenario arose not entirely from the design of its financial regulatory architecture, as from the execution of FSA's responsibilities, as well as the UK and EU regulatory contexts at the time. Illustratively, the FSA's own Internal Audit Report on Northern Rock identifies a number of shortcomings in the way it executed its responsibilities in relation to the supervision of the bank. The Report found six shortcomings namely: (i) contrary to FSA procedures, formal records of key meetings were not kept; (ii) there was no analysis by the FSA of the (flawed) business model employed by Northern Rock; (iii) the supervisory review period was increased from 24 months to 36 months; (iv) the FSA supervisory team appeared not to fully understand the requirements of the risk rating placed on Northern Rock, nor did they adequately identify and pursue risks arising in the firm as a whole; (v) there was a shortage of supervisory expertise in some critical areas, most notably in prudential banking and financial data analysis; and (vi) and, related to this, there was an over-emphasis by the FSA on

[31] *ibid*. See also Coffee and Sale (n 3).

conduct issues and an under-emphasis on prudential issues.[32] The last finding is arguably the most relevant, and it is one, which links the FSA failure to the UK context at the time.

In the period leading up to the crisis, there was intense focus by the UK public and politicians on market conduct issues. This is understandable given the 1991 BCCI scandal which was substantially induced by prudential and market conduct malpractices.[33] The result of the focus, however, was that the FSA, which had responsibility for both prudential and financial conduct regulation, focused its energies and resources where the public demands were greatest—in the enforcement of conduct issues, at the expense of prudential issues.[34] Another issue in the UK context, was the pressure exerted by the City of London on the FSA to *keep London competitive,* by ensuring that UK financial institutions were not overly regulated relative to their foreign, especially US counterparts. These pressures were unrelated to the UK financial regulatory system and validate the argument above that where a regulator succumbs to pressures which are extrinsic to its core regulatory mandate (prudential regulation and financial conduct regulation in the case of the FSA), this can invite systemic vulnerabilities.

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32 FSA, The Supervision of Northern Rock: A Lessons Learned Review (2008) 8, 27, available online at: <http://www.frank-cs.org/cms/pdfs/FSA/FSA_NR_Report_25.4.08.pdf> accessed on 23 July 2012.

33 For the facts of this scandal see: *Three Rivers District Council and Ors v Governor and Company of the Bank of England (No 3)* [2003] 2 AC 1.

34 See generally, E. Ferran, 'Examining the United Kingdom's Experience in Adopting the Single Financial Regulator Model,' (2003) 28, *Brook. J. Int'l L.* 257.

The causal implication of the EU financial regulatory context for the UK in the crisis of 2007 – 2008 was poignantly demonstrated by the failure of Landsbanki HF, an Icelandic bank in October 2008. The EU single market rules which cover Iceland as a member of the European Economic Area (EEA) allow banks in one country to operate as branches in another, with the supervision of solvency and whole bank branches resting with the home country supervisor. This is known as 'pass-porting.' The FSA as host country regulator had only limited powers relating to the supervision of local liquidity. Landsbanki's UK branch was therefore not subject to FSA's full prudential supervision. When the bank failed in 2008, with around £4.5 billion of retail deposits lost or trapped in its UK branch, the bank's home (Icelandic) regulator more than the FSA was to blame for this failure including the subsequent default of the Icelandic authorities to meet the liabilities of the Iceland deposit insurance scheme immediately to UK depositors.[35]

4.3.2.2 Context Factor in Malaysia Financial Regulatory System Success

A discussion of the context factor in relation to the relative success of the Malaysian financial regulatory system in 2007 – 08 GFC, requires an examination of the country's reform policy prior to, and in the aftermath of the Asian financial and economic

[35] See 'Lessons from the Icelandic Banking Crisis' in Turner Review (n 6) 38.

crisis of 1997 – 98.[36] The regulatory system that is generally acclaimed to have satisfactorily protected the Malaysian economy and financial system from the GFC was itself, the product of a previous crisis.[37]

The economic downturn in developed countries that was triggered by the US high-interest rate policy (the 'Volker shock') in the early 1980s resulted in a massive collapse of world commodity trade. Between 1984 and 1986, the consequence of the collapse for Malaysia, whose export economy depended on tin and palm oil, was a fall in its overall export price index. The decline in export earnings significantly derailed the funding of Malaysia's National Economic Plan (NEP), which was launched in 1971 to accelerate its industrial development. To attract alternative funding sources for the NEP, Malaysia *elected* to attract foreign investment capital, further to which a wide-ranging package of incentives were announced, including the removal in the early 1990s of restrictions on short-term capital

36 The Asian economic and financial crisis of 1997 – 98, majorly affected Thailand, Malaysia, Hong Kong, the Philippines, South Korea, Laos, and Indonesia. China, Taiwan, Singapore, Brunei and Vietnam, were less affected. The crisis is generally seen as a currency crisis, because it was precipitated by speculative attacks on the national currencies of the affected countries. However, the speculative attacks and the resulting capital flight, may not have reached crisis proportion but for the presence of five cumulative factors namely, the type of national debt (mostly short term) of the affected countries, the extent of the indebtedness, financial sector weaknesses, fixed local exchange rates, and a region wide loss of confidence. For a detailed discussion of these factors see: R. Buckley and D. Arner, *From Crisis to Crisis: The Global Financial System and Regulatory Failure* (Alphen aan den Rijn: Kluwer Law International, 2011) 55 – 72 (Chapter 4: The Asian Financial and Economic Crisis of 1997).

37 For an extensive discussion of the pre-1997 background to the Malaysian financial regulatory see: P. Athukorala, 'Malaysian Economy in Three Crises', (2011) 7 – 11, available online at: <https://crawford.anu.edu.au/acde/publications/publish/papers/wp2010/wp_econ_2010_12.pdf> accessed on 23 December 2013.

inflows, foreign shareholding in local brokerage firms and bank lending to non-residents.[38]

However, similar to what happened in Nigeria a decade later, and after the banking consolidation of 2005,[39] increased foreign equity investment in the Malaysian economy only fuelled a massive stock market boom. The boom had direct implications for the operation of the domestic banks, in that margin loans turned out to be a major source of bank credit expansion.[40] Thus, there was a strong possibility of a reversal of capital inflows to generate economic collapse through wealth contraction and banking sector instability. Even so, this possibility would not have translated into the crisis of 1997 – 98, had it not been for some serious pitfalls on the domestic policy front, namely *poor corporate governance* and *financial fragility*.[41]

In relation to corporate governance, the expansion of the equity market was not accompanied by initiatives to redress the underlying weakness in ownership and management of listed companies, most of which were tightly controlled by a handful of powerful families. These families also retained majority stakes, even in public companies. This structure of corporate ownership was aided by, and in itself, fuelled manipulation of inter-

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38 *ibid.*

39 S. Sanusi, 'The Nigerian Banking Industry: What Went Wrong and the Way Forward,' (2010) 5, available online at < http://www.bis.org/review/r100419c.pdf? frames=0 > accessed 15 May 2012.

40 Athukorala (n 37).

41 *ibid.*

company share transactions to augment profit in privately owned companies. Such manipulation made share trading vulnerable to financial panic because unconnected (minority) shareholders had every reason to worry about how they would be treated during a market downturn.[42] In relation to financial fragility, in the first half of 1990s, substantial domestic credit had accumulated in the banking system, with a heavy exposure to the property sector, which broadly included share trading and the real estate sector. By the end of 1996, the total credit to the property sector accounted for around 40 percent of total outstanding bank credit. The increased exposure to the property sector further weakened the financial position of the banks as the loans got tied down in excessive and not easily disposable real estate ventures. The crisis of 1997 – 98 that saw massive withdrawal of foreign capital from the Malaysian economy, collapsed the stock and the property market, and overwhelmingly increased the non-performing loans in the banking system, from about 2 percent in mid-1997 to nearly 12 percent in July 1998.[43]

In the volatile economic climate post 1998, the Malaysian government had to choose between two alternative policy choices. The first was to obtain a 'good housekeeping seal' on its policies from the IMF. The second was to resort to capital controls in

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42 P. Searle, *The Riddle of Malaysian Capitalism: Rent-seekers or Real Capitalists*? (Sydney: Allen & Unwin, 1999) 125 – 9.

43 BNM, *Annual Report* (Kuala Lumpur: BNM, 1999) 175; P. Athukorala and P. Warr, 'Vulnerability to a Currency Crisis: Lessons from the Asian Experience,' (2002) 25(1) *World Economy*, 33 – 57; P. Athukorala, *Crisis and Recovery in Malaysia: The Role of Capital Controls*, 2nd Edition, (Cheltenham: Edward Elgar, 2003) 146.

order to combine a fixed exchange rate with Keynesian policies,[44] while ignoring the vagaries of market sentiments. Confronted with this policy dilemma, the Malaysian political leadership *opted* for the second alternative. The core of this policy choice was capital controls, which were expected to fix the exchange rate and provide breathing space for monetary and fiscal expansion to fight recession.[45] The capital controls were strong, but they were *narrowly focused on short-term capital flows*. The aim was to make it harder for short-term portfolio investors, both foreign and local to sell their shares and repatriate proceeds, and for offshore hedge funds to drive down the currency. With the *policy autonomy* gained through the fixed exchange rate and capital controls, the government embarked on a recovery package consisting of two key elements namely, fiscal and monetary stimulants; and banking and corporate restructuring.[46]

Notably, the policy placed greater emphasis on the speedy implementation of banking and corporate restructuring programme designed by the National Economic Action Council (NEAC) in July 1998. Under this programme, three major entities were set up to address the bad debt problem of the financial system and related corporate distress: an asset management

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[44] Keynesian economic policies are based on the view that in the short run, especially during recessions, economic output is strongly influenced by aggregate demand (total spending in the economy). See A. Blinder, 'Keynesian Economics,' in D. Henderson (ed.) *Concise Encyclopedia of Economics,* 2nd ed. (Indianapolis: Library of Economics and Liberty, 2008) available online at: <http://www.econlib.org/library/Enc/KeynesianEconomics.html> accessed on 23 July 2014.

[45] Athukorala (n 37).

[46] *ibid,* at 13.

company (Danaharta) to acquire and manage NPLs from banks,[47] a banking and corporate recapitalisation company (Danamondal) to recapitalize those financial institutions whose capital adequacy ratio had fallen below nine percent,[48] and a Corporate Debt Restructuring Committee (CDRC), a joint public and private sector steering committee) to facilitate the restructuring of corporate debts through out-of-court settlement. These financial reform decisions are generally acknowledged to have laid a strong foundation for the Malaysian financial system that enabled it to withstand the 'shockwave' of the global financial crisis.

4.3.3 What Can A Nigerian Objectives-Based Approach Learn from Canadian, UK, Malaysian and US Experience?

The foregoing financial regulatory success and failure scenarios in Canada, Malaysia, UK, and the US, present several lessons for the structuring of a triple peaks financial regulatory system for Nigeria. We shall consider these lessons in relation to each of the four jurisdictions.

4.3.3.1 Lessons From The US

The US failure scenario suggests four composite lessons for a Nigerian triple peaks regulatory structure. The *first* relates to the need to *prevent* institutional regulatory gaps. To build on one of our points in Chapters 3, this can be achieved in principle by

[47] *Sections 3 and 4, Pengurusan Danaharta Nasional Berhad Act No 587 of 1998* (as at 1 February 2013).

[48] *Sections 4, Danamodal Nasional Berhad Act of 1998.*

institutionalizing inter-agency regulatory coordination, *mandatorily* and *at ministerial level*—mandatorily, in terms of a statutory duty to co-ordinate; and ministerial in terms of the need to locate the centre of regulatory co-ordination within the office of the Finance Minister. A statutory duty to coordinate, which is backed with disciplinary consequences for not doing so, arguably presents a viable compelling obligation to do so; and to position the Finance Minister at the head of the coordination mechanism eliminates inter-agency rivalry and a possible impression of a *primus inter pares,* if one regulatory agency were to be assigned the function of the coordinating agency. This approach can promote financial regulatory inter-agency coordination in Nigeria better than the current approach centered on FSRCC, which we discussed in Chapter 2.

The *second* lesson relates to the need to prevent *'regulatory turf wars'* in the sense of the triple peaks regulators working against each other. This can be achieved partly in principle, by a ministerial level coordination as suggested above. It can also be achieved in principle through the use of judicial accountability in the sense of empowering the FHC to interpret regulatory remits and where necessary impose liability in those cases where it is established that the negligence or misfeasance of one agency has undermined the work of another.

The *third* lesson relates to the crucial importance of a more effective supervision of the entire financial system for the purposes of systemic stability and particularly with respect to the safety and soundness of financial conglomerates. Here, the failure of functional financial regulation in the US and Nigeria strongly supports the case for abolition of the SEC, NAICOM and relocation of financial regulatory functions from the CBN. The functions so abolished and relocated, should first be re-organised under the heads of financial system stability, consumer financial protection, market integrity and market competition; and second, the re-organised functions should be assigned to the respective triple peaks financial regulators that we canvassed in Chapter 3.

The last point connects with the *fourth* but by no means the least lesson namely, the need to structure within triple peaks framework a dynamic mechanism to regulate financial innovation in terms of the use of financial engineering to invent novel financial derivatives products (such as credit default swaps, and collateralized debt obligations) and off-balance sheet financing and investment vehicles ostensibly to circumvent capital regulation. Admittedly, Nigeria and the US do not compare in the level and depth of financial market sophistication, but the US experience offers a cautionary tale to the possible risk to financial system stability, that can result from unbridled and poorly regulated financial innovation. Thus the proposed systemic stability regulator should incorporate a financial innovations department. This department should develop a thorough understanding of financial innovations to avoid the potential for a given innovation to cause widespread harm to consumers or prove catastrophic for the financial system.

One key principle that should be observed in the context of financial innovation regulation is the need for *precaution*. A wide range of issues can be considered under this principle, but seven are worth mentioning. What is the intended target of the innovation: e.g. individuals (retail, high-net-worth, or sophisticated); institutions (a particular category or type, cross-border, or cross-sector); a particular industry or sector; infrastructure (trading platforms, clearing and settlement systems, procedures, or process)? What is the core purpose of the innovation: e.g. risk mitigation, capital relief, regulatory or tax avoidance, revenue enhancement, hedging, arbitrage, or client need? Will the innovation result in true value added or does it represent a transfer from one entity or sector to another? What are the major assumptions underlying the innovation: e.g. existence of abundant liquidity; continued low or high interests rates, inflation, or volatility; and (or) benign macroeconomic environment? What is the timing of the innovation (i.e. in what part of the economic cycle is it being introduced and whether it has been tested under conditions of stress)? How does the product itself or the process used to produce it differ from traditional methods or products, in terms of whether it is revolutionary or adaptive? Is the innovation accompanied by a change in institutional structure or business models?[49]

4.3.3.2 Lessons From Canada

The Canadian success scenario offers six lessons for the structuring of a Nigerian objectives-based triple peaks financial regulation. The *first* lesson relates to the need to have a strong and centralized prudential regulator for the entire financial system. This lesson feeds into and is accommodated within the proposal for a Nigerian financial system stability regulator. The *second* lesson requires the financial system stability regulator to always set the Capital Adequacy Ratio (CAR) for Nigerian banks above the average level in comparator financial markets. CAR is the ratio which determines the bank's capacity to meet the time liabilities and other risks such as credit risk, operational risk etc. In the simplest formulation, a bank's capital is the 'cushion' for potential losses, and protects the bank's depositors and other lenders. Financial regulators in most countries define and monitor CAR to protect depositors, thereby maintaining confidence in the banking system. Thus an above average CAR affords a bank greater protection against loss, which in turn reinforces depositors and lenders confidence in a bank and the entire financial system. In the case of Nigeria, it is further suggested that the CAR should be set consistently with the

[49] The points are adapted from those originally canvassed by S. Lumpkin in 'Regulatory Issues Related to Financial Innovation,' (2010) Vol. 2009/2, *OECD Journal: Financial Market Trends*, 111 – 12.

prevailing licensing policy in the financial services sector, in the sense of whether banks are licensed to operate on a national and cross-border basis or regionally within a defined section of Nigeria. This should improve upon the CBN's current regulatory approach which prescribes only a minimum CAR of 15% for systemically significant financial institutions.[50]

The *third* lesson relates also to the proposed financial system stability regulator and suggests that this agency should design and enforce a strict leverage cap on the extent to which banks can create credit by borrowing on their capital. This can be done as mentioned above, in principle, by setting and enforcing different levels of leverage ratios, which are calibrated according to the levels of capital base of existing banks, other than a one size fits all ratio that can unduly restricts credit creation by strongly capitalised banks. Additionally, the regulator should always enforce a strict disclosure of both on and off balance sheet exposures of financial intermediaries.[51]

The *fourth* lesson suggests that future banking consolidation in Nigeria should be thought through; and if adjudged to be necessary, it should be matched with improvement in the regulatory framework in view of the malpractices and regulatory lapses which followed the banking consolidation of

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50 See, 'Capital Adequacy: Banks in Race to Beat 30 September 2014 Deadline,' *ThisDay* 14 September 2014 available online at: < http://www.thisdaylive.com/articles/capital-adequacy-banks-in-race-to-beat-sept-30-deadline/188979/> accessed on 18 March 2015.

51 See generally in this respect, BCBS, *Revised Basel III Leverage Ratio Framework and Disclosure Requirements* (Basel: Bank for International Settlements, 2013) 2 – 13.

2005.[52] Preferably, banking consolidation ought to be market driven, while the proposed systemic stability regulator and the market integrity regulator monitor the process and enforce preset standards. It should also be possible in principle to *de-consolidate* by breaking up financial conglomerates whose size and business practices are inimical to fair competition. This last point is now being adopted in Nigeria in that after the crisis of 2008-09 banks are now required to divest non-banking assets and subsidiaries.[53]

The *fifth* lesson relates to the mortgage market. Although the Nigerian mortgage market is relatively underdeveloped compared to that of Canada, it can yet learn from Canada and develop on a positive note by financing mostly prime mortgages. Specifically, the Nigerian Government should consider the systemic implications of any political policy, which aims to liberalise mortgage finance, in terms of the possibility that it might induce a 'flight to subprime mortgage finance.' Also, if and when securitization of mortgage debts becomes a widely used option in the Nigerian market, the proposed financial system stability regulator should in principle, set a high benchmark for an 'originate and hold' business model, with a cut off point on when and what percentage of mortgage debt can be securitized. It can of course be questioned whether it is desirable for a regulator

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52 Sanusi (n 39) 5 – 11.

53 See CBN Circular to all banks and discount houses dated 30 March 2010: *BSD/DIR/GEN/CIR/04/012-Review of Universal Banking Model.*

to tell a bank what proportion of the credit risk assets the bank originates should be retained. Still we argue that this approach merits serious consideration in Nigeria because it can make banks 'bear' some of their volatile credit risks assets which can in turn encourage greater diligence in credit expansion.

The *sixth* and final lesson, relates to the usefulness of an institutional approach to consumer financial protection. This lesson feeds into and is accommodated in the proposal for a consumer financial protection agency, under the objectives-based triple peaks architecture.

4.3.3.3 Lessons From The UK

There are arguably two key lessons that a Nigerian triple peaks regulatory framework can draw from the UK experience. The *first* lesson relates to the need to give the three regulatory institutions, *policy* and *operational autonomy* to resist either political or market pressures that could make them aim for short term economic gains, which have long term adverse effects for the financial system. Illustratively, while Lagos (Nigeria's commercial capital) does not presently rank with London as an international financial centre whose competitiveness ought to be maintained, the proposed triple peaks financial regulators should not project an African regional or global financial prominence for Lagos, through possibly a 'light touch regulatory approach' that could risk the stability of the Nigerian financial system. Indeed, this was prominent criticism of the vision behind the Nigerian banking consolidation of 2005, which according to commentators 'regulated' financial conglomerates into existence in Nigeria without a corresponding strong enforcement of financial laws, to respond to the vulnerabilities created by the new financial conglomerates.[54]

The *second* lesson requires the proposed triple peaks structure to articulate a clear approach to the cross border dimension of financial regulation in Nigeria, particularly on how the country's treaty commitments impact on the effective supervision of international financial institutions, which operate in Nigeria and on how to regulate Nigerian banks with international business operations. Specifically while Nigeria does not currently face the problem of insolvent foreign banks, a forward looking approach should be to formulate contingency plans to protect Nigerian depositors and investors from the adverse effect of cross-border insolvency of a foreign bank that might operate in Nigeria in the future. In principle, the proposed financial system stability regulator can enforce a policy, which requires those banks to ring fence their local assets and liabilities from their foreign affiliates for effective prudential supervision. Similar policy can be applied to Nigerian banks with foreign branches. Additionally and in consequence of the recent expansion of Nigerian banks into West African and other sub-

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[54] T. Ogowewo and C. Uche, in '[Mis]Using Bank Share Capital as a Regulatory Tool to Force Bank Consolidation in Nigeria' (2006) vol. 50, 2 *Journal of African Law*, 161; Sanusi (n 39); O. Famuyiwa, 'The Nigerian Financial Crisis: A Reductionist Diagnosis' (2013) 2(1) *Journal of Sustainable Development and Policy*, 1 – 25.

Saharan financial markets, the proposed systemic stability regulator should in principle devise an arrangement to coordinate the prudential regulation and insolvency resolution of these banks with the national authorities of the countries, where these banks have affiliates or branch operations.

4.3.3.4 Lessons From Malaysia

Malaysia's regulatory responses to the Asian currency crisis arguably present five prominent lessons for the proposed Nigerian objectives-based triple peaks financial regulation. *First,* the Malaysian experience demonstrates the need to match the proposed regulatory structure with sound economic policies, to enhance its effectiveness. One area where this is required for an emerging market like Nigeria relates to the monitoring of foreign short term (speculative) capital inflows which have the tendency to expose a country to the adverse effects of credit contraction that often follow financial crises in the home countries of foreign (speculative) investors. In principle, this can be done in several ways, including for the proposed financial system stability regulator to work together with the CBN and Nigerian Stock Exchange, to enforce *a targeted capital control policy* that caps the amount of short term foreign speculative capital that can enter the economy and how and when they can be repatriated through divestment, in particular, where it appears to the systemic stability regulator and the CBN that this might precipitate a systemic crisis. This would most likely require an amendment of the *Nigerian Investment Promotion Council Act* and renegotiation of a number of Bilateral Investment Treaties (BITs).

The *second* lesson and one that has largely been adopted in Nigeria after the crisis of 2008-09, relates to the need to strictly regulate margin loans and other speculative market practices. Since a stock market crash is often the first indicator of a banking and currency crises, the proposed systemic stability regulator, under the triple peaks structure, should in principle cap the percentage of a bank's credit that can fund margin trading. As a *third* lesson, the proposed market integrity regulator's remit should in principle include a rigorous enforcement of corporate governance standards, including the reduction and prevention of family ownership of financial institutions. The OSFI should also adopt a mandatory regulatory observer attendance at corporate events of financial institutions, as a practical demonstration of its robust approach to the enthronement of good corporate governance. Anecdotal evidence indicates that SEC and other regulators often attend meetings of quoted financial institutions before and after the crisis of 2008-09. But the effectiveness of this attendance is open to question given the high level of corporate governance abuse that commentators generally blamed for the crisis.

The *fourth* lesson suggests that the susceptibility of the Nigerian financial system to externally induced shocks, in consequence of the country's interconnectedness with the global financial system, should always be monitored. The proposed systemic stability regulator can be do this in principle, by imposing a cap (ideally low) on for instance Nigerian financial intermediaries' US dollar denominated investments (most likely in financial instruments issued in western financial markets) and their holding of foreign exchange. It can also stipulate that foreign investments by our financial intermediaries should be in highly liquid assets (sovereign bonds and foreign blue chip equities) and where possible these investments should be hedged against credit default of issuing governments and companies.

Finally, the *fifth* lesson requires a Nigerian objectives-based triple peaks financial regulation to incorporate a mechanism to provide a long-term liquidity and solvency assistance to illiquid but solvent financial institutions. In principle, the proposed systemic stability regulator can create an internal unit that collaborates with the CBN to provide solvency assistance to financial institutions on the basis of need. It should however be backed by a clearly stipulated cut off date and repayment terms so as not to induce moral hazard (a reckless business model, which counts on State capital injection) in the financial system. This presents a viable proactive alternative to the current CBN reactive practice which uses discount windows and other short-term lender of last resort vehicles to provide funds to solvent but illiquid financial institutions as a form of piecemeal intervention. This approach also reduces the pressure that such illiquidity often exerts on the inter-bank.

4.4 CONCLUSION

This chapter has relied on the 'middle ground school' of legal transplant to argue that a Nigerian objectives-based triple peaks financial regulation can draw lessons from the weakness and strengths of extant regulatory models, as from the regulatory progresses and pitfalls in the US, Canada, UK and Malaysia. In terms of drawing from the Canadian, Malaysian, the UK, and US, experience, this part has discussed seventeen lessons, which should feed into the design of the proposed objectives-based triple peaks financial regulation. Altogether, these lessons are reducible to two ideas namely: that the reform of financial regulation as canvassed in this thesis should be structured in a form that is pronouncedly aligned with the objectives of financial regulation rather than the functional divide of the financial system; and that objectives-based structure should accommodate the cross-border and long term implications of financial regulation in Nigeria.

Importantly, the comparative lessons discussed in this chapter show how the proposed Nigerian triple peaks financial regulatory architecture can be structured to draw from the regulatory successes and pitfalls recorded in the comparator jurisdictions. However, the lessons offer little guidance on how to make the institutions to be structured *accountable,* in terms of exploring the approaches through which government in most jurisdictions exercise oversight powers over financial institutions. The next chapter is the second part of our two-part comparative analysis and it would discuss these approaches. Notably, it debates the *pro et contra* of the use of tort law based negligence liability as a financial regulatory accountability mechanism.

CHAPTER FIVE

THE OBJECTIVES-BASED APPROACH AND REGULATORY ACCOUNTABILITY: THE CASE FOR IMPOSITION OF NEGLIGENCE LIABILITY ON FINANCIAL REGULATORS

5.1 INTRODUCTION

This chapter is the second in our two-part comparative analysis. It argues for the imposition of negligence liability on financial regulators as a regulatory accountability mechanism under the objectives-based triple peaks financial regulation that we canvassed for Nigeria. We argue for this accountability mechanism because whilst the remedial right to damages for civil wrongs is as well established as the right to judicial review of unlawful administrative actions, but the scope of liability for financial supervisory failure is in many respects limited.[1] Should financial regulators be liable for losses suffered by third parties (whether as depositors, investors, or the shareholders of regulated institutions) where a negligent performance of their supervisory tasks induced the collapse of a financial institution or a financial crisis? What consensus underpins this question? What considerations argue for, and against, the imposition of this liability? These are by no means unfamiliar questions. Legal commentators, legislators and the judiciary have expended considerable intellectual energy on them, as they have, on the

[1] Regulation focuses on rules for the conduct of financial intermediation; supervision, looks to their enforcement. See: E. Kane, 'Regulation and Supervision – An Ethical Perspective in A. Berger, P. Molyneux, and J. Wilson (eds), *The Oxford Handbook of Banking* (Oxford: OUP, 2010) 315. Because regulation and supervision tend to be combined in an agency, we shall use the terms, regulation, supervision, on the one hand and regulators, and supervisors, on the other, interchangeably in this chapter.

broad question of the relationship between unlawful governmental actions on the one hand, and the availability of pecuniary remedies against public authorities, as opposed to judicial review, on the other.[2] In the light of the part played by supervisory failure in the Nigerian financial crisis and the need for regulatory accountability implicated by that failure, these questions are inexorably central to this thesis; all the more so, to strengthen the accountability of the triple peaks framework proposed for Nigeria.

Depending to a large and varying extent on their legal traditions or their experiences with regulatory or supervisory failures, most jurisdictions have approached the question of liability for poor financial supervision differently, with solutions ranging from imposition of negligence liability, liability only for misfeasance, gross negligence, or absolute supervisory

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2 For a detailed examination of these and other interrelated questions the researcher consulted and recommends these sources and authorities: Law Commission, 'Monetary Remedies in Public Law,' *Discussion Paper*, 11 October 2004; R. Delston, 'Statutory Protection of Banking Supervisors,' (2000) Financial Sector of the World Bank Group, 1 – 2, available at: <http://www1.worldbank.org/finance/html/statutory_protection .html> accessed on 30 October 2013; *Yeun Kun Yeu and Ors v Attorney General of Hong Kong* [1988] 1 AC 175; *Davis v Radcliffe* [2009] 1 WLR 821; *Case C – 222/02 Peter Paul and Ors v Germany* [2002] ECR I-9425; *Three Rivers District Council and Ors v Governor and Company of the Bank of England (No 3)* [2003] 2 AC 1; M. Tison, 'Do Not Attack the Watchdog! Banking Supervisor's Liability After Peter Paul (2005) 42 *Common Market Law Review* 639 – 675; I. Giessen, 'Regulating Regulators Through Liability: The Case for Applying Normal Tort Law Rules to Supervisors,' (2006) 2 *Utrecht L. Rev*. 8; P. Wood, 'A Hidden Lesson of BCCI and the Bank of England,' (2006) *Butterworths Journal of International Banking and Financial Law*, Guest Editorial, 3; R. Dijkstra, 'Liability of Financial Regulators: Defensive Conduct or Careful Supervision? (2009) Vol. 10, 4, *Journal of Banking Regulation* 269 – 284; P. Athanassiou, 'Bank Supervisors' Liability: A European Perspective,' (2011) Vol. 30, *Yearbook of European Law*, 213 – 254; R. Dijkstra, 'Liability of Financial Supervisory Authorities in the European Union,' (2012) 3 *Journal of European Tort Law* 346; D. Nolan, 'The Liability of Financial Supervisory Authorities,' (2013) 4 *Journal of European Tort Law* 190.

immunity.[3] Yet, it would appear that there is a view according to which liability for third-party losses induced by acts or omissions of financial regulators should exclude negligence and be limited to cases of misfeasance in public office or bad faith.[4] This chapter challenges this view. It interrogates the justifications severally advanced in support of the preclusion of negligence liability for deficient financial regulation; and, as a thematic narrative, it defends the imposition of liability for negligent financial supervision on the State and its financial regulatory emanations.[5]

Four explanations for the approach to financial regulatory liability adopted in this chapter can be put forward: *First*, contemporary financial regulation is strongly structured into formal and often very detailed rules that often address both authorisation requirements and ongoing supervision. This makes supervisory action more challengeable by different stakeholders. *Second*, the litigation risk run by financial regulators should be situated within a broader context of the increasing assertiveness of depositors and investors, who generally experience fewer burdens in making recourse to court actions, as deposit insurance

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3 L. Dragomir, *European Prudential Banking Regulation and Supervision: The Legal Dimension* (London/New York: Routledge, 2010) 301.

4 *Yeun Kun Yeu* (n 109); *Three Rivers (No 3)* (n 2) 190 (Lord Steyn); Basel Committee on Banking Supervision (BCBS) *The Core Principles for Effective Banking Supervision* (Basel: Bank for International Settlement, 2012) 4.

5 Negligence liability in tort is founded on the proof of three elements namely, that the defendant owed the claimant a duty; that duty was breached; and the breach resulted in damage or loss for the claimant: See generally W. Rogers (ed) *Winfield & Jolowicz on Tort*, Eighteenth Edition, (London: Sweet & Maxwell, 2010) 149 – 304.

systems do not usually provide complete compensation in the event of a bank failure, for example. Such claims in practice tend to be instituted by an office holder (an administrator or a liquidator) in favour of depositors and other creditors, and if there is a surplus, then for the benefit of other creditors.[6] This may suggest that the claim belongs to the regulated institution rather than individual depositors or investors, ostensibly to avoid the reflective loss problem.[7] *Third*, negligence liability claims may also in part be informed by the perception of depositors and investors as to the financial regulators' ability to actually forestall market failure or the collapse of a financial institution. The *fourth* is the obvious points that ultimately the question of whether or not to impose liability for negligent financial supervision is one of domestic policy; and a jurisdiction can competently elect to apply this tort liability to its financial regulators even though the applicable policy in another jurisdiction differs.

This chapter is organised into five sections. This introduction is the first section. The second section analyses the arsenal of regulatory accountability-inspired instruments and

[6] This was evidently the case in *Three Rivers (No 3)* (n 2) where the claim was pursued by Deloittes, the liquidator of BCCI, against the Bank of England. The case was later brought an abrupt end, when the creditors called on Deloittes to discontinue it. See: *Three Rivers DC v Bank of England* [2006] EWHC 816.

[7] The reflective loss problem prevents a share shareholder from recovering damages, merely because the company in which has economic interest has suffered damage through the act of a third party. He cannot recover a sum equal to the diminution in the marked value of shares, or equal to the likely diminution in dividend because such a 'loss' is merely a reflection of the loss suffered by the company: *Prudential Assurance v Newman* [1982] 1 Ch 204 at 210; *Johnson v Gore Wood* [2002] 2 AC 1 at 35F per Lord Bingham.

argues for the deployment of judicial accountability as a viable mechanism to enhance the effectiveness of the proposed triple peaks financial regulation in Nigeria. The third section challenges the preclusion of the claims for losses arising from negligent financial regulation. The fourth section interrogates the justifications for the preclusion. The fifth section defends and rationalises the case for the imposition of negligence liability. The sixth and final section closes the chapter.

5.2 The Arsenal of Accountability-Inspired Control Mechanisms and Nigerian Triple Peaks Financial Regulation

Accountability as we pointed out in Chapter 3 speaks to the need for public officials to demonstrate that oversight functions have been conducted in accordance with statutory rules and standards and to report fairly and accurately on performance results vis-à-vis mandated roles and (or) plans.[8] It stands for the need to know the agency that is responsible for a regulatory matter;[9] the imperative to make public officials answerable for their behaviour and responsive to the entity from which they derive their authority; and the establishment of criteria to measure the performance of public officials, as well as oversight mechanisms to ensure that standards are met.[10] For financial regulators, in particular, it speaks to the need for them to have sound governance and be answerable for the discharge of their duties and use of resources.[11]

Accountability control instruments over financial regulators can be reduced to five main types, most of which are relevant to both central bank and non-central bank financial sector regulators,

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8 Organisation for Economic Co-operation and Development (OECD), *Public Sector Transparency and Accountability: Making it Happen* (Paris: OECD Publishing, 2002) 7.

9 E. Pan, 'Structural Reform of Financial Regulation,' (2011) vol. 19 *Transnational Law & Contemporary Problems* 796, 809.

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

11 BCBS (n 4) Principle 2, at 10, 22 – 4.

despite the different objectives,[12] and multiple principals environment,[13] which sets non-central bank financial regulators from their central bank counterparts. These instruments are (i) parliamentary accountability; (ii) ministerial accountability; (iii) market based accountability; (iv) financial accountability; and (v) judicial accountability.[14] Of concern to us here, is the question as to which of these instruments is better able to strengthen the accountability of the proposed Nigerian triple peaks financial regulators.

5.2.1 Parliamentary Accountability

This is typically exercised through ad hoc contacts between the financial regulators as the agents and the national legislature as the democratically elected delegating principal with power in principle, to assess the manner in which the regulators' mandates are performed, but ultimately to change it by law or in extreme cases to abolish a regulator and replace it with another. In jurisdictions such as the UK and US, submission of annual reports to the national legislature, followed by their publication, as well as appearances by the Heads of regulatory agencies before the legislature or any of its

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[12] C. Goodhart, 'Regulating the Regulators – An Economist's Perspectives on Accountability and Control in E. Ferran and C. Goodhart (eds.) *Regulating Financial Services and Markets in the 21st Century* (Oxford: OUP, 2001) 156 – 7.

[13] M. Bovens, 'Public Accountability' in E. Ferlie et al (eds.) *The Oxford Handbook on Public Management* (Oxford: OUP, 2004) 184 and 189 (referring to an 'accountability forums' confronted with 'multiple potential accountors').

[14] For a comparative account of the concrete accountability-inspired control instruments applied to financial sector supervisors in the US, Canada, Australia, the UK and France, see J. Black and S. Jacobzone, 'Tools for Regulatory Quality and Financial Sector Regulation: A Cross-Country Perspective' *OECD Working Paper on Public Governance, No 16*, OECD Publishing, 2009. See also E. Hupkes, H. March and M. Taylor, 'The Accountability of Financial Supervisors: Principles and Practice,' IMF Working Papers, No 05/51, March 2005.

standing and (or) ad hoc legislative committees are amongst the most frequently practiced forms of parliamentary accountability.[15]

In law, the Nigerian National Assembly has legislative oversight powers over the country's financial regulators.[16] In practice, the exercise of these powers is often weak and controversial. A classic instance of the weakness of parliamentary accountability in the Nigerian context, is the documented refusal of the leadership of the Central of Bank of Nigeria to obey the summons to appear before the House of Representatives Ad Hoc Committee set up in 2012 to investigate the collapse of the capital market in the Nigerian financial crisis of 2008 – 09. While one may question the propriety of the three year gap between crisis and the commencement of the investigation, it is instructive to note that the leadership of the CBN refused to submit to the committee on request, the special examination report upon which the CBN intervened in the eight insolvent banks in 2009.[17] Indeed the recommendations of the committee including particularly the one on the need to subject the leadership of the CBN and SEC to a code of conduct, which has appropriate penalties for regulatory failure,

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15 For instance the Federal Reserve ('the Fed') is accountable to the US Congress in that it reports annually on its activities to the Speaker of the House of Representatives (the Lower House) and biannually on its monetary policy stance to the Congressional banking committee. Fed officials also make ad hoc appearance before Congress as and when requested. Similarly, the Bank of England is accountable to Parliament, with its Annual Report being laid before the House of Commons Treasury Committee annually before being made public and with Bank of England officials appearing before other select committees, as and when requested.

16 *Sections 4 and 88, second schedule Part 1 (Exclusive Legislative List, Item 6) Constitution of Federal Republic of Nigeria, 1999.*

17 House of Representatives, *Report of the Ad-hoc Committee on the Investigation into the Near Collapse of the Nigerian Capital Market 2012*, ('Ad-hoc Committee Report') 76.

have yet to be implemented.[18] There is a credible ground to doubt their implementation, given the experience in Nigeria that the executive arm of government rarely implements legislative recommendations, it perceives to 'witch-hunt' its officials. Assuming *arguendo* that the recommendations are eventually implemented for whatever they are worth; questions will still remain as to how to remedy the third party losses (mostly in form of lost investments) induced by the failure. For this reason, it is argued that parliamentary accountability is a weak instrument to strengthen the accountability of proposed objectives-based triple peaks financial regulators in Nigeria.

5.2.2 Ministerial Accountability

This relates to the vertical relationship between the supervisory agency and the executive arm of government that usually appoints and dismisses the regulatory institution's head and (or) its board members. Regular reporting obligations and the exercise, more often than not by the Finance Minister, of oversight authority over the manner in which delegated regulatory powers are exercised typically reflects this type of accountability. In Malaysia, the *Banking and Financial Institutions Act of 1989*, expressly provides for ministerial accountability powers over the BNM. For instance, the BNM's powers over an insolvent financial institution are exercisable only with the prior consent of the Finance Minister.[19] The Minister may also from time to time, modify, amend, alter, or

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18 *ibid,* 79.

19 *Section 73(2) of the Banking and Financial Institutions Act, 1989.*

replace an order by the BNM, where it is possible or just to do so.[20] This contrasts with the situation in Nigeria in that while CBN,[21] SEC,[22] NAICOM,[23] CAC,[24] and NDIC are statutorily subject to ministerial oversight,[25] these statutory provisions are at best facetious. This is because in practice the Nigerian Finance Minister is not known to institute accountability review over the actions of financial regulators, even where a credible case for such review is manifest, such as was arguably the case in the allegation of expropriation of ownership of the eight insolvent banks which were subject to CBN intervention in 2009.[26] In view of this background to ministerial accountability in Nigeria, it is argued that it has a limited prospect of strengthening the accountability of the proposed Nigerian triple peaks financial regulators.

5.2.3 Market-based Accountability

This stems from the financial regulator's duties in relation to two main constituencies: regulated entities (which often bear some, at least of the regulatory costs through the payment of fees, levies, or administrative fines) and the consumers of financial services (depositors and investors). Financial regulators in jurisdictions such as the UK and US on numerous occasions are known to hold

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20 *ibid, section 73(3).*

21 *Section 1(1) of the BOFIA (as amended by Act No. 4 of 1991).*

22 *Sections 5 and 315 of the ISA.*

23 *Sections 4 and 65 of the NAICOM Act.*

24 *Sections 2 and 610 of the CAMA.*

25 *Sections 6 and 59 of the NDIC Act; section 88 of the Constitution of the Federal Republic of Nigeria, 1999.*

26 O. Gabriel, E. Uja, B. Komolafe, V. Ahiuma-Young and M. Eboh, 'Shareholders to sue CBN, NDIC, AMCON,' 10 August 2011, *Vanguard* (Nigerian newspaper) 1 and 5.

market and consumer consultations before they introduce key measures that are likely to affect those consulted.[27] In Malaysia, this type of accountability is statutorily provided in terms of a duty to give regulated institutions, reasonable opportunity to make representations against or otherwise in respect of a proposed order.[28] In contrast, market-based accountability in Nigeria is often a subject of controversy on account of allegations of abuse and (or) misuse of regulatory powers. Put simply, Nigerian financial regulators are not known to be subject to market-based accountability in that some of their actions, especially in relation to banking supervision, have often been criticised as flagrant breach of the legitimate expectations of regulated financial institutions and their shareholders.[29] Indeed, allegations of abuse of power, arbitrariness, disregard for legitimate expectation of shareholders of banks and lack of transparency, mostly characterise the court cases challenging the intervention of the CBN in the eight insolvent banks and their resolution from 2009.[30] In view of this

[27] For instance, the UK Independent Commission on Banking, held wide ranging consultations, the outcomes of which were incorporated into its Final Report Recommendations, published in September 2011.

[28] *Section 73(4*) of the *Banking and Financial Institutions Act of 1989*. The section even goes further to stipulate that hearing must be afforded even where an order has been made expediently and such other can be revoked in consequence of hearing.

[29] T. Ogowewo and C. Uche, '[Mis]Using Bank Share Capital as a Regulatory Tool to Force Bank Consolidation in Nigeria,' (2006) 50, 2 *Journal of African Law*, 161, 165 – 6.

[30] These cases include, Appeal No. CA/L/698/11: *Okezie and 3 Ors. v Mainstreet Bank Ltd and 11 Ors*. (This is an appeal by the shareholders of Afribank Plc, Bank PHB Plc, and Spring Bank Plc, against the ruling of the Federal High Court, dismissing their action challenging the liquidation of the three banks; Appeal No. CA/L/689/11: *Nwosu and anor. v Finbank Plc and 14 Ors.* (This is an appeal against the ruling of the Federal High Court, dismissing the action of claimant/appellants challenging their removal as directors of Finbank Plc by the CBN in 2009; Appeal No. CA/L/606/11: *Akingbola and anor. v Intercontinental Bank Plc and 15 Ors.* (This is an appeal against the ruling of the Federal High Court, which dismissed the action of the

background experience, it is submitted that market-based accountability also has little prospect of strengthening the accountability of the proposed Nigerian triple peaks regulators.

5.2.4 Financial Accountability

This relates to the submission by regulators of their financial accounts and balance sheet for the review and control of internal audit committees and external independent auditors including financial reporting authorities statutorily designated to receive and review such accounts. Often the aim of financial accountability is to ascertain that supervisors manage their resources soundly and efficiently, spending public money prudently in the pursuit of their respective mandates. Until lately, Nigerian regulators are not known to be subject in practice to this type of accountability. However and unprecedentedly, the CBN Governor was suspended early in 2014 to give way for the investigation of alleged financial irregularities, flagged by the Financial Reporting Council in its review of the CBN's annual accounts.[31] The suspension of the CBN Governor can of course herald a robust use of financial accountability, but how and to what extent has that suspension led to a review of the CBN's actions or inactions which precipitated the crisis of 2009 would remain a key question. Accordingly, while financial accountability can serve as a veritable disciplinary tool to

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appellants challenging their removal as directors of Intercontinental Bank Plc and the subsequent sale of the bank).

31 See the online news report on this suspension: 'Jonathan Suspends Lamido Sanusi as CBN Governor,' 20 February 2014, Vanguard available at: <http://www.vanguardngr.com/2014/02/jonathan-suspends-lamido-sanusi-cbn-gov/> accessed on 28 May 2014.

check financial improprieties in regulatory institutions; in the sense of forestalling or remedying financial supervisory failure, it is argued that it has little prospect so long as the fiscal allocation to the regulator is not tied to performance, or where the regulator does not depend entirely on such allocation.

5.2.5 Judicial Accountability

This guarantees the fundamental right of legal redress to those affected by regulatory decisions. Judicial accountability can take one of two main forms: judicial review and regulatory liability for damages caused by a regulator's acts or omissions in the exercise of its delegated regulatory powers. Judicial review encompasses the set of established administrative law procedures, which ensure that supervisors act within the limits of their delegated powers (that is, intra vires), and consistently with basic principles of good administration, to protect the interests of those subject to their supervisory authority. Because judicial review often ends in the grant of declaratory relief in relation to the legality or otherwise of the regulator's action, it is not well suited to cases where pecuniary relief is sought for third party losses induced by regulatory failure. Regulatory liability actions, on the contrary, can provide both declaratory and pecuniary relief to remedy such third party losses. The prospect of such actions can in principle keep regulators on their toes and this ordinarily should argue for the greater use of judicial accountability to forestall and (or) remedy negligent financial regulation which is more often than not, the root causes of regulatory failure. But in most jurisdictions including Nigeria, it is considered as a point of high policy priority to protect financial regulators (through the grant of statutory immunity) from judicial accountability founded on regulatory negligent actions. However, and given what has been said above in relation to the prospects of other types of accountability-inspired instruments, it is argued that negligence based judicial accountability offers in principle a higher prospect of keeping the proposed Nigerian triple peaks financial regulators on their toes.

In a subsequent part of this chapter, we shall develop and justify the case for a negligence liability based judicial accountability. To do this, we shall debate the *pro et contra* of the imposition of negligence liability on financial regulators. In the next section and as a preliminary task, we shall demonstrate the absence of a truly universal consensus to preclude this sub-type of accountability-inspired instrument.

5.3 Is There A Consensus To Preclude Liability for Negligent Financial Supervision?

This section challenges the view according to which the non-binding prescription contained in international financial soft law,[32] is to be accepted as the standard for the determination of whether there should be a liability sounding in negligence for regulatory or supervisory failure. In what follows, we shall first give an analytical overview of three areas namely: the international soft law on legal protection of financial regulators, the common law's position on liability for financial supervisory negligence, and the law in Malaysia, Nigeria, and the United States. Thereafter, we shall use comparative law to demonstrate the absence of a uniform approach to preclude liability for negligent financial supervision across both common and civil law jurisdictions. The evidence we present shows that the question is more of a domestic policy decision than a putative compulsion to adopt a purported (universal) 'consensus;' and even when viewed against the background of this 'consensus', assuming *arguendo* there is one, negligence liability appears to preponderate across jurisdictions more than should have been the case.

[32] A rule of law is a norm coupled with coercive power. International soft law is only the norm. A vast number of such non-coercive norms exist, with normative tilt toward respect for human right, democracy, and effective regulatory governance. See generally, A. D'Amato, 'International Soft, Hard Law and Coherence,' (2008) Northwestern University Public Law Research Paper No. 08-01, 1-5 available online at: <http://ssrn.com/abstract=1103915> accessed on 26 February 2014; A. Guzman and T. Meyer, 'International Soft Law,' (2010) Vol. 2, No. 1 *Journal of Legal Analysis*, 171.

5.3.1 International Soft Law on Legal Protection of Financial Regulators

There is a view on the protection of financial supervisors from liability arising from supervisory negligence which is encapsulated in the Basel Committee on Banking Supervision (BCBS), *Core Principles for Effective Banking Supervision* and the International Organisation of Securities Commissions' (IOSCO), *Objectives and Principles of Securities Regulation*. BCBS' *Core Principle 2*, which prescribes the essential preconditions for independence, accountability, resourcing and legal protection for regulators stresses, inter alia, the need for '[t]he legal framework for banking supervision' to include 'legal protection for the supervisor.'[33] The explanatory memorandum to this Principle specifies further that:

> Laws provide protection to the supervisor and its staff against lawsuits for action taken and/or omissions made while discharging their duties in good faith. The supervisor and its staff are adequately protected against the costs of defending actions and/or omissions made while discharging their duties in good faith.[34]

The kernel of these prescriptive principles is that financial regulators and supervisors should be protected from, and, where necessary, indemnified against, adverse claims except where it can be shown that they have acted without good faith or, alternatively, in bad faith. Bad faith imputes malice; and to the extent that a

33 BCBS (n 4) 10.

34 *ibid*, 22 – 4. The counterpart prescription in IOSCO's Objectives and Principles of Securities Regulation (May, 2003) is contained in Principle 6.2, to the effect that '[t]he capacity of the regulator to act responsibly, fairly and effectively will be assisted by. . . adequate legal protection for regulators and their staff acting in the bona fide discharge of their functions and powers.'

malicious exercise of administrative (supervisory) power can ground a claim for misfeasance in public office,[35] one can deduce that the protection prescribed in the BCBS' *Core Principle 2* and IOSCO's *Principle 6.2*, is not available for misfeasance in financial supervision. But the prescriptions are what they purport to be – mere principles. They should by no means be regarded as legally enforceable rules or binding stipulations on municipal governments. Their *effet utile*, it can be surmised, is to serve as an international financial soft law commended for the guidance of municipal governments in designing an effective banking supervision and securities regulation. It should be stressed, moreover, that the principles projected by the BCBS and IOSCO primarily emanate from the representatives of the regulatory authorities themselves, who have an evident self-interest in promulgating immunity from liability, as a standard for financial regulation; but in so doing, they have generated a questionable global consensus.

5.3.2 The Common Law's Position

By restricting liability to only cases evidencing lack of good faith, the international soft law on legal protection of financial regulators, *prima facie* aligns with the common law of misfeasance in a public office, as enunciated in *Three Rivers*.[36] The availability

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35 *Calveley v Chief Constable of the Merseyside Police* [1989] AC 1228 at 1240 (Lord Bridge of Harwich); B. Garner (ed), *Black's Law Dictionary*, ninth edition, (St. Paul, MN: West Publishing, 2009) 1090. See generally on misfeasance: Rogers (n 5) 383 – 410.

36 To the effect that first there must be an unlawful act or omission done or made in the exercise of power by the public officer; second, the act or omission must have been done or made with the required mental element; third, the act or omission must have been done in bad faith; fourth, the claimants must demonstrate that they have a sufficient interest to sue the defendant; and fifth,

of the tort misfeasance in a public office is one of the reasons of justifying the non-actionability of a claim in negligence, where there is an act of maladministration.[37] The common law specifically sets its face against any recovery by depositors, for losses resulting from negligent licensing, supervision, or failure to withdraw a bank's licence.[38] As will be shown, however, this rule is based on questionable justifications. For our present purposes, it is instructive to note that the rule is not followed across all common law jurisdictions. Courts in Guernsey and Canada follow a different rule, according to which financial regulators can be sued for negligence. For instance, in *States of Guernsey v Firth*, the Court of Appeal of Guernsey (Civil Division) held that a depositor has a cause of action against a public authority statutorily responsible for publishing lists of bodies registered to accept deposits, by reason of his loss resulting from the failure to publish a list.[39] Similarly in *Baird v The Queen*, the Canadian Federal Court of Appeal held that a depositor had a cause of action against the Canadian Government in respect of alleged breaches of its financial supervisory duties.[40]

5.3.3 The Position in Malaysian, Nigerian and United States Law

De lege lata Malaysian, Nigerian and United States law mirror substantially, the prescriptions in the international financial soft

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the act or omission must have caused the claimants' loss: [2003] 2 AC 1 at 189 – 196 (Lord Steyn), 246 (Lord Hope of Craighead).

37 *Three Rivers (No 3)* (n 2) 190F; *Calveley* (n 35) 1228, 1238F.

38 This has been confirmed in *Yuen Kun-Yeu* (n 2); *Davis* (n 2).

39 Unreported 14 May 1981, Court of Appeal of Guernsey (Civil Division) Appeal No 10 civil.

40 (1983) 148 DLR (3d) 1.

law referenced above. In Malaysia, no action can be brought against the Federal, State Government, or the Bank Negara Malaysia (BNM, the Malaysian central bank), the Securities Commission, and their officers and employees for any act or omission in pursuance of executing the provisions of the *Banking and Financial Institutions Act of 1989*; provided the act or omission was in good faith.[41] The relevant provisions in Nigerian law are similarly worded.[42] In the United States, all federal employees including financial regulators are protected under the *Federal Tort Claims Act 1946* (the 'FTCA'). The 'discretionary function' exception in *Section 2680(a)* of the *FTCA*[43] is the one most often used to defend bank examiners. While the immunity of the federal government is waived to some extent by *FTCA*, financial regulators are still immune from claims arising from their exercise of a discretionary function. United States courts, have found this to be applicable to claims alleging negligence against bank regulators.[44]

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41 *Section 114 of the Banking and Financial Institutions Act of 1989.* Identical provisions can be found in *section 87 of the Central Bank of Malaysia Act of 2009*; and *section 55 of the Capital Markets and Services Act of 2007.*

42 *Section 53 of the Banks and Other Financial Institutions Act of 1991* as amended; *section 52 of the Central Bank of Nigeria Act of 2007*; *section 302 of the Investment and Securities Act No 29 of 2007.*

43 This provides protection against any claim based upon an act or omission of an employee of the Government exercising due care, in the execution of a statute, whether or not such statute or regulation be valid, or based upon the exercise of performance or the failure to exercise or perform a discretionary function or duty on the part of a federal agency or an employee of the Government, whether or not the discretion involved be abused.

44 M. Bates and D. Gilbert, 'Claims Against U.S. Bank Regulators for their Conduct in Supervising and Liquidating Financial Institutions,' (June 1996) Presentation at the 3rd International Insolvency and Creditors' Rights Seminar, London.

The effect of these legal provisions is that in Malaysia, the BNM and Securities Commission cannot be impleaded for third-party losses occasioned by their supervisory negligence. The Nigerian CBN and SEC cannot be sued on similar ground. But the law in the US should be read advisedly, because closely examined, it is arguable that the country's financial regulators (SEC, the Federal Reserve, the OCC, the CFTC, and the Federal Insurance Office) and officials are only immune from such a claim where they have acted with due care. This means that in the US, it is notionally possible to bring a claim against federal financial regulators for lack of due care. However, whether this can be used to bypass the preclusion of negligence claims will need to be tested in court.

At any rate, the legal provisions in the three countries read together, do not protect their regulators and even the State, from claims arising ordinarily for breach of contract or for vicarious liability arising from the ordinary (non-regulatory) torts of their officials. *Trendtex Trading Corporation v Central Bank of Nigeria*, for instance, has established that the CBN and the Nigeria State can be sued for breach of contract.[45] This decision can be relied upon as a persuasive precedent before Malaysian and US courts where such reliance is not precluded by a local statute or case law. In the US, courts have jurisdiction to try actions seeking pecuniary damages for injury, property loss or death caused by the negligent or wrongful acts or omissions of federal employees. However, the

[45] [1977] 2 W.L.R. 356.

government is only liable if the employee was acting within the scope of his office or employment, and the law of the place where the act or omission occurred will be used to decide this question.[46] But of course, cases alleging breach of contract or vicarious liability which are often bipolar litigations (one claimant against one defendant) are not easily comparable to a mass tort (involving depositors, investors and shareholders) scenario that is possible in a claim for losses arising from negligent financial supervision, because the remedial consequences of the latter for the State or the regulator, are most likely to be greater than that of the former. This is one justification (argued below) for precluding financial supervisory negligence claims. Still, in a number of jurisdictions, as will be shown below, there is no distinction between single and mass tort claims against financial regulators and the State, which means that in those jurisdictions the State and its regulatory emanations are directly or vicarious liable for all proven cases of negligence.

5.3.4 Comparative Law

The foregoing overview arguably invites certain questions, including whether there is truly a consensus to preclude liability for negligent financial regulation; and whether there are jurisdictions in which negligence claims against financial regulators are permitted in a way that provides a broader remedial response to the culpability of the State and financial regulators,

46 *Section 1346(b)* of the *FTCA*, 28 U.S.C.; See generally, J. Axelrad, 'Taking Uncle Sam to Court,' (1993) *The Brief*, p. 19.

beyond the narrow compass of bad faith. There are no uniform answers to these questions, but four trends are deducible from the way countries structure the liability of the financial regulators namely, the imposition of negligence liability, liability for gross negligence, liability only in cases showing bad faith, and absolute supervisory immunity.

Two caveats are apposite with respect to these trends. *First*, while the legal measure of negligence is known, there is no clear definition of what conduct or omission will amount to gross negligence. Clearly, it takes in more than the standard 'duty-breach-and-damage' sequence to be found in negligence, but what it takes in beyond this sequence and how this is determined remain unclear, because jurisprudence is lacking on this question. For our present purposes, we can assume that it signifies an egregious instance of negligence, but again whether this assumption can found a claim would need to be tested. Instructively, the term has 'never been accepted in English common law as a concept distinct from negligence.'[47] The *second* caveat is that no one trend seems to predominate totally across jurisdictions, although negligence liability seems to be more common than would have been expected.

Claims alleging losses from negligent financial supervision can be brought against financial regulators or in some instances directly against the State, in Australia,[48] Czech Republic,[49]

47 *Tradigram SA v Internek Testing Services* [2007] EWCA Civ 154 at [23].

48 *Section 70A* of the Australian *Banking Act of 1959*.

49 *Articles 3 and 13* of the Czech Republic *State Liability Act*: Dijkstra (n 2) 352.

Denmark,[50] Finland,[51] Greece,[52] Hungary,[53] the Netherlands,[54] Portugal,[55] Slovenia,[56] Slovakia,[57] Spain[58] and Sweden.[59] Should any public official including a financial regulatory official in Japan, cause damages to a third party, illegally on purpose, or negligently in the performance of his duties; the government shall be liable for the damages to the third party.[60] Similarly, Norway,[61] the Philippines,[62] and Switzerland,[63] permit third party negligence claims to be brought against financial regulators and their officials. Typically in these jurisdictions, the State indemnifies the culpable

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[50] *ibid*, 352 – 53.

[51] *Section 2 of the Financial Supervisory Authority Act, No 278 of 2008*; *section 69 of the Financial Supervisory Authority Act*; *Chapter 3, section 2, paras 1 and 2 of the Tort Liability Act (412/1974)*: *ibid,* 253-54.

[52] *Article 914 of the Greek Civil Code; Article 105 and 106 of Greek Law 2783/1941; article 105*: *ibid,* 355-66.

[53] *Sections 339 and 349 of the Hungarian Civil Code of 1959*: *ibid,* 356.

[54] *Article 6:162* of the *Dutch Civil Code*. Notably, the Supreme Court of the Netherlands pointed out in the *Vie d'Or case* that, in order to determine whether financial supervision complies with the standards of reasonable care, all circumstances of the individual case have to be taken into account. These circumstances include the 'nature' of financial supervision, the fact that financial regulators have discretionary powers in order to fulfill their supervisory duties, and the fact that financial regulators face the difficult task of taking into account both the interests of the supervised institutions and individual consumers (the supervisor's dilemma): *ibid,* 259.

[55] *Article 22* of the *Constitution of Portugal 1976*; *article 7* of *Law no 67/2007* of 31 December 2007: *ibid,* 360-61.

[56] *Articles 131(1)* and *135* of the Slovenian *Code of Obligations (No 001-22-117/01)*: *ibid,* 361-62.

[57] *Article 43(1)* of the *Supervision of the Financial Market Act No 747/2004*; *article 4(1)(g)* and *9(1)* of *Act no 514/2003* on *Liability for Damage Caused during the Exercise of Public Authority*: *ibid,* 362.

[58] *Article 139* of the *Legal Regime of Public Administrations and General Administrative Procedure Act of 1992* (LRJAP): *ibid,* 362-63.

[59] *Chapter 3, Section 2* of the Swedish *Tort Liability Act of 1972* (1972:207): *ibid,* 363.

[60] *Article 1 of the* Japanese *Government Compensation Law.*

[61] *Sections 2-1 and 2-2 of the Damages Act; section 435 of the Civil Procedure Act* (Norway).

[62] *Section 28 of the Administrative Code Act* (Philippines).

[63] *Articles 7 and 8 of the Federal Law on Liability of the Swiss Confederation.*

official or institution in the event of an award of damages in favour of the third party.[64]

Why do these countries permit negligence claims to be brought against regulators and the State? Does this reflect a policy to provide broad remedial responses to wrongs alleged against the State as well as regulatory institutions and their officials, who can be regarded in reality as emanations of the State? These questions arguably engage two considerations. The first relates to the legal implications of the policy choices countries often make in relation to the remedial rights of their citizens against the State, in terms of the limits and extent of what are permissible as claims against the State and its agencies. The second and connected consideration relates to whether or not a State adopts a position to allow a public grievance management process in which the exercise of the various regulatory powers entrusted to the State is subject to judicial scrutiny and specifically with respect to cases where there are allegations of negligence in public administration.

It should be noted on the contrary that in Belgium,[65] Bulgaria,[66] Cyprus,[67] Estonia,[68] France,[69] Ireland,[70] Italy,[71]

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64 Delston (n 2) 2.

65 *Article 68* of the *Supervision of the Financial Sector and Financial Services Act of 2002*; *article 26 (1) section 4 of the Law of 2nd of July 2010*: Dijkstra (n 2) 350.

66 *Article 1* of the *Liability of the State and the Municipalities role for Damages Law of 1988*; *article 79(8)* of the *Law on Credit Institutions of 2006*: *ibid,* 351.

67 *Part XII, Article 32(1*) of the Cyprus *Banking Law No 66(1) of 1997*, the Central Bank of Cyprus is liable in cases of gross negligence or bad faith: *ibid,* 351-52.

68 *Section 58* of the *Financial Supervision Act 2001*; *paragraph 13(3*) of the *State Liability Act of 2002*: *ibid,* 353.

69 Normal gross negligence (*faute lourde*) rules regarding governmental liability apply: *ibid,* 354.

Luxembourg,[72] and the United Kingdom,[73] nothing short of gross negligence and (or) bad faith, would suffice to ground third-party liability of financial regulators. In Austria,[74] Germany,[75] and Poland,[76] third-party supervisory liability seems to be altogether excluded.

The foregoing review of the contrasting approaches to third-party negligence liability of financial regulators across countries demonstrates the absence of a wide acceptance of the prescriptive standard in the international soft law on legal protection of financial regulators. More specifically, it demonstrates that far from a putative compulsion to follow this standard a country's choice of liability rule is policy driven. Nor can it also be argued on the footing of this review that there is a truly a common law consensus to preclude such liability. As we have shown with the examples of Australia, Canada and Guernsey, the exclusion of liability for negligence financial supervision is not commonly shared within the common law family. The evidence altogether

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70 *Section 33AJ* of the *Central Banking Act*: *ibid,* 356.

71 *Article 24(6)* of the *Law* 28 of December 2005: *ibid,* 357.

72 *Article 20(2*) of the *Law Creating a Commission for the Supervision of the Financial Sector (1998)*; *Article 24* of the *Law on the Insurance Sector (1991)*: *ibid,* 358.

73 *Schedule 1, section 99* of the *Financial Services and Markets Act* (FSMA) 2000 (as amended by the *Financial Services Act 2012); section 244* of the *Banking Act 2009.*

74 *Section 3 para (1)* of the *Federal Act on the Institution and Organization of the Financial Market Authority (FMABG 97/2001)*: B. Steininger, 'Austria,' in: H. Koziol and B. Steininger (eds), *European Tort Law* (2009) 108, no 18 f. See also European Central Bank (ECB), *Recent Developments in Supervisory Structures in the EU Member States* (Frankfurt: ECB, 2010) 8.

75 *Section 839* of the *Bürgerliches Gesetzbuch* (German Civil Code, BGB); *section 4(4) Finanzdienstleistungsaufsichtsgesetz* (*Financial Services Supervision Act*): Dijkstra (n 2) 354 – 55.

76 *Article 133.4* of the *Polish Banking Act of 29* August 1997: *ibid,* 359-60.

supports two conclusions. The *first* conclusion is of course apparent from our analysis thus far and encompasses the point which we highlighted in section 5.1 above that ultimately, the question of whether or not to impose liability for negligent financial supervision is one of domestic policy; and a jurisdiction can competently elect to apply this tort liability to its financial regulators even though the applicable policy in another jurisdiction differs. The *second* is that this liability is not impossible of precise enunciation in principle, where the facts of a case require such a remedial response. What arguably militates against such enunciation in jurisdictions such as Malaysia, Nigeria and the United States, can be approached from two perspectives. There is the law as it is in that the three countries have statutory rules precluding such liability and their courts may be inclined to follow *Yuen Kun-Yeu* and *Davis*. Apart from the law, several normative justifications argue in favour of this preclusion.

In the next section, we shall debate the justifications, which are often put forward in support of the preclusion of recovery for financial supervisory negligence.

5.4 Arguments Against Liability for Financial Supervisory Negligence

This section discusses the justifications for the preclusion of liability in the context of negligent financial supervision. For ease of analysis, we shall resolve these justifications into eight arguments namely: the 'conflicting public interests argument;' the 'defensive regulation or supervision argument;' the 'floodgate of claims argument;' the 'lack of control argument;' the 'nonfeasance argument;' the 'misfeasance in public office precludes negligence argument;' the 'loss shifting' argument;' and the 'constitutionality argument.'

5.4.1 'The Conflicting Public Interests Argument'

The 'public interest argument' states that to accept that supervisors can incur third party liability for the deficient performance of their public tasks is to acknowledge that financial sector supervision encompasses the defence of individuals' interest and the supervisor's remit should not merely be to protect the public interest in the financial soundness of regulated institutions or in the preservation of systemic stability, but also to safeguard the interests of depositors, investors, and shareholders.[77] In spite of its prima facie persuasiveness, the 'public interest argument' is unduly formalistic, because in reality, 'public interest' is no more than the aggregate interests of depositors, investors, shareholders and other

[77] P. Athanassiou, 'Financial Sector Supervisors' Accountability: A European Perspective,' (2011) European Central Bank (ECB), *Legal Working Paper Series No 12*, 30 – 1.

third party stakeholders in the regulated institutions. Arguably, it is by protecting this aggregation that the rules of prudential supervision can serve their purported public interest aims.

Further, while the realisation that financial sector supervision serves a plurality of sometimes conflicting interests is inextricably intertwined with the 'public interest argument,' this alone should not be cited as a reason for precluding third liability for supervisory negligence. The bankruptcy of the Icelandic savings bank Lansesbanki in October 2008 is a classic illustration of this scenario. According to a report from the European Consumers' Organisation, the Icelandic Financial Supervisory Authority (FME), Landesbanki's home country prudential supervisor, was already aware in August 2008 that the bank was facing difficulties. The supervisor justified its decision to take no action until October 2008, when Landesbanki went bankrupt, by invoking its concern for the preservation of the stability of the financial system. What was a legitimate decision eventually had significant adverse effects for depositors in Iceland, the UK and the Netherlands and even spiraled into a diplomatic espousal of the rights of affected UK and Dutch depositors to deposit insurance compensation.[78] To argue that a supervisor should not be liable in negligence for a deficient performance of their public tasks as reflected in this case seems

[78] *ibid,* 31 referencing European Consumers' Organisation, 'Financial Supervision in Europe: Consumer Perspective,' Ref.: X/054/2009 - 16/07/09 BEUC. See also the 'The Icesave Dispute' available online at: <http://en.wikipedia.org/wiki/Icesave_dispute> accessed on 21 December 2014.

convincing on the ground of striking a balance between the supervisor's tortious liability towards individuals on the one hand, and the effective performance of its financial stability function. Even so, the supervisor's liability should not be excused where the facts show that it has focused excessively on financial stability, to such an extent that its margin of appreciation of the risk of harm to investors and depositors by its failure to respond proactively to emerging threats in a regulated financial institution becomes fettered.

Ultimately of course, the fundamental goal of financial supervision is not to eliminate the possibility of financial crises or the collapse of financial institutions, any more than the goal of criminal law can be supposed to comprise the elimination of crime. It is rather to minimise the risk of failures through preventive care.[79] Accordingly, to impose third-party negligence liability on financial supervisors arguably contradicts the rationale of prudential supervision which is not to eliminate the risk of financial intermediaries' failures, but rather to mitigate the risk of their occurrence through the constant monitoring of the supervised entities and the opportunity (rather than the guarantee) that this provides for the early detection of fault lines, with an emphasis on

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[79] This point was made in *Hill v Chief Constable of West Yorkshire* [1989] 1 AC 53, where it was held that, for reasons of public policy (i.e. the fear of defensive conduct and a variation of the 'floodgates' argument), the police were under no general duty of care to individual members of the public for their activities in the investigation and prevention of crime, and that only in exceptional circumstances would the police assume such a responsibility, giving rise to a duty of care to an individual. For a thoughtful account of this and other English cases involving remedies for police inaction see: M. Burton, 'Failing to Protect: Victims' Rights and Police Liability,' (2009) 72 (2), *MLR* 272-295.

those capable of bringing down supervised entities or threatening systemic stability.[80] Assuming *arguendo* that this is the core of the 'public interest argument' it is argued that properly examined, it is not an argument against third-party negligence liability, rather, it supports the conclusion that where the supervisor's evident lack of diligent mitigation of systemic risk induces a financial crisis, its accountability to depositors and investors who can be regarded as third party stakeholders in the financial system might be engaged.

5.4.2 'The Defensive Conduct Argument'

The defensive conduct argument stresses that if third-party negligence liability were to be imposed on financial regulators, they will constantly 'look over their shoulders' for the fear of being molested with court processes in the performance of their work. But it is an argument in the debate on the imposition of common law duty of care on public officials, as it is in relation to the question of liability for financial supervisory negligence. In *Hill v Chief Constable of West Yorkshire*, Glidwell LJ held inter alia that imposing a duty of care on police officers to prevent harm to members of the public by known felons might induce defensive policing.[81] Lord Keith of Kinkel, in *Yuen Kun-Yeun* forcefully

[80] R. Smits, *The European Central Bank: Institutional Aspects* (The Hague: Kluwer, 1997) 322.

[81] [1989] AC at 63 – 64. Similarly, in *Barret v London Borough of Enfield*, Lord Browne-Wilkinson, articulated this fear of defensive conduct in public administration resulting from an imposition of common law duty of care in the sense that the proper performance of the defendant's primary functions for the benefit of society as a whole will be inhibited if they are required to look over their shoulders to avoid liability in negligence: [1999] 3 All ER 193 at 199. The line of reasoning encapsulated in Lord Browne-Wilkinson's articulation, arguably influenced, *section 1* of the *Compensation Act* (UK), which enjoins the court to consider the deterrence effect of potential liability for negligence or breach of statutory duty committed by public authorities.

articulated this argument in the sphere of financial regulation, to the effect that if financial regulators were to be held to owe actual or potential depositors a duty of care in negligence this would be a reason to apprehend that the prospect of claims would have an inhibiting effect on the work of the (financial) regulator. A sound judgment, in his Lordship's view, would be less likely to be exercised if the regulator were to be consistently looking over his shoulder at the prospect of claims against him and 'his activities would be likely to be conducted in a detrimentally defensive state of mind.[82]

This argument is with respect is open to criticism at three levels: the empirical, jurisprudential, and the remit of financial supervision. At the *empirical* level, the fear seems more putative than real. Credible evidence is lacking to suggest that there is such a thing as defensive conduct in relation to the imposition of negligence liability on regulatory authorities does exist. Of course the absence of evidence does not by itself suffice to dismiss the possibility that such a fear may exist. Still the few empirical studies of this alleged phenomenon have yet to provide convincing evidence, and in some cases even inconclusive evidence.[83] Illustratively, a research on the effect of the liability on English Fire Departments found that the possibility of negligence liability neither led to defensive conduct on the part of the fire fighters, nor

82 [1988] 1 AC 175 at 194 – 5, 198E.

83 J. Feinman, 'Liability of Accountants for Negligent Auditing: Doctrine, Policy and Ideology,' (2003) 31(1) *Florida State University Law Review*, 50.

to high costs in relation to buying insurance against liability.[84] This evidence chips away at 'the defensive conduct argument' because if the influence claimed to be present is not proven, the argument itself can and will not be decisive either.

At the *jurisprudential* level, the justification when examined closely speaks to an implicit social injustice. If damage occurs evidently through negligent supervision, the injured depositor or investor cannot justifiably be denied compensation simply because this might lead to 'defensive conduct.' Compensation here flows from the first principle of justice and the result of a social justice choice made much earlier in time, namely that where there is a wrong there ought to be a remedy. To deny compensation is to rewrite this principle; to deny compensation is to pander to a putative fear and subordinate social justice to the controversial expedience of public administration.

Concerning *the remit of financial supervision*, financial regulation and supervision cannot be assimilated to policing, or equated with conventional public administration. This is because, a financial regulator, depending on its precise statutory powers and duties, has a narrow supervisory remit, focused on specified financial intermediaries. Its duties, powers and functions are defined within this remit. For instance, the regulatory duties and powers of the Central Bank of Nigeria are limited to banks, under

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84 J. Hartshone, N. Smith and R. Everton, ' " Caparo Under Fire:" A Study into the Effects Upon the Fire Service of Liability in Negligence,' (2000) *MLR*, 519. In *Capital and Counties Plc v Hampshire CC* [1997] 2 All ER 865, this argument was rejected at 891.

the statutory scheme of the *Banks and Other Financial Institutions Act* (BOFIA). Where, as often, this is so, its liability also, ought to be defined within that narrow remit. Thus defined, there is no sensible reason in principle why it cannot be liable for third party losses caused by negligent supervision. Even if it were to be argued that the fear of litigation from depositors and investors, which together only represents a subset of the general public, could induce defensive financial regulation or supervision; that fear is valid to the extent that financial regulators are sued where they have acted diligently and proactively. If regulators are not so sued, or when sued, can show that they have acted diligently within their statutory powers, the defensive conduct justification is unpersuasive because in the end, it amounts to a shield wrought by policy to protect negligent financial supervision.

A surer protection for a regulator against adverse claims sounding in negligence is a reputation for diligence and thoroughness. In a financial system with a weak regulatory accountability process, this reputation will be a strong source of public confidence in the regulator, a measure of security and safety by users of the financial market. Where the reputation does not exist, in the sense that the regulator is notoriously negligent, the protection against adverse claims on the basis of the defensive conduct argument arguably reflects a policy choice to suppress a judicial alternative to a presumably weak executive and legislative oversight over the conduct of financial regulation.

5.4.3 'The Floodgate Argument'

Arguably, the greatest fear which tends to justify the preclusion of negligence liability in financial regulation and supervision is expressed in the argument that going beyond a theoretical possibility, such liability will open the floodgates to claims from an unascertainable number of claimants. It is as much a concern in common law countries as it is in civil law jurisdictions. In common law, this fear is rooted in the need to find (before recognizing that individuals have enforceable rights) a duty of care in favour of a limited and ascertainable class of claimants, who stand in a proximate relationship to the prospective defendant, and whose claims ought as a matter of policy to be recognised by the law. The prospective defendants should not be exposed to 'liability in an indeterminate amount for an indeterminate time to an indeterminate class.'[85] In civil law jurisdictions, it has been argued that the bill would be set too high for supervisors if they were to pay for losses caused to insolvent supervisees in the financial world.[86]

This argument is open to criticism on three grounds: *First*, indeterminate claimants and indeterminate compensation should not and has never truly deterred the law from providing a remedy where the facts of a case warrant. Admittedly, the objection we contend against is not procedural but substantive in the sense that it is

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85 *Ultramares Corporation v Touche* 225 NY 170, 179 (Benjamin N. Cardozo C.J.). See also *Yuen Kun Yeu* (n 2) at 190 (Lord Keith of Kinkel).

86 M. Andenas and D. Fairgrieve, 'Misfeasance in Public Office, Governmental Liability, and European Influences,' (2002) *International Comparative Law Quarterly* 19 (French law).

wrong to allow claims by an indeterminate number of persons which cannot be identified, quantified or insured. Nevertheless, we argue that a court can use consolidation, aggregation of claims, and global settlement to surmount a possible procedural indeterminacy. Consolidation allows the court to merge identical claims to save time and costs. Aggregation of claims is a procedural device for a representative class of litigants to prosecute a claim on behalf of all the litigants. Where a class sues on behalf of all litigants, the court can order that the resulting award or settlement should be a global settlement for all possible claims and claimants linked to that case. So long as the case is widely publicized and potential claimants are allowed to opt in or out of the case, the floodgate impediment can be easily managed.[87] Linked to this first objection is the *second* according to which in practice, the liquidator or administrator of the insolvent regulated institution most often brings claims of this type for the benefit of shareholders, depositors, and other creditors.[88]

The *third* objection is founded on the argument that where the intended liability is precisely and unconditionally defined, the large size and indefinite character of the class benefited should not be conclusive against the conferment of enforceable rights. This argument finds support in comparative case law. For instance, the

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87 For an extensive discussion of the principles and practice relating to consolidation, aggregation of claims, and global settlement see A. Zuckerman, *On Civil Procedure: Principles of Practice*, (Chapter 12: Joining Claims and Parties) second edition, (London: Sweet & Maxwell, 2008) 501 – 27.

88 As was the case in the *Three Rivers cases*.

jurisprudence of the European Court of Justice (ECJ) shows no reluctance to find a right enforceable by very large and ill-defined groups of individuals, if a European Union Treaty provision or a European Commission Directive is found on a purposive construction to impose an obligation capable of giving rise to correlative rights. The interests of the group of individuals could be as employees,[89] consumers,[90] traders,[91] or simply as inhabitants with an interest in a clean and healthy environment. Imposing liability as the cases show, for losses to potential members of the class of persons affected by the wrong committed by public officers, be they administrators or regulators, will not open an imaginary floodgate any more than the imposition of liability for those who are actually members of the class at the time. It should of course be noted that where a policy to impose liability for negligent financial supervision supervenes, a regulator or its officials could always avoid liability by choosing not to act in a way that they know to be negligent.

5.4.4 'The Lack of Control over Regulated Institution Argument'

The State and financial regulators it has been argued do not have sufficient control over the affairs of regulated institutions, to justify the imposition of negligence liability for supervisory

89 See *Marshall v Southampton and South West Hampshire Area Health Authority (Teaching)* [1986] ECR 723, ECJ; *Francovich v Italian Republic* [1991] ECR I-5357, ECJ.

90 *Dillenkofer v Federal Republic of Germany* [1996] ECR 4845, ECJ.

91 *Van Gend en Loos v Nederlandse Administratie der Belastingen* [1963] ECR 1; *R (Factortame Limited) v Secretary of State for Transport* [1996] QB 404; *R (Hedley Lomas (Ireland) Ltd) v Ministry of Agriculture, Fisheries and Food* [1997] QB 139.

failure. The liability will be secondary and the primary liability may lie in the fraudulent or negligent conduct of the supervisee or regulated institution.[92] In *Yuen Kun Yeu*, Lord Keith articulated this justification, in the context of the liability of the Commissioner of Deposit-Taking Companies of Hong Kong to the effect that the Commissioner did not have any power to control the day-to-day management of any deposit taking company; that whereas the Commissioner's power to put the company out of business would be a powerful incentive, impelling the company to carry out its business in a responsible manner; but if those in charge were determined upon fraud, it is doubtful if any supervision could be close enough to prevent it in time to forestall loss to depositors.[93]

There is much force in this argument, but even so and with due respect, 'day-to-day control' cannot be the touchstone or the irreducible minimum for a duty of care by a regulator, still less for a right of action against a regulator for breach of an obligation to supervise. For its common law provenance, it is a notion taken from the wholly unrelated circumstances (liability for damages caused by borstal boys) under consideration in *Dorset Yacht Co. Ltd* and should not be given general application regardless of context in which the question of control has to be decided, especially where that context involves as here the control and monitoring of the

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92 [1988] 1 AC 175, at 195 – 6.

93 *ibid,* Lord Keith relied on *Dorset Yacht Co Ltd v Home Office* [1970] AC 1004, where a group of borstal boys broke free and damaged Yachts that were moored at the claimant's private harbour.

strategic roles played by financial intermediaries in the financial system. The law's measure of the level and quality of control over borstal boys expected from prison officers in *Dorset Yacht* should not be argued as a standard measure that applies to all situations regardless of factual and contextual variations. Nor should it be regarded as an immutable rule that a regulator cannot be liable for the wrong committed by a party, over which it has no control. This is because it is settled that the fact that a damage on which a claim is founded, was caused by a human agent quite independent of the person against whom a claim in negligence is made does not, of itself, preclude success of the claim; since breach of duty on the part of the person against whom the claim is made may also have played a part in causing the damage.[94]

To ascertain the breach of duty on the part of the regulator will necessarily require inquiring into the regulator's knowledge of the affairs of the regulated institution before the event leading to the loss suffered by the claimants. The knowledge may be provided affirmatively in pleadings or be inferred from circumstances. The guiding criteria it is submitted should be as follows: (a) actual knowledge; (b) willfully ignoring the obvious; (c) willfully and recklessly failing to make appropriate inquiries as a diligent and reasonable person would make; (d) knowledge of circumstances which would indicate the facts to an honest and reasonable person in the position of the regulator; and (e) knowledge of circumstances

94 *Smith v Littlewoods Organisation Ltd* [1987] 1 All ER 710 at 720 (Lord Mackay).

which would put an honest and reasonably diligent regulator on inquiry.[95] Knowledge is not the same as bad faith or even negligence, but where a regulator ought reasonably to know about a fact or set of facts pointing to malpractice and fails to act; bad faith and (or) negligence can be imputed to its conduct. If a regulator does not draw inferences or make the obvious inquiries the question is, why not? If it is because, however foolishly, it did not suspect wrongdoing or, having suspected it, had its suspicions allayed, however unreasonably; that is one thing. But if it did suspect wrongdoing yet failed to make inquiries because 'it is none of its business,' that is quite another thing.[96] A regulator thus sued has no convincing case, if for the purposes of liability, it is deemed to have failed in preventing harm to third parties from the primary wrong of its supervisee. The question as before only turns on a policy shift according to which the court can make this line of inquiry.

5.4.5 'The Nonfeasance Argument'

Closely linked to the last justification is the argument that imposition of liability for negligent supervision merely punishes regulators for nonfeasance – passive inaction in the absence of an incumbent duty to act. Broadly, the arguments here are as follows: The regulator neither assumes any responsibility, nor bears any duty towards third parties (depositors and investors inclusive) to

[95] This is an adaption of Millet J.'s formulation of the liability test as a constructive trustee in *Agip (Africa) Ltd v Jackson* [1990] Ch 265 at 293.

[96] *ibid.*

prevent the collapse of a financial institution. The regulator's duty is towards the general public and should not be impressed with a special responsibility towards individual members of the public.[97] Even where a regulator has licensed a financial institution, this is not to be conflated with a guarantee of solvency and soundness of the institution so licensed, nor does it invite a duty to ensure such solvency and soundness.[98]

In truth there ought to be some judicial uneasiness whenever the law is called upon to impose liability on those who fail to act to save others who are in danger. Where as would most likely be the case that this notional defendant has only a moral and not a legal duty to save the claimant, his liability should only accepted with pronounced circumspection. This is because it is one thing for the law to say that a person who undertakes some activity shall take reasonable care not to cause damage to others. It is another thing for the law to require that a person who is doing nothing in particular shall take steps to prevent another from suffering harm from the act of third parties.[99] It is another thing because there is, in our view, no sense, no justice, and no equity in a punitive expedition by the law into the province of a citizen's lawful discretion not to be 'a good Samaritan.' Our right to choose whom

97 *Peter Paul* (n 2) [3], [41] (to the effect that European Union Banking Directives do not expressly grant rights to depositors as to having certain supervisory measures taken on their behalf).

98 *Yuen Kun-Yeu* (n 2) 196 – 7.

99 *Stovin v Wise* [1996] All ER 801 at 806 (Lord Nicholls), 819 (Lord Hoffman).

to save from danger or not in cases where our own conduct or the law imposes no duty to save should always be respected.

But we are not dealing with the simple case of an individual 'bad Samaritan.' Rather, we are concerned with public regulatory institutions to whom the citizens through the State have delegated the powers to monitor financial intermediaries and whose discretion to be conscientious bad Samaritans is limited by the very fact of this delegation that imposes on them the status of mandatory good Samaritans. As mandatory good Samaritans, we argue that negligence liability can be imposed on financial regulators upon the application of *three cumulative conditions*. *First*, are the potential defendants easily identifiable? *Second*, do the defendants stand in a special or strategic relationship with the potential claimants? *Third*, who as between the claimants and defendants is better placed to appreciate the risk of harm to the claimant and should prevent it? This formulation, it is strongly argued, can be applied to displace the nonfeasance argument and thus enable liability for negligent financial supervision.

In the context of financial regulation, we are dealing with a limited number of depositors and investors and not plenitude of potential defendants, whose regulatory remits are easily ascertainable. Financial regulation and supervision together engages relationships that are special and strategic. It is special as between the regulator and the regulated institution because the former is locked in a bilateral supervisory relationship with the latter that commences from its registration to its liquidation. It is strategic, as between the regulator and the stability of the financial system, because the presence of the regulator creates an expectation that an agency is responsible for the safety of the financial market and the trustworthiness of the operators allowed into this market. Implicitly, the regulator's remit involves anticipating dangers early in situations where depositors and investors may not be able to do, because unlike the regulator, they do not have access to information that can assist them to anticipate danger. Typically, this is expressed in terms of a duty to take prompt corrective action against an erring financial institution, either to check an imprudent business model or to prevent a fraudulent depletion of its assets.[100] Where, such a duty exists, a policy to protect the financial regulator from liability that results from its failure to apprehend or forestall possible harm to investors and depositors is irreconcilable with this duty. Moreover, if facts show that a diligent regulator should have appreciated that a financial institution was being operated in a fraudulent or reckless manner, it is inconsistent with the duty to take prompt corrective action, where the regulator allows the institution to continue to operate.

The foregoing will of course confront the objection and one with a formidable case law support that, where as here, the case is that a regulator has breached a statutory duty, the remedy for that breach must be located within the statute wherein the duty is

[100] *Section 32 of the Nigerian Deposit Insurance Corporation (NDIC) Act of 2007.*

created or can be inferred. This is because a common law duty can neither be grafted on nor 'grow parasitically out of a statutory duty not intended to be owed to individuals.'[101] This objection, it is submitted, should not apply because of the special and strategic relationships involved in financial regulation. In Nigeria, *section 32 of the NDIC Act* which provides for the duty to take prompt corrective action does not provide concurrently for a remedy for the non-performance of this duty. The fact that a statutory remedy is not provided implicates an accountability gap in the law; and we reason that this gap can be filled by a judicial pronouncement which does not necessarily usurp the constitutional power of the Nigerian National Assembly to amend the Act, but relies only on the special and strategic nature of financial regulation to point out this gap for necessary legislative amendment.[102] Without this judicial pronouncement and legislative amendment it is clear that much of the losses from negligent financial supervision would continue to be borne by depositors and investors. Without this judicial pronouncement and legislative amendment the supervening immunity of Nigerian financial regulators from negligence liability could create a 'regulatory moral hazard.' This hazard is in the sense

[101] *Gorringe v Calderdale MBC* [2004] UKHL 15; [2004] 1 WLR at [17] (Lord Scott).

[102] On the admonition that the courts should not usurp the constitutional powers of the legislature to amend the law, see generally: *Mellon RDC v Newport Corporation* [1952] AC 189 (HL) 199 (Viscount Simon LC). To be clear, what we argue for is that a negligent liability for the breach of statutory duty should be made possible in this context through legislative amendment. We do not argue that the liability should extent to all breaches of statutory duties as a matter of common law.

of the regulators not acting as diligently as they could and should, because no liability attaches to such lack of diligence.

There can be no public policy in the interest of sound financial regulation for a regulator to act negligently without liability consequences attaching to such negligence. Power goes hand in hand with responsibility. Unless supervisors are accountable for shortcomings in the performance of their duties, there is a risk they might ignore warning signals or otherwise fail to devote sufficient resources to their monitoring. The Madoff scandal in the US,[103] the run on Northern Rock in the UK and the global collapse of Lehman Brothers, to cite but some of the situations in which regulators may have fallen short of the standard of care expected of them, argue in favour of negligence liability.[104] A rule of law that denies such liability in cases were supervisory negligence is evident is detrimental to accountability in financial regulation, because it creates a veil over the negligent conduct of financial regulators. A legislative policy to empower the courts to interrogate the merits of this veil stands on the side of accountability. When, as here, a statutory duty is imposed on a

103 See chapter 7 ('Bernie Madoff: Frauds, Swindles, and the Credit Cycle') in C. Kindlebrger and R. Aliber, '*Manias, Panics and Crashes: A History of Financial Crises,* sixth edition, (Basingstoke: Palgrave Macmillan, 2011) 117 – 53

104 Indeed in two of the cases (Northern Rock and Lehman Brothers) there are grounds to believe that supervisory errors substantially contributed to the collapse of the financial institutions and the losses suffered by their customers. In the case of Northern Rock it was deficient prudential regulation and in the case of the Lehman Brothers it was lax regulation on the part of SEC that allowed investment banks to select into less stringent prudential regulation. See respectively on the two cases: M. Taylor, 'The Road from "Twin Peaks" and The Way Back,' (2010) 16 *Conn. Ins. L. J.* 61 at 78 – 82; J. Coffee and H. Sale, 'Redesigning The SEC: Does The Treasury Have A Better Idea?' (2009) 95 *Va. L. Rev.* 707 at 727 – 48. See generally on how financial regulatory deregulation fed into financial regulatory failure in the US: The United States Financial Crisis Inquiry Commission, 'Chapter 4: Deregulation Redux' in The Financial Crisis Inquiry Report (January, 2011) 27 – 37.

financial regulator to perform its functions so as, inter alia, to prevent such damage to users of financial services, a public policy not to allow that regulator to answer albeit remedially for its failure to discover the inevitability or probability of harm because of its willful disregard of that duty would ultimately ensconce the regulator on a pedestal higher than the law.

5.4.6 'The Misfeasance in Public Office Precludes Negligence Claim Argument'

The immunity of financial regulators from supervisory negligence claims is often excepted in cases involving misfeasance in public office namely, where the regulator has acted in bad faith or maliciously to cause injury, or culpable for deliberate and unlawful action or inaction. The availability of the tort of misfeasance in public office, it has been contended, is one reason justifying the non-actionability of a claim in negligence where there is an act of maladministration;[105] and additionally that an ultra vires act, will not necessarily give rise to liability in tort.[106]

This case law justification cannot be transposed into the context of liability for financial regulatory negligence for three reasons. *First,* the preclusion of negligence liability in the context of financial regulation, is generally codified and thus a matter of statute and not necessarily case law. As a matter of statute law,

105 *Three Rivers (No 3)* (n 2) 190F (HL) Lord Steyn citing for support *Calveley* (n 35) 1228 1238F. It should of course be noted that beyond misfeasance in public office, '[t]here is no such distinct wrongful act known to the law as "misfeasance:" ' *Re B Johnson (Builders)* [1955] Ch. 634; [1955] 3 W.L.R. 269; [1955] 2 All E.R. 775, Evershed M.R.

106 *X (Minors) v Bedfordshire County Council* [1995] 2 AC 633.

there is no universal statutory preclusion of this liability, because as shown above, countries such as Australia, Japan, the Philippines and Switzerland permit liability for negligent financial regulation and supervision, concurrently with liability for misfeasance or gross negligence. Clearly, the decision whether or not to preclude this liability as with all laws, is policy driven. Where therefore a country elects through an enactment to have a policy that permits liability for financial regulatory negligence, the existing case law exclusionary rule, is no more an impediment, than there been no impediment in the first place. This is because statute can and has been known to reverse case law.

Second, the preclusion, with respect, is misconceived because it conflates negligence with misfeasance in public office, even though there is a clear distinction in principle between the two. Negligence speaks to breach of duty of care, which need not necessarily be accomplished with malice or bad faith. Misfeasance in public office takes in cases of evident malice, bad faith or unlawful action in public administration. In practice, a financial regulator can breach a duty of care to third party investors or depositors without being malicious in the process. It can be malicious and yet not be in breach of duty. It can breach its duty and be malicious concurrently, but breach of duty and malice should not be conflated. Where therefore, the regulator is in breach of its duty, liability and remedy should lie, just as they should, were the regulator to be culpable for misfeasance. A fortiori and *third* reason, *Calveley*, on which Lord Steyn relied in *Three Rivers (No 3)* for the proposition that misfeasance in public office claims preclude negligence liability, turned on the liability of police officers and not of financial regulators. In *Yuen Kun Yeu, Davis* and *Three Rivers*, where the courts decided on liability for negligence and misfeasance in financial supervision respectively, this issue was neither considered nor decided upon.

5.4.7 'The Deposit and Investment Guarantee Scheme Argument'

Another frequently invoked argument against liability for negligent financial supervision is that it is irreconcilable with the existence of deposit and investment guarantee schemes, because it would appear to over-compensate depositors and investors who would have received partial loss mitigation payouts from the deposit insurance fund and investors' protection fund.[107] Thus, further compensatory awards from third-party negligence claims will allow depositors and investors to shift their residual financial losses (losses not covered by deposit insurance) on the resources of the regulator and the State.

This argument needs unpacking, because on closer scrutiny, it is misconceived. *First*, as these schemes rarely provide unlimited coverage, it would not be unreasonable for aggrieved depositors or investors to try to recover from supervisors losses caused by supervisory negligence that are not covered by deposit and investor

[107] *Peter Paul* (n 2) [45] to the effect that depositors are protected under the Deposit Guarantee Directive 94/19 EC, even in situations where the banking failure is (in part) caused by defective banking supervision. See further Tison (n 2) 639 – 40.

guarantee schemes. *Second,* the rationale of such schemes is to 'ensure the immediate partial recuperation of deposits entrusted to the failing bank' rather than 'protecting supervisory authorities from pressure arising from potential liability claims.'[108] *Third*, such schemes are financed through the mandatory contributions of all banks and investment firms, rather than from the State budget, so they cannot be diverted into compensating third-party claims against supervisors.

Historically, a deposit insurance scheme was arguably not intended to be a full compensation mechanism. Nor can it be sensibly regarded as a substitute for pro-active supervision.[109] It is a financial system stability mechanism, impelled by the run on United States banks during the Great Depression of the 1930s. Its key objective is to prevent the collapse of the payment system through excessive withdrawals (retail run on banks) induced by financial panic. It holds out a guarantee to depositors that a percentage of their deposit is safe and will be paid should their bank collapse. This forestalls the mass panic to withdraw their money upon a slight suspicion of financial crisis.[110] Arguably, the need to prevent moral hazard on the part of bankers informed the conscious election to insure only a percentage of the deposits and

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108 Dragomir (n 3) 317.

109 Tison (n 2) 670 – 1.

110 K. Spong, Banking Regulation - *Its Purposes, Implementation and Effects* (Kansas City: Division of Supervision and Risk Management Federal Reserve Bank of Kansas City, 2000) 55 – 6.

not all.[111] Experience has however shown that this ingenious mechanism has not eliminated occasional bouts of systemic crisis. Increases in savings and deposits are crucial to economic recovery after a financial crisis, because they can boost banks' financial intermediation and the domestic debt market. Deposit insurance under which banks pay a premium for the 'cover' provided by the insurance fund, impliedly encourages depositors to entrust their money to banks, while the banks bear part of the cost of possible payouts to depositors. The fund should not however be seen as a cover for faulty financial regulatory policy choices or imprudent business operations by financial intermediaries. The sensible cover for these two is for the correct choices to be made and for financial intermediaries to act prudently or be made to act accordingly through effective supervision. Where an evident combination of faulty national macro-economic policy choices and lack of effective financial supervision, induce the collapse of a financial institution as was the case with the supervision of the US investment banks before the crisis of 2007-8, the State as the institution ultimately responsible for policy and supervision must have strong exculpatory reasons for these lapses, or be ready to account for the resulting injury to third party investors and depositors, its limited resources notwithstanding.

The foregoing is predicated on the fact that under general law the State is liable to compensate victims of wrongs committed by

[111] For a discussion of the moral hazard implications of deposit guarantee systems, see: Dijkstra (n 2) 278 – 80.

its servants and agents in the course of their employment or where the acts leading to the wrongs are closely connected to what they (servants and agents) are authourised to do. As emanations of the State, recovery for losses arising from supervisory failure by financial regulators therefore does not and will not draw from the limited resources of the State any more than the State is liable to pay vicariously for the wrongs of its agencies acting for the State and within their delegated powers. Two prerequisites to avoid such recovery are: the implications of macro-economic policy choices should be considered carefully; and effective accountability mechanisms to enhance the diligence of financial regulatory agencies need to be structured into the regulatory audit framework.

5.4.8 'The Constitutionality Argument'

Lastly, but by no means the least is the question of the constitutionality of judicial intervention in financial regulation, an area that according to a commentator, is governed more by administrative discretion than the private law of obligation.[112] On this view, for instance, it is not immediately clear how a civil liability regime for supervisors can be appropriate if it is effectively to run in parallel with and, through the interposition of the judicial system, to challenge the wisdom of a political decision to choose a specific national supervisory structure that does not provide a role for the judiciary in assessing substantive prudential supervisory issues or the business case behind a specific

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[112] Athanassiou (n 77) 36.

supervisory decision. Thus where supervisory failures are not attributable to misfeasance or bad faith, they should only have political consequences for the responsible government minister or the head of the regulatory agency involved; either in the sense of loss of career progression opportunities or the re-organisation or dissolution of the agency. They should not necessarily lead to liability for damages that effectively make the courts the final arbiter of the correctness of supervisory decisions post facto and with the benefit of hindsight, so it is argued.[113]

These are undoubtedly formidable arguments, but they cannot entirely overcome a counter argument based on fairness, 'natural justice' and the rule of law. It is difficult to accept that private individuals can be denied right to recover compensation for their financial losses from those who are deemed to have caused them through their wrongful acts, or to have failed to avert them through negligent omissions, even though in most cases financial regulators will be no more than secondary tortfeasors in this case. To bar liability towards third parties, therefore, on the ground of the constitutionality arguments, flies in the face of the basic right to judicial redress for losses suffered through the wrongful acts or omissions of another, especially where such loss cannot be recovered from another source. It also negates the normative rightful entitlement of users of financial services to diligent financial regulation.

113 *ibid.*

In the next section, we shall examine more fully, this and other considerations that argue for the imposition third-party liability for negligent financial supervision. We shall also respond to the criticisms of these considerations, to show that in spite of all, the arguments in favour of negligence liability outweigh those against it.

5.5 Rationalising Liability for Negligent Financial Supervision

This section presents and defends the case for applying tort law negligence liability to financial regulators. The rationality of the advocacy here is founded on seven arguments namely, 'the equal treatment argument,' 'the deterrence argument', 'the reliance argument,' 'the compensation argument,' 'the socializing the cost of liability argument,' 'the meta-supervision argument,' and 'the law and economics of optimal supervision.'

5.5.1 'The Equal Treatment Argument'

An equal treatment argument can be made in support of subjecting financial regulators to third-party negligence liability. It is unclear why regulators who are governed by public law should enjoy immunity from negligence claims when quite apart from any criminal liability they may incur, the officers and directors of private companies can be held jointly and severally liable for negligence in the performance of their fiduciary or statutory duties vis-à-vis their shareholders and other creditors, especially in cases where they have failed to forestall a corporate insolvency. For instance in the UK, company directors have a duty to exercise reasonable skill and care and to promote the success of their company. Members of the company can take action against directors or the entire board of directors for an actual or proposed act or omission which involves breach of this duty, whether or not the directors benefits personally from that breach.[114]

The example of the liability of directors in the UK indeed provokes two questions: Should not the legal and public policy arguments in favour of protecting regulators from liability, and the wider margin of appreciation they have in the exercise of the ‘business case behind a specific supervisory decision,’ also apply to the commercial sphere? How can a double standard and the preferential treatment of regulators be justified?[115] These questions arguably expose the inequality in the preclusion of third-party liability for negligent financial supervision. The fact that private and public bodies move in seemingly separate spheres cannot justify fundamental differences in the way they are treated under the law, because it encourages in the latter, a feeling of ‘entitlement to privilege’ which can corrode responsible public administration.

It can of course be argued as a counter that the ‘equal treatment argument’ is merely egalitarian in that it glosses over the fiduciary nature of the duties, which the officers and directors of companies owe to their shareholders.[116] However, this argument should be set against considerations of fairness and rule of law, which suggest that the law should remedy private losses, which are

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114 *Sections 171 – 177* of the *UK Companies Act of 2006*.

115 Wood (n 2) 3.

116 Athanassiou (n 77) 34.

the consequences of wrongful acts of private and public tortfeasors.[117]

5.5.2 'The Deterrence Argument'

Liability for negligent financial supervision will, all else unchanged, deter deficient supervision which in turn enhances the ability of regulators to fend off the vulnerabilities that can induce the collapse of a financial institution, or a financial crisis.[118] The deterrence arises from the fact that negligence liability forces the regulator to apprehend its culpability, if it is found subsequently that its conduct caused the losses suffered by potential claimants. When the Dutch bank, Van der Hoop Bankiers, became insolvent in late 2005, for instance, questions were raised as to the nature of and quality of the supervision provided by the Dutch Central Bank.[119] But mere questions even when they lead to 'political consequences' will not necessarily lead to liability for negligent supervision, if law and policy do not permit any negligence claim against the regulator.

If there is a policy to allow courts to adjudicate allegations of negligent supervision, rationally, the regulator as secondary tortfeasor will seek to offset its possible liability by stipulating for greater prudence on the part of institutions within its remit. These

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117 For a detailed discussion of this point and other conceptual underpinnings of the financial supervisory liability, see further, Athanassiou (n 2) 235 – 9.

118 Feinman (n 83) 58 (supervising accountants is an incentive to take care); F. Parisi, 'The Cost of Delegated Control: Vicarious Liability, Secondary Liability and Mandatory Insurance,' *Law and Economics Working Paper Series* (2002) 2 and 23, available at ssrn.com/abstract _id=343120, accessed on 23 August 2013.

119 Giesen (n 2) 8, referencing Kamerstukken II 2005 – 2006, 30 300 IXB, no. 22, and 2006 *Nederlands Juristen Blad* (NJB) 460 – 461.

institutions are the primary tortfeasors, but they are mostly likely to be incapable of meeting the losses inflicted on third parties by their imprudence. This is because their financial strength would have been weakened either by insolvency or the ensuing financial crisis.

It can of course be argued that deterrence is a counter-productive ground for a financial supervisor's negligence liability, because the possibility of that liability can encourage regulated institutions to act less carefully. But this argument is weakened by the fact that the secondary liability of the regulator does not necessarily arise because a regulated institution has had an imprudent business model. It must be shown that the imprudence resulted not only from the regulator's breach of duty of care, but also that it caused the losses suffered by the claimants. Even where this sequence is established, the regulator can still join the regulated institution as a party to the suit, but with the possible drawback that the latter might be impecunious at the time of the action. Given this possibility, the regulator's sensible 'insurance policy' against liability is to work proactively to discourage inclinations towards imprudence on the part of the regulated institution. The proposed Nigerian systemic stability regulator for instance can do this through a robust micro-prudential regulation in terms of a strong enforcement of the rules that are meant to ensure the safety and soundness of the financial institution. The market integrity regulator can mount a high regulatory vigilance against market manipulation and corporate governance abuses by officials of financial intermediaries.

The deterrence argument can also be countered by the argument that the reputational cost of liability to the primary tortfeasor, (in the sense of bad image, loss of integrity for management of the culpable regulated institution) serves as an alternative and possibly far reaching 'punishment' than a 'one off' negligence liability. This argument is unsupportable in principle and practice. In *principle*, it is based on the hackneyed 'Efficient Market Hypothesis' (EMH) which, as discussed earlier in Chapter 3, presupposes that financial markets work less because of law or the threat of liability, but rather because information is provided, collected, verified and disseminated by 'reputational intermediaries' (investment banks, auditors, securities analysts, and rating agencies) who purportedly pledge their reputational capital behind their opinions and judgments; hence they would have little incentive to misrepresent or distort.[120] From the early 1980s EMH motivated financial regulatory deregulation, because it was felt that the reputational cost of 'bad behaviour' could substitute for State regulation of certain aspects of the financial services industry such as accounting and auditing. But the regulatory appeal of EMH has waned in large part because behavioural economists have persuasively questioned its credibility and emphasized, in

120 R. Gilson and R. Kraakman, 'The Mechanics of Market Efficiency,' [1984] 70 *Va. L. Rev*, 594, 604 – 05, 619 – 21.

particular, the limits of arbitrage.[121] EMH and by extension regulatory deregulation should now be rejected not least because they have failed to make financial markets truly efficient, but dysfunctional and more susceptible to crisis. EMH argues for a reduction in State regulation of financial services; that we should trust financial market operators to play either by the rules, or where there are no rules, to act consistently with what is necessary to maintain the integrity of the financial system. In contrast, there is a growing sense that EMH influenced regulatory deregulation may have deepened the GFC particularly in the United States, which a process of international regulatory arbitrage arguably extended and enforced.[122]

Practically also, EMH is not a substitute for liability. The series of crises in the US financial services sector since the 1980s when EMH was the ascendant philosophy of financial regulation supports this assertion.[123] There was a rapid succession of market crashes and scandals, which revealed pervasive misconduct by 'reputational intermediaries,' and shook the confidence in the financial market.[124] One inference from these crises is that in real

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121 Coffee and Sale (n 104) 710 – 11.

122 *ibid,* 711

123 For an extensive background on EMH and the damage done to the US financial system by the hypothesis, see G Cooper, *The Origin of Financial Crises: Central Banks, Credit Bubbles and The Efficient Market Fallacy* (Petersfield: Harriman House Ltd, 2008) 19 – 90, 155 – 172.

124 Some of the crises were, the 2000 dot.com stocks crash, the 2001 – 20002 accounting irregularity scandals that culminated in the bankruptcy of Enron and WorldCom, the New York Attorney General led investigation of securities analyst conflicts of interest that resulted in a global settlement in 2003, the 2003 – 2004 'market timing' scandal involving mutual funds, the stock option backdating investigation that began in 2006, and most significantly, the subprime mortgage crisis of 2007 – 8. See generally Coffee and Sale (n 104) 712 – 13.

life there is often a critical gap between principle and practice, which can be exploited by the 'unscrupulous few' to the detriment of the 'unwitting many.' Another inference, and one which is relevant in the present context, is that without clear rules on permissible conduct and their robust enforcement, financial intermediaries cannot always also be trusted to act rightly on the basis of the reputational cost of their bad behaviour.

5.5.3 'The Reliance Argument'

The presence of a financial regulator transmits a message that an agency watches over the operators within the remit of the regulator. This creates reliance on the part of third parties dealing with these operators. In theory, this reliance is founded on an implied policy decision to substitute uncoordinated societal control for a specialist institutional supervision of financial services. The institutional supervisor is by this election given delegated powers and instruments conducive to the effective performance of its work.

The collapse of a regulated institution or the financial system may not necessarily suggest that the regulator was negligent, but it raises questions as to whether the powers and instruments given to the regulators were effectively used. Still these questions do not eclipse an inquiry into the supervisor's culpability for negligence, because third parties including investors and depositors should be taken to have relied on the implicit guarantee of specialist supervision, which attaches to the creation of a specific body designed to regulate and supervise.[125] On this view, the reliance induced by the creation of the regulator, and its failure, which can be reflected in third-party losses from the collapse of a regulated institution or the financial system, argue strongly in favour of an inquiry into the negligence of the regulator and the State. Where a court is called upon to undertake this inquiry, the burden should be on the claimants to show that but for their reliance on the presence of the regulator and the failure of supervision, they would not have suffered the loss pleaded in the case.

In practice and further support of the foregoing, supervision encapsulates preventing harm or damage to others and creating and safeguarding reliance.[126] It means that ultimately, the supervisor is responsible for doing its job properly. This can engage a legal responsibility for failure to act with the care expected of a diligent supervisor who is similarly circumstanced. A (financial) supervisor should therefore aim to supervise diligently because its lack of diligence can have serious implications for the financial system as well as the third parties who rely on its work for the safety of their transactions with the intermediaries in the system.

In sum, the regulator's secondary legal responsibility for losses suffered by third parties from the primary wrongs of the intermediaries in the financial market arises in principle from the

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125 Giesen (n 2) 16. Opposed to this view (people may not rely on the supervisor to control the supervisee) are R. Smits and R. Luberti, 'Supervisory Liability: An Introduction to Several Legal Systems and a Case Study,' in M Giovani and G Heinrich (eds), *International Bank Insolvencies: A Central Bank Perspective* (The Hague: Kluwer, 1999) 377.

126 Tison (n 2) 5.

fact, by its creation and powers, the regulator assumes an implied duty to protect third parties from harm resulting from the conduct of intermediaries within its remit. If the regulator cannot make good on the amount of care it is supposed to deliver; it can be considered to have acted wrongfully itself, in taking up the task of supervising others in the first place. The regulator's own independent conduct, and not merely the blame and responsibility for the acts of others, is the basis of liability founded on the reliance argument.

5.5.4 'The Compensation Argument'

The compensatory function of tort law, the idea that a defendant ought to answer in remedial terms for the wrong he has inflicted on the claimant,[127] would be served if negligent financial supervision were met with a finding of the regulator's liability. If the preconditions for this liability are set higher than the three elements required for the proof of negligence namely, a duty of care, its breach and damage, to include, for instance, additional proof of malice or bad faith, this will increase the claimant's burden of proof.

It can of course be argued that the certainty of recovery in the form of compensation for negligent financial supervision depends not so much on the remedial function of tort law, as on a prior policy to permit that recovery. Here again, is the heart of the

127 For a classic discussion of this point and the jurisprudence of corrective justice in tort law, see: J. Gardner, 'What is Tort Law For? Part 1: The Place of Corrective Justice,' *University of Oxford Legal Research Paper Series*, available at: <http://ssrn.com/abstract=1538342> accessed on 23 August 2013

discussion in this chapter namely, why should third parties injured materially by the consequences of negligent financial supervision acquire a remedial right of action against the supervisor?

Policy decides what the law can grant as a remedial right. A legislative policy that precludes the negligence liability of financial regulators in any country effectively precludes a judicial debate on the issue. However, this does not necessarily suggest that legal commentators cannot normatively question the sense in this policy. The law creates and validates the organs of the State, their emanations and their powers, jointly and severally. The power to project and enforce policies depends largely on what the law has conceded to the policy maker. This concession means that the law retains a residual supervisory jurisdiction over policy, in that the latter is only valid to the extent of its consistency with its enabling law; and coherent to the extent of its alignment with the seamless rationality of the law, in the sense that the several parts of the legal and policy framework of a country fit together harmoniously and sensibly. The power to issue financial policy rules for instance is dependent for legality upon the law, as much as the power to determine the remits and liabilities of regulators. In this scenario, the law functions in a dual capacity: first, in a *primary* role, by providing the legal foundation for the powers thus exercised in the two cases; and second, in a *secondary* role, in the sense that once made, the rules themselves, much like the law, assume the character of guiding principles. It is in this secondary capacity that the policy precluding liability for negligent financial supervision seems to have worked the law into a paradox. It uses the law to create regulators in its primary function and yet sets them, in its secondary function above itself (the law), by denying recourse against these regulators for their negligence. It is a paradox founded on arguments, which as shown above are unsupportable.

Recourse against financial regulators for supervisory negligence confirms the residual monitoring role of tort law. It enables the law to redefine and revalidate the powers and duties reserved for the regulators, as it interrogates the regulator's remit. Properly used, this can promote legality and accountability. Where for instance a regulator has, when in possession of relevant facts, failed to take prompt corrective action against a reckless financial intermediary, that failure engages negligence. Similarly, the rational coherence of the law, as between its primary and secondary capacities, is convincing when recourse is permitted for this negligence, for it makes no sense to create a power or duty without accountability. A fortiori, by breaching its primary regulatory duty, the regulator assumes a secondary accountability duty to atone for that breach; and in holding the regulator accountable; the compensatory function of tort law plays two crucial roles beyond the facile scenario of 'cash for loss.' It validates the law's residual monitoring role, as much as it magnifies its seamless rationality. This answers the question on why third parties injured materially by the consequences of negligent financial supervision should acquire a remedial right of action and in principle, be able to recover against the culpable regulator.

5.5.5 'The Socialising Regulators' Liability Argument'

The liability of financial regulators for supervisory negligence can be founded on the idea that compensatory payment for supervisory failure will be spread across the society in the form of taxes and other charges. By implication, the argument for liability here rests on solidarity: that is, more shoulders can carry a heavier burden.

It is an argument that will contend with the objection that the courts are not well placed to distribute tax burden or created to fashion a social subsidy for the negligence of financial regulators. This objection becomes even striking where the State is a defendant on record. Socializing the cost of the regulator's liability therefore through taxation, it will be argued is a work that politicians can do better, because it will involve weighing arguably complex considerations relating what to tax; how and when to tax; and who should pay the tax?[128] But this objection is unsupportable, in that judgments against the State have always led to some form of cost spreading. The court would award damages for instance against the State for breach of a contract to build a bridge and the State would pay without pointing out to the court the difficulties, if any, of recovering the payment through taxation. The court's role therefore, in awarding damages for supervisory negligence is no

[128] Giesen (n 2) 24 – 5.

different from what it does in awarding damages against the State for breach of contract.

It can also be objected that cost spreading can have the overall effect of raising the cost of supervision either because the regulators will have to take out liability insurance or increase the charges payable for certain services provided by supervisor. This objection should be set against two counter arguments. First, the State can always indemnify the regulators against liabilities, which is the practice in countries such as New Zeeland [129] and the Philippines.[130] Evidence of an increase in the cost of regulation is yet to come from the countries with this approach. Second, the costs involved in establishing and maintaining a system of supervision cannot be determined because the net surplus (benefit minus cost) is not easily calculable, but society gains from effective financial supervision in the form of a functioning system of financial intermediation, reduction in malpractices and the frequency of financial crisis. Damages paid for the negligence liability of financial regulators, if paid out of public revenue, should be seen as a public expenditure to enhance the effectiveness of financial regulation in the future.

5.5.6 'The Meta-Supervision Argument'

Imposing negligence liability on financial regulators is a form of supervision – supervision of the supervisors – that will bring about what can be termed as meta-supervision. Meta-supervision can also

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[129] *Section 14b of the Reserve Bank of New Zealand Act of 1989.*

[130] *Section 15 of the Central Bank Act* (the Philippines).

be imposed on the State in its supervisory capacity. This form of supervision magnifies the 'accountability and responsibility of financial regulators and the State.[131]

Two grounds can be articulated in defence of meta-supervision. The first relates to the fact that a regulator is considered successful to the extent that its work helps to reduce the occurrence of financial crises; although it can never be entirely certain whether or not the fact that crisis did not occur has been due to the diligence of the supervisor or to luck.[132] Successful financial regulation is thus not easily measurable. However promoting financial stability is usually one of the principal objects of regulators.[133] They can do this and to demonstrate their pro-activeness, by exploring creative ways to prevent a crisis; and where a crisis eventuates to be able to say that it was not induced by their lack of diligence. Creative supervision in theory can take the form of a bargain between the regulators and the supervisees in which regulators promise to refrain from enforcing stringent regulatory measures that might impair the profitability of the supervisees if they (supervisees) in return adopt specified in-house preventive measures. This bargain would rely on an understanding that the regulators and the supervisees would maintain the balance

131 For an extensive discussion of regulatory accountability under this idea, see R. Lastra and M. Shams, 'Public Accountability in the Financial Sector,' in E. Ferran and C. Goodhart (n 12) 167.

132 C. Goodhart, 'Regulating the Regulator – An Economist's Perspective on Accountability and Control, in Ferran and Goodhart (n 12) 154 and 157. See also N. Taleb, *The Black Swan – The Impact of the Highly Improbable* (London: Penguin, 2010) (arguing in part that financial crises are often the result of unpredictable events).

133 For instance, *section 2(d)* of the *Central Bank of Nigeria (CBN) Act of 2007* (Nigeria), lists promotion of a sound financial system as one of CBN's objects.

of care necessary to prevent the collapse of the regulated financial institutions or a crisis. Nevertheless, where a crisis does occur, 'the buck stops' at the regulators' table. They arguably cannot point to a regulatory bargain or another subjective measure of performance as a conclusive support of their diligence. Meta-supervision allows for the scrutiny of the performance of the regulators and where necessary a refinement of supervisory approach.

The second ground relates to the fact that measuring the success of regulators again involves, among other things, looking at the *process* of supervision – how many visits were made, how many fines were imposed, and how many compliance cases were determined. The data set to be studied is quantitative, which says little about the *quality* of supervision. For instance, a negligent regulator may have made an extensive number of 'house calls.' Expending time and energy however does not mean that the time and energy were well spent. In light of this, meta-supervision allows the court as a dispassionate outsider to examine both the *quantity* and *quality* of supervision.

5.5.7 Law and Economics Approach[134]

From a law and economics perspective, tort law, particularly a rule of negligence, can play an important role in generating incentives in order to achieve more careful financial supervision. How does this mechanism work in theory? What conditions have to be met in order to receive this kind of incentive from tort law?

[134] The discussion under this point draws from Dijkstra (n 2).

A negligence rule gives all parties incentives for careful behaviour, because actors have to comply with a legal standard of care in order to avoid liability. The applicable standard of care financial regulators can be represented as S°. Thus when financial regulators act beneath the level S°, the reasonable care or due care, they are held liable, whereas a level equal to or above S° leads to no liability. The basic model assumes that the required level of care is set at a level of care that is equal to the socially optimal level. Further, it is assumed that parties involved know this level ex ante.

In theory, the socially optimal level should lead to a diligent financial supervision. A financial regulator will not choose a supervision level above the level of care S*. This is because any care in excess of the standard would be more costly without reducing the costs of compensation, as due care is enough to be non-liable. In addition, it will not choose a level below due care, because of the risk of bearing the total amount of expected damages. Thus under a negligence rule, financial regulators receive proper incentives in order to perform their supervisory tasks with adequate care.

5.6 CONCLUSION

This second part, of our two-part comparative analysis, has argued centrally that judicial accountability in terms of negligence based liability, can better strengthen the accountability of the proposed Nigerian triple peaks regulators. In support of this argument, it has been shown that beyond the optional prescriptions in the international soft law on legal protection of financial regulators, there is no universal consensus and practice to preclude the liability of financial regulators for supervisory negligence. It has been shown also that the question is more of a national policy decision than a putative compulsion to adopt a (universal) consensus. In countries such as Australia, Japan, the Philippines and Switzerland, financial regulators can be impleaded for supervisory negligence, but not so in the UK, Poland and Germany. The preclusion also holds in Malaysia, Nigeria, and the United States of America. The justifications for the preclusion, it has been argued here, are unsupportable. Considerations which include, equal treatment, deterrence, reliance, compensation, socializing the cost of liability, meta-supervision, and the law and economics of optimal supervision, argue for liability to be imposed for negligent supervision. But in the end, whether or not the proposed objectives-based triple peaks financial regulators would be liable for negligence as reflected in supervisory and regulatory failure is ultimately a policy decision. In deciding what the right policy should be, serious consideration needs to be given to the fact that a regulatory approach, which permits an incremental growth in the principles and practice relating to public sector accountability by exposing financial regulators to the remedial consequences of negligent supervision is to be preferred.

Specifically in the Nigerian context, and in the context of the proposed triple peaks regulatory structure, to submit these regulators to a negligence liability regime, potentially evidences an element of strength of the disciplinary mechanism in the reformed financial system. Conversely, to maintain the old immunity from liability arising from supervisory negligence risks the continuation of the regulatory impunity in terms of lack of a strong accountability mechanism to redress losses induced by regulatory failure. In the proposed triple peaks structure, a negligence liability regime which also takes due account of the nature of financial regulation and the need for sufficient discretion in taking supervisory measures, would function as a monitoring mechanism with respect to the exercise of supervision, and eventually benefit the financial system as a whole. In this regard, it is of critical importance to find the right balance between the legitimate expectations of depositors and investors as to the quality of financial supervision, and the need to allocate primary responsibility for bank failures to the banks themselves and their shareholders. Still the researcher believes that financial systems which generally eliminate liability or limit it to bad faith on the part of the regulator, do not strike a fair balance between the interests at stake, and may fail to sufficiently discipline regulatory authorities to exercise due care in their tasks. In Chapters 6 and 7 which follow next, we shall lay out the normative principles and institutional configuration for a Nigerian triple peaks regulatory structure and how negligence liability and other reform strategies can be used to respond to challenges of the proposed structure.

CHAPTER SIX

Implementing Objectives-Based Financial Regulation: The Normative Principles and Institutional Architecture

6.1 Introduction

This chapter continues with the reform themes in chapters 4 and 5. It articulates the first in the two levels of the proposals that underpins the advocacy for the adoption of an objectives-based triple peaks financial regulation in Nigeria. [1] This is in terms of how the principles and institutional configuration comprised in the proposed financial regulatory architecture can and should be implemented for a better and more effective regulatory approach to financial system stability, consumer financial protection, market integrity and financial market competition. It proposes prophylactic countermeasures to the regulatory issues discussed in chapters 1 and 2. These countermeasures in turn operationalise the objectives-based triple peaks financial regulatory (theoretical) framework canvassed in chapter 3. They also tie the discussions in chapters 4 and 5 to the reform of financial regulation in Nigeria and move the research closer to its conclusion. Thematically therefore, this chapter focuses on two questions: what principles, strategies and institutions are comprised in the proposed financial regulatory framework; and how should they be implemented?

This chapter is organised into six sections. This introduction is the first section. Sections two, three, four, and five articulate the normative principles and implementation strategies for financial system stability, consumer protection, market integrity, and

[1] The two levels of the reforms are, the normative principles, strategies and institutional regulatory structure (chapter 6), and the strategies for strengthening the proposed regulatory framework (chapter (chapter 7).

financial market competition respectively. The sixth section concludes the chapter.

6.2 FINANCIAL SYSTEM STABILITY

Financial system stability regulation as we explained in chapter 2 focuses on the health, safety and soundness of a country's monetary system and its financial services industry. We explained in that chapter that the implementation of financial system stability in Nigeria is partly *centralised* and partly *functionally fragmented*; that this arrangement creates regulatory deficiencies chiefly in the sense of a duplicative regulation and a regulatory blindside in which systemic risks spillovers across banking, insurance and securities sectors may be difficult to perceive early. We urged the adoption of an alternative approach that gives a highly nuanced attention to the stability of the Nigerian financial system—highly nuanced in terms of expanding the perimeter of financial stability; using an analytical method to measure systemic risks spillovers; establishing a dedicated financial system stability agency; and having a streamlined systemic liquidity management framework among others. This section fleshes out these proposals and others thus far recommended in relation to financial system stability.

It should of course be noted as a preliminary point that the normative principles and implementation strategies which underpin financial system stability regulation under the objectives-based triple peaks financial regulation that we canvass for Nigeria are intended to anticipate and respond effectively to threats to the financial system including those that may arise from the individual and correlative risks of financial intermediaries. To achieve this level of regulation, the thesis recommends three key strategies: (a) a comprehensive redefinition of the perimeters of financial system stability in Nigeria; (b) a streamlined systemic liquidity management approach; and (c) pro-active crisis management toolkits for the financial services industry.

6.2.1 The Regulatory Perimeter of Financial Stability in Nigeria

Re-defining the regulatory parameters of financial stability, under an objectives-based approach, requires in principle that all financial activities that pose systemic risks should be *comprehensively* and *analytically* regulated. To achieve comprehensive regulation of financial system stability the thesis proposes the creation of a Financial System Stability Authority (FSSA) to reform the regulatory deficiencies induced chiefly by the current functional financial framework discussed in chapter 2. Two key objects of the FSSA should be to identify emerging risks across the financial system and implement preventive systemic stability measures particularly with respect to financial intermediaries whose failure(s) can precipitate systemic crisis.

To expand the perimeter of financial system stability regulation also requires an *analytical* approach to prudential regulation in order to measure quantitatively and effectively the relative (individual) and correlative (bounded) risks of financial institutions. In relation to micro-prudential regulation—the safety and soundness of individual financial intermediaries—this requires that capital regulation, liquidity and risk management, should reflect individual financial institutions' risk, as much as they reflect their potential to coalesce into systemic risk. Macro-prudential regulation—the safety and soundness of the financial system—should in principle focus on how to dampen the pro-cyclical inclination of Nigerian financial intermediaries which, and much like their global peers, tend to operate a business model that runs in tandem with economic 'boom and bust cycles.' The approach canvassed here essentially requires that the gap between micro and macro prudential regulation should be narrowed. One way to achieve this is to adopt a classification of financial institutions based on objective risk measures that capture the risk-spillovers from one institution to the next. That is, the institution's actions and asset-liability structure determine the fault line of regulatory action, while its legal identity as a bank, an insurance company, a securities firm, or a discount house only plays a secondary role.

Different systemic risk spillover measures can be used for this purpose, but the thesis recommends the use of Conditional Value-at-Risk (CoVaR).[2] It is the value-at-risk (VaR) of one financial institution, conditional on another financial institution experiencing financial distress. The latter institution is said to be at its VaR.[3] This proposal quantifies how the insolvency risk of one financial institution can increase that of other financial

2 Other systemic risk measures proposed by financial regulation scholars and economists after the GFC include, Marginal Expected Shortfall (MES) which is the marginal contribution of a financial institution to systemic risk, as measured by the Expected Shortfall to the financial system; the Systemic Expected Shortfall (SES) which is the amount of financial institution's equity drops below its target level (defined as a fraction of K of assets) in case of a systemic crisis when aggregate capital is less than K multiplied by aggregate assets; and Systemic Risk Measure (SRISK) which is the expected capital shortfall of given financial institution, conditional on a crisis affecting the whole financial system. A common issue with these measures, is that compared with CoVaR, they are less able to measure risks correlatively across several financial institutions, because of their focus on the failure of one financial institution in relation to the financial system. For a comparison of the four measures and their econometric simulations, see S. Benoit, G. Colltaz, C. Hurlin, C. Perignon, 'A Theoretical and Empirical Comparison of Systemic Risk Measures,' (2013) 1 – 47, available online at: <http://ssrn.com/abstract=1973950> accessed on 8 July 2014.

3 See generally on this and for the econometric simulation of this measure of spillover risk: T. Adrian and M. Brunnermeier, 'CoVaR,' (2011) *The Federal Reserve Bank of New York Staff Reports No. 348*, available online at: <http://ssrn.com/abstract=1269446> accessed on 8 July 2014. See also, M. Brunnermeier et al, *The Fundamental Principles of Financial Regulation: Geneva Reports on the World Economy 11* (Geneva: International Centre for Monetary and Banking Studies, 2009) 25 – 8.

institutions. Unlike the typical VaR, which captures the risk of a single institution CoVaR captures the risks across several institutions. More specifically, institution X's CoVaR is the conditional VaR of institution X's counterparty or the whole financial sector after conditioning that institutions X is in difficulty.[4] In particular, if institution X causes some risk spillovers on its counterparties, then the CoVaR exceeds the unconditional VaR.

Furthermore and as an improvement on the current approach in which the CBN annually designates a selection of banks as Systemically Important Financial Institution (SIFI), risks distinctions should be used to group financial institutions in a financial sector wide configuration. This should be into four categories: *individually systemic,*[5] *systemic as part of a herd,*[6] *non-systemic large,*[7] and *tinies.*[8] The risk spillover measure should

4 The same measure 'conditioning-method' can be used for any risk-measure and is not restricted to VAR, which is not the ideal risk measure. The 'co-expected short-fall' is an alternative spillover risk measure: ibid, 25.

5 This describes financial institutions, which can cause risk-spillovers and include institutions that are large and massively interconnected, and so iconic as 'national financial institutions' that the government should not allow them to fail. They thus require macro-prudential regulation and also micro-prudential regulation. In this category can be included six SIFIs (bank) whose aggregate assets and liabilities account for 56.8% and 59.6 % respectively, of the banking sector total in 2013: See CBN, *Financial Stability Report June 2013* (Lagos: CBN Research Department, 2013) 15.

6 This describes financial institutions, which may be sufficiently small and insignificant for their individual condition to be of great concern to the proposed FSSA, particularly to the extent that this is driven primarily by idiosyncratic factor. But when they move together as part of a larger group, their correlated fluctuations may well be systemic. Hence they require some macro-prudential regulation, but very limited micro-prudential regulation, which might in the case of the non-SIFIs be implemented through a lower Capital Adequacy Ratio (CAR) and less stringent prudential rules.

7 This describes financial institutions that do not conventionally pose a serious systemic threat, regardless of their size, and also not highly levered, such as insurance companies, and discount houses. These institutions need full micro-prudential regulation, but no additional macro-prudential regulation.

8 This describes institutions, which are small in size and are also unlevered, such as community banks, microfinance banks. These should have lowered micro-prudential but not full macro-prudential regulation.

determine whether a financial institution needs more stringent macro prudential regulation and influence the extent of capital and liquidity charges. The approach should however be flexible enough to match (on at least an annual basis) the institutional risk distinctions with the prevailing risk profile across the financial sector. For instance, where a large insurance company (such as National Insurance Corporation of Nigeria) moves into a volatile business, such as extensive underwriting of credit risk exposures with the potential danger that its resources may be insufficient to meet indemnity pay-outs in case of escalating credit defaults in the financial system, then it should in principle be included in the category of individually systemic financial institutions.

To dampen the pro-cyclical inclination of financial institutions, which follows mostly from relying on a boom and bust economic cycle to chase returns on equity, maintain value at risk, including, using mark-to-market valuation and risk approaches, the FSSA should focus on *counter-cyclical regulation*, namely, to reduce the systemic risk that fluctuation in the conditions of an institution or market would have on the rest of the financial system. This requires that financial institutions that are categorized as systemically important individually or as part of a herd should be regulated in direct proportion to the systemic risk they pose. To achieve this, differentiated CARs should be framed and updated constantly and consistently with the risk distinctions among the financial institutions that operate in the financial system. This should focus on a risk-spillover measure that takes leverage, maturity mismatch and financing into account. The measures to reiterate, should be counter-cyclical i.e. tough during a credit boom and more relaxed during crisis.[9]

6.2.2 Systemic Liquidity Management

Financial system stability under the objectives-based financial regulation approach also addresses how to rationalise systemic liquidity management. First and crucially, there is the need for a new approach to the disbursement of allocations to the three tiers of government, because the monthly distribution of oil revenue and proceeds of selective taxes often creates lumpy shifts in liquidity, whereas the Fiscal Liquidity Management Committee (FLAC) meets weekly.[10] The weekly meetings has often helped to improve liquidity forecasting, but anecdotal accounts and media reports on institutional disagreements among the CBN, MoF and NNPC on the one hand in respect of remittance of crude oil export earnings; and inter-ministerial disagreements on the release of budgetary allocations on the other hand make it difficult to quantify the effectiveness of the FLAC.[11]

The objectives-based approach argues for a centralized and less acrimonious approach to liquidity management in the sense of scrapping the FLAC and creating a Systemic Liquidity Monitoring Department (SLMD) within the FSSA. The SLMD should focus primarily on systemic liquidity surveillance across the financial

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9 For more on the major components of counter-cyclical regulation, see 'Chapter 4: Counter-cyclical Regulation' in Brunnermeier et al (n 3) 31 – 38.

10 FLAC is composed of representatives from the CBN and FGN Ministries, Departments and Agencies.

11 Some of these inter-ministerial disagreements can be read here: http://www.premiumtimesng.com/business/156000-neiti-accuses-nnpc-of-failing-to-remit-another-n3-65-trillion-oil-revenue.html, accessed on 14 November 2014; http://dailyindependentnig.com/2013/12/nnpc-cbn-missing-49-8bn-oil-revenue/ accessed on 14 November 2014.

system including specifically, public fiscal disbursements, the sale and purchase of foreign exchange by the CBN, as well as the inflow and outflow of funds. In particular and to address the monthly lumpy shifts in liquidity, it is suggested that serious consideration should be given to a statutorily based fortnightly distribution of oil revenue among the three tiers of government. The workability of the last proposal admittedly depends on a number of variables including particularly how much is available to allocate to the three tiers of governments. Still, the systemic liquidity stability benefits of a fortnightly disbursement should be seriously considered. Further, it is suggested that the signaling role of the Monetary Policy Rate (MPR) corridor including the clear communication of policy decisions to the market should be reformed to work more effectively. In principle, this can be achieved through a regulation under which the FSSA is able to monitor the prompt communication of policy changes to the market by the CBN.

Further and considering the fact that banks' cash reserve requirements tend to fluctuate, the use of Cash Reserve Ratio (CRR) changes as an instrument for structural liquidity should also be infrequent and only when there is a strong reason for not using market-based instruments such as FGN Treasury Bills and bonds and CBN Bills. Where the CRR is to be used a two-step approach is suggested: a primary CRR (about half of the total CRR) can be fulfilled on a daily basis, and the overall CRR can be subject to a month long averaging mechanism, to align the maintenance period with the prevailing monthly distribution of oil revenues. [12]

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[12] The CRR serves several objectives, including the prudential, monetary control and liquidity management objectives. Reserve averaging, which was introduced in March 2011, was

Lastly but by no means the least, the FSSA should have statutory powers to do two things to regulate systemic liquidity. First, it should have powers to develop and enforce guidelines to separate the CBN's role as a structural supplier of foreign exchange from its interventions in the foreign exchange market to dampen excess volatility in the exchange rate. This should in theory refine and streamline the CBN's intervention policy to allow for greater flexibility in the exchange rate without compromising on the stability of the exchange system. Second and to reiterate a major regulatory lesson from the Malaysian currency crisis, the FSSA, should be empowered to impose temporary capital controls to check inflow and out flow of foreign investment for purely short term speculative purposes, especially where it perceives that such inflows could induce systemic crisis. This as we noted earlier will necessitate an amendment of *section 24 of the Nigerian Investment Promotion Council Act* and *Rules 412 and 413,* of the *SEC Rules, 2013,* which permit unfettered reparation of investment profits from Nigeria, to allow for the introduction of a 'staggered' reparation of investment profits and (or) divestment from the financial sector where necessary, and for a temporary stoppage to be imposed on massive capital outflows, when such outflows are adjudged as likely to lead to the collapse of the Nigerian financial system.

6.2.3 Proactive Crisis Management Toolkits

Integral and no less crucial to the objectives-based triple peaks financial regulation in the context of financial system stability is the requirement of proactive crisis management toolkits. These are

suspended in October 2011. The current rate is set at 12 percent (increased from 8 percent in July 2012)—marginal 4 percent is remunerated at SDF rate.

measures to forestall both localized and systemic crises; and (or) provide speedy and effective resolution of those crises, which are unpreventable. Four regulatory measures are proposed as the components of the proactive crisis management toolkits: the use of stock market 'circuit breaker,' official financial support, orderly and effective resolution, and recovery and resolution planning for systemically significant financial institutions. Each of these measures is discussed below.

6.2.3.1 Capital Marker 'Circuit Breaker'

As a proactive financial crisis management mechanism, the FSSA should be empowered to close the Nigerian capital market temporarily to halt an escalating stock market crisis. The aim should be to 'arrest' the crisis before it induces the collapse of the entire financial system. The market can then be re-opened at a time when the FSSA adjudges the market to be in less critical crisis condition. Had this mechanism been in place in 2008, it arguably would have been used by SEC or NSE to stabilize the Nigerian capital market and prevent its meltdown which spread to nearly all aspects of the country's economy.[13]

6.2.3.2 Official financial support

This is conceived as a two-pronged yet streamlined strategy that comprises Emergency Liquidity Assistance (ELA) and long-term solvency support (LSS). Emergency funds are often required in crisis situations and a central bank is typically the only regulatory agency that is able to quickly mobilise such funds. The CBN should therefore be the source of ELA. This is supported by the fact that

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[13] F. Partnoy, 'Why Markets Crash and What Law Can Do About It,' (2000) 61 *U. Pitt. L. Rev.* 741, 782 – 83.

the CBN in the crisis of 2009 improvised an Expanded Discount Window (EDW) to provide loans to banks for up to 360 days. This was done because (as we mentioned in chapter 2) the CBN had no ELA facility to assist individual solvent banks facing liquidity problems, beyond 90 days. The CBN should not only play the role of ELA facility provider; it should also develop a comprehensive statutory framework supported by a *BOFIA* amendment, for a longer term ELA facility up to 180 days. Included in such a framework should be clear policies, guidelines, and procedures for this function, including, a solvency test, eligibility requirements, applicable interest rates (which should be typically penal) and acceptable collateral. Financial institutions that access the facility should also be subject to more intrusive supervision under an insolvency prevention plan specially crafted for such financial institutions.

The existence of a standing ELA facility necessarily requires that the *NDIC Act* should be amended to remove the possibility of the NDIC providing liquidity support to banks.[14] Financial support from the Corporation if at all permissible should be limited to assisting in those cases which involve banking resolution measures and should be subject to a cap and a least cost test. The Corporation can in principle stipulate that financial assistance is the least cost to the deposit insurance fund of all the possible methods for resolving an insolvent insured institution (e.g. liquidated payouts). The least cost method incentivises shareholders and large creditors to impose more discipline on the management of insured financial

[14] The Corporation can do this at present pursuant to its power in *sections 2(1)(b) and 37 of the NDIC Act, No. 16 of 2006.*

institutions to operate safely and soundly. This proposal draws from the approach in United States and Canada, where the Federal Deposit Insurance Corporation (FDIC) and Canada Deposit Insurance Corporation (CDIC) are subject to a Least Cost Resolution (LCR) requirement, which means that they must adopt the resolution method with minimal cost to the deposit insurance fund regardless of other objectives.[15] In the Nigerian context and pursuant to the proposed objectives-based triple peaks financial regulation, the assistance can be provided when facilitating a purchase and assumption transaction (P&A) or a bridge bank transaction, but such assistance should be capped at the amount of insured depositors' funds that would have been paid out by the Corporation if the bank had instead been liquidated.

The provision of LSS beyond liquidity assistance for illiquid but solvent banks and other financial institutions is conventionally the role of the Finance Ministry or a governmental agency outside the Central Bank. It is generally known that The Department of the Treasury in the US and Her Majesty's Treasury in UK, coordinated and provided the funds for the long term solvency of nearly all the rescued insolvent banks in the two countries following the GFC in 2008. To incorporate this best practice approach into the proposed objectives-based financial regulation, it is suggested that the provision of the LSS should be the role of the FSSA. This suggestion is founded on four reasons. *First,* it enables the FSSA to provide a financial system wide solvency support (i.e. not limited

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15 *Section 38, Federal Deposit Insurance Act* (as amended by Public Law 112 – 215, enacted on 20 December 2012). See generally on the least cost approach to banking insolvency resolution, P. Brierley, 'The UK Special Resolution Regime for Failing Banks in an International Context,' (2009) Bank of England, *Financial Stability Paper No. 5*, 5 – 6.

to banks alone). *Second,* it enhances accountability and transparency in that it separates ELA from LSS and FSSA can be made accountable to the MoF and the National Assembly on the source and the use of the LSS funds. *Third* and in theory, it insulates the provision of LSS from interest group pressure to favour the banking sector of the financial services industry, or a section of the country, which pressure might be brought to bear if the role were to be assigned to the CBN or the MoF. *Fourth,* it can deepen the financial services sector in that the FSSA can securitise the LSS fund and explore several funding sources, including private investment in the fund. The fund can also be used to mop up excess liquidity in the financial system when necessary, through the sale of 'LSS bonds'. To achieve this, the FSSA will require statutory powers, to set up the fund and ensure that the LSS can be made available on an expedited basis. If in the interim, the MoF or the CBN provides such support there should be a statutory indemnity from the FSSA to the MoF or the CBN, as the case may be.

Notably and similar to the ELA, the existence of the LSS necessarily requires that the blanket guarantee issued by the CBN during the 2008 – 09 crisis should be officially unwound, including specifically an exit strategy for AMCON to remove a potential source of creeping systemic moral hazard, in which banks indirectly 'offload' their NPLs to taxpayers and prudent banks through the agency of a government backed asset management company (AMCON).[16]

[16] *Section 26 of the AMCON Act* 2010, provides that all its bonds shall are to be underwritten by the government (MoF specifically). In resolving the crisis of 2009, the CBN provided solvency support to the banking sector through AMCON and continues to contribute to the Banking Sector Resolution Cost Fund (established for the purposes of paying the AMCON bonds). The Fund is financed through annual levies, starting from end-2011, with the CBN providing an

6.2.3.2 Orderly and effective resolution

Under the proposed objectives-based financial regulation, orderly and effective resolution ought to have a two-fold thrust: going concern resolution and orderly liquidation.[17] To achieve both, to reform and strengthen the insolvency resolution powers contained in the *BOFIA*[18] and *NDIC Act*[19] and specifically to address the issues thrown up by the banking insolvencies resolution related court actions after the crisis of 2009, we recommend the adoption of four financial regulatory principles: regulatory override of shareholders rights; non-suspension or reversal of resolution actions; capital write downs; the use of quantitative and qualitative regulatory intervention triggers.

i. Regulatory Override of Shareholders' Rights

This is recommended for the purposes of orderly liquidation. Its adoption would arguably enhance speed and flexibility in the exercise of resolution powers. However and given that most financial intermediaries in Nigeria are incorporated companies, this necessarily requires that the provisions of *CAMA* relating to shareholders' right be dis-applied in the context of financial (avowedly banking) insolvency resolution.[20]The disapplication of

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annual contribution of ₦50 billion, essentially a public sector co-payment, and the banks paying a flat premium of 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).

17 Going concern resolution is conceived in terms of strategies to sustain an insolvent but commercially viable financial intermediary. Orderly liquidation is conceived in terms of speedy and less disruptive liquidation of a failed financial intermediary.

18 *Sections 35 – 42 of the BOFIA* (as amended by Act No. 38 of 1998). These sections empower the CBN to manage and restructure a failing bank; turn over control of failing banks to NDIC for management and restructuring.

19 *Sections 37 – 43 of the NDIC Act.* These empower the NDIC to manage and restructure a failing insured institution; incorporate bridge banks to purchase the assets of the institution, and to liquidate a failed insured institution.

20 These are contained mostly in Part VII, CAMA on Meeting and Proceedings of Companies.

the relevant provisions of *CAMA* should enable resolution authorities to administratively and without recourse to the courts: (a) carry out a mandatory recapitalisation of an insolvent financial intermediary where necessary without pre-emptive rights of shareholders, (b) carry out a purchase and assumption transaction involving the transfer of any type of assets and liabilities without having to obtain shareholders' approval, and (c) carry out a merger and acquisition transaction without a shareholders' vote at a general meeting and court sanction.

To ensure that the exercise of the proposed powers are subject to due process safeguards, the Malaysian financial regulatory accountability approach can be adopted, in which a BNM resolution action must have the prior approval of the Malaysian Finance Minister; and, where such action requires the removal of an officer or director of a financial institution, it must be shown that he or she has been given a reasonable opportunity to make representations against, or otherwise in respect of the proposed action.[21]

ii. Non-Suspension or Reversal of Resolution Actions

This principle suggests that *BOFIA* and *NDIC Act* should be amended to provide that: (a) in the event that there is any challenge to resolution actions, there should be no suspension of resolution proceedings; and (b) it should not be possible to reverse the measures taken by resolution authorities. Redress for wrongful revocation of licence or liquidation should therefore take the form of monetary compensation. The NDIC should be appointed as a liquidator immediately upon the revocation of licence of an

[21] *Section 73 (1) (3) (4)*, of the *Banking and Financial Institutions Act 1989* (Malaysia).

insolvent bank and the statutory requirement for advertisement of the petition for winding up before appointment should be dis-applied.[22] This proposal addresses the arguably insalubrious experience with bank liquidation in Nigeria, in which procedural delays often occasion uncertainty for bank depositors and creditors, which in turn erodes confidence in the banking system and raise the cost of bank failures. In three cases for instance (Savannah Bank Plc., Societe General Bank Plc. and Citizens Bank Plc.) the courts reversed the CBN's decision to revoke bank licences. The court proceedings lasted several years (seven years in the case of Savannah). Five years after the courts re-awarded the licences, the banks have yet to recommence business due arguably to higher capital requirements and the inability to resume business based on original, but now decayed infrastructure (i.e. obsolete and dilapidated information technology systems, documentation and physical premises among others). In the meantime, depositors' funds in these banks have been frozen and debtors have not been servicing loans. Societe General Bank Plc. for instance has had to sell its banking licence, ostensibly because selling the licence was adjudged to more prudent compared with the cost of resuscitating its seriously decayed banking business.[23]

iii. Capital Write Down

The third reform principle relates to the use of capital write down and this is particularly relevant for the purposes of going concern resolution. It encompasses the power to write down equity and for

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[22] As contained *section 40* of the *BOFIA 1991* (as amended by Act No. 38 of 1998) and *section 40(2)* of the *NDIC Act No. 16 of 2006.*

[23] Information on the sale is available online at: http://newtelegraphonline.com/ifie-sekibo-rewriting-sgbns-story-through-heritage-bank/ accessed on 9 October 2014.

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.[24] The objective should be to return the financial institution to compliance with prudential requirements and to restore its viability. This should however respect the hierarchy of claims in liquidation. Equity should absorb losses first, followed by subordinated debt (including regulatory capital instruments) and, finally, senior unsecured debt. Creditors should have the right to compensation where they do not receive at least the amount they would have received in a liquidation of the insolvent financial institution. The potential for capital write down to be used as a corporate governance disciplinary tool that kicks in when a financial institution is managed recklessly will be discussed extensively in chapter 7.

iv. The Use of Qualitative and Quantitative Intervention Triggers

The fourth principle requires the use of both *quantitative* and *qualitative triggers* for supervisory intervention in failing financial institutions. This suggests that statutory triggers should be harmonized under *BOFIA*[25] and *NDIC Act* to include both quantitative triggers (tied to CAR, liquidity ratios etc.) and

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[24] See for a discussion of bail-in, J. Zhou et al, 'From Bail-out to Bail-in: Mandatory Debt Restructuring of Systemic Financial Institutions,' (2012) *IMF Staff Discussion Note SDN/12/03*, available online at: <http://www.imf.org/external/pubs/ft/sdn/2012/sdn1203.pdf> accessed on 13 July 2014.

[25] This available online at: < http://www.cenbank.org/OUT/2011/PUBLICATIONS/BSD/CBN%20SUPERVISORY%20INTERVENTION%20GUIDELINE%202011%20FINAL%20TO%20PUBLISH%20V%202.PDF> accessed on 13 July 2014.

qualitative triggers (e.g. breaches of laws and regulations, carrying on business in a manner detrimental to the interests of depositors), to grant the resolution authorities greater discretion in invoking resolution proceedings.

The next section articulates the normative institutional structure, principles and reform strategies for effective consumer and investor protection under the objectives-based approach.

6.3 Consumer Financial Protection

In chapter 2 we justified consumer financial and investor protection, as a financial regulatory inducement for depositors and investors to patronise the financial services sector. We argued that consumer financial protection under Nigeria's current functional financial regulatory framework is ineffective owing largely to a duplicative and generally lax enforcement. This section articulates the normative institutional structure, principles and implementation strategies for an effective consumer and investor protection in Nigeria, under an objectives-based financial regulation—effective in terms of: (a) a holistic and institutionally centralised approach to consumer protection, (b) an aggressive consumer and investor activism, (c) imposition of liability for negligent financial regulation, (d) a national financial literacy policy, and (e) application of behavioural economics to consumer protection.

6.3.1 Institutionally Centralised Approach to Consumer Financial Protection

An essential first step to achieve a more effective consumer financial protection in Nigeria is a changeover from the current fragmented, duplicative and less effective approach, to a central institutional structure. It is essential because in large part the success of the other measures to be canvassed below depends on having a central coordinating institution for consumer financial protection. This agency, which is strongly canvassed for Nigeria, would for our present purposes be called the Consumer Financial Protection Authority (CFPA).

The creation of the proposed CFPA gives consumer and investor related issues an independent seat at the regulatory table for the Nigerian financial services industry. Given the problem with consumer financial protection discussed in chapter 2, the independent seat should be seen as an 'irreducible minimum,' for the emergence of a sound financial regulatory framework in Nigeria. This is because if the CFPA is effectively structured and administered, it can enhance public confidence in the financial market and reduce the occurrence of consumer panics that can threaten market stability. *A fortiori* and to enhance the competitiveness of the Nigerian market, the existence of the CFPA demonstrates that the Nigerian financial system places a high value on helping responsible financial consumers and investors thrive and that they are treated fairly.

6.3.2 Aggressive Consumer Financial Activism

Consumer financial activism encapsulates an assertive and engaging advocacy for the protection of users of financial services with focus on depositors and investors. The creation of the CPFA is the first step in this approach. The next step is conceived in terms of two pronged proposals: *First,* the CPFA should enforce a regulatory regime, which requires that all dealings and disclosures with consumers, investors and other users of the financial services industry be reasonable, balanced in their content, presentation of benefits and clearly conspicuous in their identification of costs, penalties and risks. The *second* proposal relates to the need for the CPFA to be able to institute relator actions on behalf of consumers against an erring financial intermediary.[26] A relator action is

[26] A relator is the legal term which means a private person at whose relation or on whose behalf a suit is filed. The relator appears as one beneficially interested, but the action is maintained on his behalf. The relator furnishes the knowledge or facts on which, information or a proceeding in is based. Such a proceeding is usually in the name of the State.

particularly recommended where the conduct constituting the infraction is egregious and flagrantly injurious to a large number of consumers and calculated to result in profit for the defendant financial intermediary. It should also be the case that without such an action, the relator financial consumers will be rendered remediless on account of lack of sufficient means to aggregate and prosecute the claim against a potentially culpable financial intermediary. This proposal is not of course intended to derogate from or constrain the Attorney General's constitutional power at the federal and state level, to enforce the law or direct public litigation. Thus where there is a conflict between this proposal and powers of the Attorney General to conduct public litigation, the latter should as a rule prevail.

6.3.3 Liability for Negligent Financial Supervision

Losses to consumers and investors can result generally from the acts, omissions or outright unlawful conducts of financial intermediaries. But these conducts or omissions may have been facilitated by negligent financial supervision. The negligence of the regulator thus constitutes the primary cause and the injurious conduct of the financial intermediary is the secondary causality for the pecuniary losses which its customers suffer. It should in principle be possible for the customers to recover against the regulator for the losses. Such a recovery, in part, reflects a policy to provide a broader private law remedy in the financial services industry beyond those enshrined in the contractual relationship between the customers and financial institutions. It can serve as a disciplinary and accountability mechanism which enables the judiciary to scrutinise the dutiful use of the governmental monopoly of the public regulatory power over the financial system.

In chapter 5, we discussed extensively, the *pro et contra* of, and defended the imposition of this liability. We demonstrated that there is no truly universal consensus in law and practice that speaks against the imposition of this liability. Nor is the liability, as we demonstrated from the law and practice in several countries, impossible of judicial enunciation if it is permissible in policy to do so. The objectives-based financial regulatory approach canvassed for Nigeria thus strongly recommends that liability for negligent financial regulation should, as a matter of regulatory policy, be incorporated into the country's financial regulatory remedial and accountability mechanisms.

6.3.4 Financial Literacy

Financial illiteracy and lack of general awareness of financial services are arguably critical impediments to financial inclusion and investor protection in Nigeria. A World Bank Report on the financial services in Nigeria published coincidentally with the crisis of 2009 found that most Nigerians are unaware of financial services products and the benefits that can be obtained from them. [27] The Report recommended a concerted education programme to educate consumers on the benefits of using financial services and the rights, which accrue from doing so. [28] This finding and recommendation validate the causal narrative that we referenced in chapter 2 that financial illiteracy enabled financial institutions to

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[27] The World Bank, *Making Finance Work for Nigeria* (Washington D.C.: IBRD, 2009) 92.

[28] *ibid.*

engage in misconduct (mostly disclosure and transparency related) in the crisis of 2008 - 09.[29]

To enhance financial literacy under the objectives-based financial regulatory approach, a national policy on financial literacy is strongly recommended for Nigeria. This recommendation builds on the World Bank Report and the policy thrust should centre on a public education programme on the opportunities, risks, obligations, and consumer rights in the financial services industry. This policy should be coordinated with the education ministries at the three tiers of government to be impactful, in terms of its incorporation into academic curricular planning. Further, the policy should particularly target artisans, tradesmen, and market women, who arguably constitute the larger segment of the financially illiterate.

Questions will of course be asked whether the policy does not reflect a wasteful paternalism, in terms of whether the information so disclosed will be read, understood, put to use, and whether the exercise will not ultimately be wasteful, if the disclosure does not impact the financial decisions of the target consumers and investors in a tangibly measurable way. Still we strongly argue that the merit of a financial literacy policy should not be dismissed because of these questions. It should be seen as a key measure to teach Nigeria's non-financially knowledgeable consumers and investors how to look after themselves.

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[29] See generally S. Sanusi, 'The Nigerian Banking Industry: what went wrong and the way forward,' (2010) convocation lecture delivered on 26 February 2010 at Bayero University, Kano, Nigeria.

6.3.5 Applying Behavioural Economics as a Consumer Protection Toolkit[30]

Behavioural economists in the context of consumer behaviour argue that financial consumers like ordinary human beings are prone to biases in their decision making in large part because their thought process often relies on intuition (thinking fast) rather than reasoning (slow, deliberately controlled thought process). With a biased consumer, information asymmetry (when one party to a transaction e.g. consumer, has less access to relevant information than the other party) can also arise where consumers can assess the information but are less able to process it.

Requiring financial intermediaries to give consumers the relevant information may solve some information asymmetry problems. But interventions to correct an information asymmetry in the presence of biased consumers can introduce further complications. For instance, when consumers lack the relevant information and have biases, it may be difficult to establish the most significant cause of the problem. This is because while lack of relevant information can make even a rational consumer to make poor choices, information provided in lengthy legal terms that make it excessively costly to access and assess can also induce poor choices. Consumers often then rely on advisers who are selective, either because of their own or because of misaligned incentives.

Behavioural biases can also render regulatory interventions which address information asymmetries ineffective. For instance,

[30] This proposal was inspired by the leading work on behavioural economics by D. Kahneman, *Thinking Fast and Slow* (New York: Farrar, Straus and Giroux, 2011) — analyzing how biases arise in human decision-making and these biases affect quality decisions including the decisions on financial products.

when there is lack of relevant information in the market, and consumers make poor choices as a result, the CFPA may intervene to ensure that firms provide this information. But behavioural economics show that when consumers are biased, such intervention will only be successful if the information is provided in the right way. Susceptibility to framing means, for example, that consumers often focus on a few headline rates and ignore the additional information about charges that is provided to them. Information disclosure requirements that do not take into account how consumers process information are therefore likely to be ineffective or even counterproductive.

Applied to the Nigerian context, measuring how retail financial consumers who are not often financially knowledgeable process information is most likely to be a difficult exercise, as would, a study of how their behavioural biases influenced their financial decision. For these reason, it is suggested that the CFPA should collaborate with the market integrity regulator proposed below, to monitor the indicators of consumer detriment from the business practices of financial intermediaries. Seven signs can be used to detect this detriment.[31] These signs can be broken down into more specific indicators. These signs are discussed below, but it should be noted that while they illustrate how different sources of information can help detect risks arising from consumer biases; the signs themselves do not do not demonstrate the existence of biases, as they could have alternative causes, but they are *indicative* of biases.

[31] These signs were first proposed by J. Campbell, H. Jackson, B. Madrian and P. Tufano, 'Making Financial Markets Work for Consumers: An Open Letter to America's First Consumer Protection Czar,' (2011) 87(7), *Harvard Business Review*, 47 – 54.

6.3.5.1 'Rip-offs'

There can be at least two signs of exploitation of consumer mistakes in an intermediary's overall strategies or profitability namely, uncompetitive high margins (hereinafter referred to as 'rip-offs') and concentrated profits from a small group of consumers (hereinafter referred to as 'suckers'). Sample indicators of rip-offs include persistent excess profitability, price dispersion unrelated to cost, and high penetration rate for high-margin unessential add-ons; and for suckers, cross-subsidies between consumer groups or products, and very different financial sophistication across targeted consumers. These indicators can support analysis of financial intermediary-specific and thematic issues that cut across several intermediaries, e.g. the indicators can be used in monitoring the sale of retail financial products such as micro credit schemes to retail bank customers and credit card loans. Some of the indicators that do not rely on an intermediary's past performance (e.g. cross-subsidisation) can also be used to analyse risks when approving a new product to be launched into the market by a financial intermediary.

6.3.5.2 'Bargains' and 'Traps'

There are two signs, which can show that biased consumers are vulnerable to specific product features or sales tactics, namely, innovative products that appear very cheap ('bargains') and contract features that often target behavioural biases ('traps'). Indicators of bargains include, 'too good to be true' headline prices or returns, and some material charges or exclusions which are hidden or under-emphasised; and for traps, teaser rates especially if combined with automatic renewals, cancellation charges or other hurdles, and default options for some key contract elements e.g. opt-out purchase for add-ons. Applied to the Nigerian context, if a financial intermediary promises its potential customers too good to be true high returns on a small investment, this can alert the CFPA to suspect exploitation of consumer bias.

The indicators enunciated here could have assisted with the early detection of one of the classic cases relating to exploitation of consumer bias in Nigeria: *Nospecto Oil & Gas Ltd v Olorunnimbe & 15 Ors.*[32] This case arose from an egregious mix of 'a wonder bank' and 'a ponzi scheme,' which in reality was an unlicensed collective investment scheme. The Appellant, a registered company and operator of this scheme, solicited investments in the scheme from members of the Nigerian public, who were represented in the appeal by the 1st to 14 Respondents with the promise of incredible returns. Following regulatory concern by the SEC and CBN over the legality of the scheme under *ISA* and *BOFIA,* the two agencies jointly froze the Appellant's bank accounts. The 'investors' represented by the 1st to 14th Respondents instituted action before the IST in 2010 against the Appellant, SEC and CBN, for mostly declaratory reliefs to ascertain and release the funds in the accounts to them. The indicators of exploitation of consumer bias for bargains articulated above put cases like *Nospecto* in clear regulatory context and should provide a normative basis for early detection of similar future cases. But these may not always be in the form of incredible returns. It can for instance also be in the form of financial promotions by banks to

32 Appeal No: CA/L/474/11

attract new depositors, while the terms and conditions of the promotions including charges are under-emphasised.

6.3.5.3 'Regret', 'Confusion' and 'Folly'

Finally, three signs of consumer behaviour can also point to exploitation of consumer bias namely: reported or potential distress ('regret'), choices out of line with common sense ('folly'), and observed or likely mix up ('confusion'). Indicators of regret can be in form of widespread reports of consumer regret not caused by foreseeable risk and the fact that a financial product is rarely purchased and thus give little scope for consumers to learn. The fact that a financial product is inconsistent with similar products already purchased by a consumer or with the consumer's financial goals and the fact that the product provides poor value for some groups of consumers can indicate exploitation of consumer folly. Exploitation of consumer bias in the form of confusion can show in cases where consumers are unable to describe key product features or prices after purchase and where the product is complicated for some or all because of structure or number of options.

6.3.5.4 How Should the CFPA Intervene?

There are four ways in which the CFPA can intervene when financial consumers are at risk of harm because of exploitation of their biases. *First,* it can require financial intermediaries to provide specific information in a way that is not likely to exacerbate consumer weaknesses or prohibit specific marketing or promotion materials or practices where they unfairly target such behavioural weaknesses, biases or mistakes. For instance, CFPA can require an insurance company, which is promoting a new product to give consumers data on past product usage or claims ratio. *Second,* it can adjust how choices are presented to consumers to address biases. For instance, it can set default options for products by requiring consumers to make an active decision instead of being automatically ‘opted in’ to buying a product. *Third,* it can require products to be promoted or sold only through particular channels or impose marketing restrictions in relation to certain types of clients. *Fourth,* it can ban specific product features or products that appear designed or otherwise likely to exploit consumer mistakes to their detriment or require products to contain specific features to address the risk of detriment arising from such mistakes. It can for example require the removal or limited use of high exit charges.

Now, the proposal for application of behavioural economics to protect consumers and investors can be criticised as a form of regulatory paternalism, which is contrary to freedom of contract and its allied caveat emptor rule, according to which contractual counterparties such as financial consumers should see to their financial safety and be ready to accept responsibility for their investment decisions, foolish or sensible. This criticism is unsupportable in that it overlooks the fact that interactions between financial intermediaries and consumers are often susceptible to underlying resource (financial intermediaries having more human and material resources) and information (financial intermediaries usually generate and package the relevant information) asymmetries, which can be used to the detriment of consumers. Given these asymmetries, a banker-customer relationship for instance cannot be equated with a contract between counterparties of equal means and power anymore than one can contend that the party with more power and resources should always prevail over the weak and vulnerable, even if that party deploys his power and resources unfairly. Without the interposition of the regulator between the investor and the investment bank, between the bank and its customer, particularly in a financial system like Nigeria, with a generally acknowledged low financial literacy, there is no guarantee that financial intermediaries will not prey on their consumers' biases.

In the next section, we shall discuss the normative institutional framework, principles and strategies for an objectives-based approach to financial market integrity regulation.

6.4 MARKET INTEGRITY

Financial market integrity regulation to recapitulate the points made in chapters 2 and 3 prevents abusive practices that can increase transactional cost in the financial services sector. Finding the right approach to implement this objective under Nigeria's current functional financial regulation, and in spite of extensive rules, as shown in chapter 2, has thus far proved an intractable problem. To address this intractability, this section canvasses four regulatory strategies: (a) the consolidation of existing market integrity rules in banking, securities and insurance sectors into a coherent financial market integrity rulebook; (b) a specialist regulatory agency for market integrity that closes the gaps induced by functional financial regulation; (c) the enactment of rules to empower the market integrity regulator to administratively adjudicate both civil and criminal infractions of market integrity rules; and (d) implementation of market conduct risk management framework by financial intermediaries.

6.4.1 Market Integrity Rulebook

Given, as we demonstrated in chapter 2, the introduction of substantial financial market integrity rules in the Nigeria post 2009, what is arguably needed is a strategy to make the rules more effective for enforcement purposes and for better accessibility. It is suggested therefore that the various rules applicable in the three sectors should be harmonised, consolidated and published as a single *Financial Market Integrity Rulebook*. The Rulebook should serve as a comprehensive regulatory reference material for market integrity that applies across the financial system. The suggestion is not for a single set of rules that apply uniformly to banking, insurance, and securities businesses. Rather, it is for a set of coherent rules that are structured according to the type of standard conducts and the level of integrity expected in each of the three financial business sectors. Essentially, the Rulebook should not be a ‘one size fits all’ compendium. Nor should it be a compendium of principles of ‘good conduct’ without explicit implementation and enforcement rules and one that leaves the margin of appreciation of permissible conduct to the financial intermediary. It should be an explicitly rules-centred regulatory compendium that states how the law should and will be implemented, including particularly, the punitive consequences of possible violation of the rules.

The proposal for a market integrity rulebook can of course be criticised, as a formalistic and perhaps an unnecessary gloss which does not translate to a substantive accretion to the rules. But this objection should be set against the benefit that having a market integrity Rulebook with commentaries, has the potential to address and enhance financial literacy, although whether most of the retail investors and financial consumers will be able to read, ‘digest’ and put the contents of the rulebook to good use is a concern. Still, the initiative of having a Rulebook should at least provide a coherent and one-stop reference material for those who are literate and wish to refer to it.

Even if the idea of a market integrity rulebook sounds appealing in principle, the expense (time and pecuniary) of compiling what might eventually become a huge tome on financial market conduct and the possibility that it might limit flexibility and discretion in the interpretation and enforcement of the rules, can argue against the publication of such a book. This argument should not serve as serious impediment not least because the expense of compiling the Rulebook would be well compensated for in that it would enhance clarity, certainty and consistency in the interpretation and enforcement of the rules. This in turn, can assist financial intermediaries and their legal advisers to better appreciate and structure their operations in compliance with the relevant rule(s).

6.4.2 Financial Market Integrity Regulator

The foregoing proposal for a Rulebook can in principle achieve greater impact if a specialist regulator enforces the rules. It can achieve greater impact because the focus, resources and expertise of the specialist regulator will be directed at enforcing market integrity in all its ramifications and across the financial system without regard to the functional division along banking, insurance and securities lines. The enforcement of a consolidated financial market integrity rules by a specialist regulator which we for our present purposes would call the Office of Superintendent of Financial Services (OSFS), has several key advantages over the present functional approach, in which financial market integrity is inefficiently regulated along three functional and by similar number of functional regulators.

One advantage is the obvious and immediate elimination of wasteful financial regulation, in that the OSFS provides a single regulatory entry and administrative enforcement point for all matters relating to market integrity. Financial intermediaries will not be dealing with three different regulators for the purposes of market integrity and the resources of the State will not be expended on maintaining that structure.

Greater regulatory clarity and consistency is another advantage of the approach canvassed here. Regulatory clarity describes an approach in which the architecture of financial regulation is designed to better magnify the objectives to be achieved which in this sense is financial market integrity. Regulatory consistency describes among other things a process-driven financial regulation, in which the implementation of policies, rules and objectives, is done in a manner that gives regulated intermediaries expectation of regularity, reliability and uniform treatment of similarly circumstanced operators. The OSFS can give clarity to the enforcement of market integrity and its work overtime should establish a consistent procedure and precedents for the enforcement of this objective.

Further, the existence of the OSFS will enhance regulatory accountability in the context of a financial crisis that is induced substantially by violations of market integrity rules. Functional regulation and more specifically the fact that the CBN, NDIC, SEC, NSE, and NAICOM are severally responsible for financial market integrity arguably make it difficult to hold one regulator responsible for the lapses that facilitated the financial malpractices responsible for the crisis of 2008-09.[33] The approach canvassed here will address this difficulty. The existence of a specialist market integrity regulator means that blame for supervisory failure under its watch cannot be passed on to other regulators. The specialist regulator is accountable for the deployment of it resources, expertise and powers. This arguably gives effective expression to

33 O. Famuyiwa, 'The Nigerian Financial Crisis: A Reductionist Diagnosis,' (2013) 2 (1) *Journal of Sustainable Development Law and Policy* 1 – 25.

our argument in Chapter 5 that power should go hand in hand with responsibility and accountability.

6.4.3 Power to Adjudicate Criminal and Civil Breach of Market Integrity Rules

Given the scale of the market integrity violations in the crisis of 2008-09 and the fact that some of these violations were barefacedly criminal, [34] the proposed OSFS should be empowered to administratively adjudicate criminal and civil violations of market integrity rules. This suggestion reforms the rule under Nigerian law according to which, only conventional courts can try a crime; and where an administrative tribunal, such as the one suggested here, is confronted with a civil claim bounded up with a crime, it can decide the former, in so far as it is possible to *sever* it from the latter.[35]

In place of severance, it is submitted that the applicable rule should be *totality of enforcement*. This signifies that where a civil complaint referred to an administrative tribunal implicates a crime, it should be permissible in principle for the tribunal to make a finding of guilt for the purposes of a disciplinary decision. The reasoning behind this submission can be approached from two perspectives. First, a finding of guilt for a criminal offence by an administrative tribunal operates in reality only as a *disciplinary penalty*, in that judicial power is not necessarily usurped by a finding of guilt which does not operate as a conviction for a crime,

[34] Sanusi (29).

[35] *Military Governor of Imo State v Uwauwa (1997) 4 NWLR 675; Sofekun v Akinyemi (1980) 5 – 7 SC 1; Garba v University of Maiduguri (1986) 1 SC 128.*

but intended to serve as a basis for regulatory disciplinary action.[36] Second, where an administrative body such as the OSFS is legally empowered to decide complaints relating to the rights and obligations of others, the body ought to be regarded as a tribunal established by law under section 36(1) of the CFRN 1999. Implicitly, the body should be able to set up an administrative tribunal that would adjudicate both civil and criminal cases that fall within its remit and subject to the right of the parties to appeal to higher courts or tribunals.[37]

6.4.4 Market Conduct Risk Management Framework

The Global Financial Crisis of 2007-08 and the Nigerian financial crisis of 2008-09 have among several things shown that without effective regulatory monitoring, there are no limits to the extent to which financial intermediaries can go in pursuit of value. Where regulatory monitoring is deficient, the crises again show that financial intermediaries may not implement in-house framework to monitor the conduct of their officials in relation to market integrity violation. This is arguably more so, given the involvement of senior management officials in some of the malpractices, particularly in the cases of Intercontinental Bank Plc. and Union Bank Plc. For these reasons, it is argued that an agenda to reform financial regulation as here canvassed for Nigeria should, for the purposes of thoroughness, include a proposal to reform internal self-monitoring processes within financial intermediaries. Research interviews conducted in this regard shows that Nigerian financial

[36] See for support: B. Nwabueze, *Military Rule and Constitutional Law* (Ibadan: Spectrum Law Publishing, 1992) 86.

[37] See for support: C. Okonkwo, *Discipline, Nigeria University and the Law* (Lagos: Nigeria Institute of Advanced Legal Studies, 1996) 38 – 9.

intermediaries have yet to embrace the practice of market conduct risk-mapping,[38] and monitoring of their internal market conduct risk appetite.[39]

Going forward, the proposed OSFS should work with financial intermediaries to articulate and map their market conduct risk appetite in a manner that serves as an internal disciplinary framework to check market integrity malpractices. To achieve this, a financial intermediary should be made to follow three steps: (a) develop its peculiar conduct risk appetite; (b) communicate and monitor; and (c) update it regularly. In terms of developing a conduct risk appetite, the Management and Board of Directors a financial intermediary should, in line with the guidance from the OSFS, decide which conduct aligns with the regulatory obligations and expectations, and which presents the least threat to reputation, solvency and profitability, assuming *arguendo* that these are the three key areas in business planning. The conduct risk appetite document together with the strategies for its implementation should be submitted to the OSFS.

Having developed or mapped its conduct risk appetite, an intermediary should devise an effective framework to communicate it. It should first create an overall risk appetite statement that is

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38 Market conduct risk-mapping is a technique to identify, evaluate and prioritize a group of business risks, which could significantly impact an organization's ability to accomplish its business objectives. It is an iterative process that refines management's understanding of the exposures it faces and measures the effectiveness of the strategies used to control risk. Risk mapping can range from a simple exercise to a highly structured and intensive approach such as Enterprise Risk Management (ERM). See generally, L. Rittenberg and F. Martens, *Enterprise Risk Management: Understanding and Communicating Risk Appetite,* (Durham, North Carolina: Committee of Sponsoring Organisations of the Treadway Commission, 2012) 1 – 3.

39 Market conduct risk appetite is the amount of risk, on a broad level, a financial intermediary is willing to accept in pursuit of value. This might be in terms of estimation of the likely reputational cost and penalties resulting from violating financial regulations, or in terms of the likely threats to solvency and profitability, that malpractices within the financial intermediary might induce.

broad and descriptive enough for organisational units to manage their risks consistently within it. In should next communicate the conduct risk appetite for each major class of organisational objectives including for different categories of conduct risks i.e. loss of custom, regulatory penalties, reputational damage, loss of profits, and (or) insolvency.

Once the risk appetite is communicated, the Management with Board of Directors support needs to revisit and reinforce it. Risk appetite cannot be set once and then left alone. Rather, it should be reviewed in relation to how the organisation operates, especially if the business model changes. The OSFS should work with the management of each financial intermediary to monitor internal operations and activities within the intermediary for consistency with the risk appetite, through a combination of unscheduled on-site monitoring and placement of OSFS resident compliance officers in those intermediaries adjudged to have lax internal monitoring processes. Internal regulatory audit can and should support in this monitoring and this should focus on creating a business culture that is risk-aware and which pursues organisational goals consistently with regulatory obligations and expectations.

In the next section, we shall consider the normative strategies for an effective financial market competition regulation under the objectives-based approach.

6.5 FINANCIAL MARKET COMPETITION

Financial market competition regulation, as pointed out in chapter 2, prevents business practices that are harmful to market development and limit the choices available to users of financial services. This section articulates how financial market competition objective can be effectively implemented under the proposed objectives-based financial regulation.

The objectives-based approach argues for a coherent, consistent, and dynamic financial services competition promotion principles. Coherence speaks to the formulation of regulatory principles that are connected in a logically comprehensible way. Consistency means that the principles are implemented uniformly and predictably across the functional divide of the financial system; and dynamic, in that the principles are structured to accommodate, respond to and shape market practices which have implications for competition. To achieve this framework, four regulatory strategies are proposed, namely: (a) a market centered approach to competition regulation; (b) the alignment of competition regulation with market integrity regulation; (c) a dynamic and analytical approach to competition; and (d) imposition of sanctions for ant-competitive practices.

6.5.1 A Market Centered Approach to Competition Regulation

This approach relies more on market dynamics to determine the financial institutions that ought to be allowed to operate in the market. We noted in chapter 5 that ultimately the focus of financial regulation is not to prevent the failure of a non-performing financial institution any more than it can be said that the focus of criminal law comprises the prevention of criminal wrongs. It is arguable on the contrary and we concede that prevention of failure of a non-performing financial institution is a plausible objective of financial regulation. All the same, we reason that one area in which a market centered competition regulation should apply on the objectives-based approach relates to how competition in the provision of financial services is regulated in Nigeria. Heavy reliance, as shown in chapter 2 on minimum capital based competition regulation, merely serves to keep non-performing (in terms of uncompetitive) financial institutions and intermediaries in existence, as long as they are able to meet minimum capital requirements.

Illustratively, the result of CBN's regulatory intervention in 2009 showed that two banks (Unity Bank Plc. and Wema Bank Plc.) that met the minimum capital requirement of 2005 (N25 billion) were found not to be performing competitively relative to their peers. In the case of Unity Bank, its finances were found to be weak and it had not published audited accounts in at least two years.[40] But the regulators allowed the banks to continue in business. The two banks were not shown to be serving any veritable niche markets, other than for the parochial reason that the two of the country's largest ethnic groups own them.[41] Going forward, it is suggested that the *first principle* of financial services competition regulation should be that the market and business performance determine which financial intermediary continues in business.

A caveat should be appended to the use of market and business performance in the competition regulation. The suggestion

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[40] S. Apati, *The Nigerian Banking Sector Reforms: Power and Politics* (Basingstoke: Palgrave Macmillan, 2012) 125.

[41] *ibid.*

is not for the survival of the most ruthless and reckless in a desperate 'race to the bottom' among financial intermediaries. Rather, it means that a financial intermediary that is soundly managed and with consistent profitable performance to show it ought to be regarded as competitive. This of course will require a rigorous enforcement of accuracy of the returns that intermediaries submit to regulators. For financial intermediaries that do not display this quality, regulatory effort should be directed them to exit the financial market in a minimally disruptive way if it is impossible to run them profitably.

This approach also means that market regulation for competition purposes should prevent monopolistic competition in the provision of financial services from squeezing out the small players who cater for retail investors, small savers, petty traders and tradesmen. This makes a case for the continued existence of community banks, micro finance institutions and small stockbrokers who often provide the services required by this category of users of financial services. Competition regulation in the financial system should therefore be nuanced, in the sense of recognising and preserving the several niches there are in the market. If, for instance, the pattern of investment in the stock market shows that small brokers are more successful in encouraging retail investors to buy shares, than the big and established stock broking firms, this category of brokers should not be regulated out of the market by for instance increasingly high regulatory capital and over stringent regulatory standards.[42] Nor should the big firms 'muscle' them out

[42] See for instance the current controversy on the implications of the new minimum capital requirements for capital market operators recently introduced by the SEC as reported in Nigerian newspapers: I. Nwachukwu, 'Minimum Capital Requirements for Market

by business practices, which unfairly raise the cost of business for the small brokers.

6.5.2 Align Competition with Market Integrity Regulation

The suggestion above that competition should not be a ruthless and reckless race to the bottom means that to be effective, competition regulation should also be aligned with market integrity regulation. On this approach, the institution that regulates market integrity (the OSFS) should also regulate financial services competition.

The approach can be criticised in terms of the possibility that assigning the implementation of two regulatory objectives to one agency may lead to more attention being focused on one objective to the possible neglect of the other, as was the case under the defunct FSA in the UK, in which more attention was focused on conduct of business to the neglect of prudential regulation.[43] But this criticism overlooks the fact that competition and market integrity objectives are arguably closer in terms of the skill sets (mostly legal, monitoring and enforcement skills) required for their implementation, than conduct of business and prudential regulation. Prudential regulation requires a combination of accounting, econometric and financial analytical skills. There is therefore an arguable case for assigning market integrity and prudential regulation to separate agencies as effected under the post GFC financial regulatory reforms in the UK. By parity of reasoning, there is also an arguable case for assigning complementary objectives such as market integrity and competition regulation to

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Operators…Matters Arising,' *BUSINESSDAY,* 8 August 2014, 1; 'Market Operator Seek Review of SEC's New Capital Requirement,' *LEADERSHIP,* 16 JUNE 2014, 3.

43 M. Taylor, 'The Road From "Twin Peaks" And The Way Back' (2009-2010) vol. 16 *Conn. Inst. L. J.* 61, 71 – 72, 91.

one agency. The present UK approach, in which the FCA regulates conduct of business and competition, supports this argument. [44]

In addition to the obvious synergy of implementing two complementary objectives through one agency, this approach is also cost effective in that it obviates the need for a separate financial competition agency, with its concomitant requirements of staffing and annual budgetary allocation. A further advantage is that authorisation, supervision and examination of the business models operated by financial intermediaries in the context of market integrity regulation, should provide opportunity for the OSFS to build competition considerations into the design of its policies, regulatory interventions and remedies.

6.5.3 Dynamic and Analytical Approach to Competition

In financial services as well as in other areas of the economy, the benefits of effective competition are enhanced efficiency, more innovation and lower prices, which in turn help to provide a broader range of better products and services that meet consumers' needs. But identifying competition issues arguably requires detailed analysis and understanding of the competitive constraints on intermediaries and when intervention is needed. To do this, a dynamic and analytical approach, in the sense of a forward looking and methodical competition surveillance strategies are suggested. These strategies can include but not necessarily limited to: (a) a study of the market power held by intermediaries, with focus on how rivalry is restricted because it is difficult for new organisations to enter the market or to grow rapidly which might be

[44] *Chapter 1, Part 1E*, *Financial Services Act 2012* (UK). See also, FCA, *The FCA's Approach to Advancing Its Objectives* (London: FCA, 2013) 36 – 44.

as result of strategic behaviour of established intermediaries or their reputation; (b) a study of the problems in the flow of information between market participants, with focus on where intermediaries cannot obtain the information they need on consumers, or consumers cannot obtain the information they require on the services available in the market; (c) a study of the reasons why consumers do not switch intermediaries, including whether intermediaries artificially raise the perceived costs and risks of switching, in turn preventing the market from working well; (d) a study of the pattern of consumers' take up of financial products, with focus on why potential consumers or groups of consumer do not buy certain financial products, owing possibly to a lack of consumer awareness or understanding, or because the products are unsuitable or because they are unnecessary, anti-competitive restrictions on the availability of products; and (e) a sustained study of how existing regulatory measures have adverse effects on competition, for example, through making it more difficult for new financial intermediaries to enter and grow.

6.5.4 Punitive Sanctions for Anti-Competitive Practices

To strengthen the effectiveness of the foregoing proposals, and to reform the current arguably weak disciplinary framework for handling a generally acknowledged anti-competitive practice in which financial intermediaries 'de-market' (spread negative market information about) one another, the proposed objectives-based financial regulation advocates the imposition of punitive sanctions in cases where it is established that one or more financial intermediaries have directly or through their officers, sought to undermine their competitors. The sanctions can range from fines, suspension from participating in the capital and (or) money markets, to an official request for the dismissal of the liable officials of an erring financial intermediary.

Sanctions are canvassed because of their potential to deter and stigmatise anti-competitive conducts among intermediaries. For greater effectiveness, the OSFS should have the power to fit sanctions to the gravity of the conduct in *a proportional and ascending scale* from fines to suspension, dismissal and for serious cases. Where it is established that an anti-competitive conduct of a financial intermediary or a group was calculated to exploit or has exploited consumers, the sanctions to be applied should incorporate restitutionary sanctions that are meant to 'claw back' and return to the consumers, the gains from the conduct. The disciplinary approach is recommended not only for anti-competitive conducts but also for violations of market integrity rules.

6.6 CONCLUSION

This chapter has presented the first in the two levels of the reform proposals under the objective-based financial regulatory approach canvassed for Nigeria. It has articulated the normative principles and strategies for a better and more effective implementation of financial system stability, consumer protection, financial market integrity, and financial market competition.

The principles and strategies discussed in this chapter are extensive and far reaching, in terms of their potential to bring substantial and quality change to financial regulation in Nigeria, particularly those strategies dealing with the establishment of three specialist financial regulators; the redefinition of the perimeters of systemic stability; imposition of liability for negligent financial regulation; the use of 'circuit breakers' to halt market meltdown; the use of market conduct risk mapping; and application of behavioural economics to consumer protection. They are extensive, because they address most of the issues we discussed under the anatomy of financial regulatory crisis in Nigeria in Chapters 1 and 2. They are far reaching because they operationalise the theoretical advocacy for a Nigerian objectives-based triple peaks financial regulation in Chapter 3. In so doing, they argue practically for amendments to and (or) repeal of existing laws and the abolition and realignment of the functions performed by SEC and NAICOM and for the CBN to be divested of its financial stability function. Chapter 7 that follows next discusses the normative proposals to deal with the potential pitfalls and paradoxes of the reform strategies and principles canvassed in this chapter. It also articulates complementary strategies to enhance the prospects of the reform proposals canvassed thus far in this thesis.

CHAPTER SEVEN

Pitfalls, Paradoxes and Prospects of Objectives-Based Triple Peaks Financial Regulation in Nigeria

7.1 Introduction

This chapter presents the second level of the reform proposals and strategies comprised in the advocacy for the adoption of an objectives-based triple peaks financial regulation in Nigeria. First, it addresses the potential pitfalls and paradoxes in the reforms, ideas and strategies canvassed thus far in the thesis. Second and to enhance the prospects of the proposed regulatory framework it engages with three arguably universal concerns in financial regulatory reform regardless of whether the context of the reform is an emerging or an advanced market namely: (a) the inherent fragility of the financial system (the perpetually risk prone business operations—asset and liability mismatch—of financial intermediaries, (b) the political economy of financial regulation and a regulatory sine curve under which a period of rigorous regulatory scrutiny after a financial crisis is followed by increasing relaxation of the rules and typically capture of the regulator (or at least to some degree) by the industry and (or) vested interests outside the industry; and (c) the cognitive limitations on the ability of both private gatekeepers (i.e. the financial press) and public regulators to perceive new financial system risks accurately before it is demonstrably too late.[1]

[1] These three concerns have been articulated in different forms by commentators and scholars in the field of financial regulation including but by no means limited to the following leading

The chapter uses two approaches to address the pitfalls, paradoxes and prospects. The first approach mounts counter arguments against some of the key proposals canvassed thus far in the thesis and responds to these arguments. The second approach explores a financial regulatory strategy to enhance the viability of our reform proposals. It does this in terms of a proposal for introduction of a mandatory regulatory capital rule for systemically significant financial institutions in Nigeria, as a complementary and preventive reform strategy to achieve three goals: curb excessive leverage; act as a corporate governance disciplinary regulatory tool; and minimise the need for future public bailouts.

Within the framework of these two approaches, the chapter is organised into five sections. The first section is this introduction. The second section highlights and critiques key proposals in chapter 4 (comparative regulatory lessons from Canada, Malaysia, United Kingdom and United States), chapter 5 (negligence liability as a regulatory accountability tool) and 6 (strategies for implementing an objectives-based triple peaks financial regulation in Nigeria). The third section canvases and defends the use of Irredeemable Convertible Debentures (ICDs)

figures, J. Coffee first in 'Systemic Risk After Dodd-Frank: Contingent Capital and the Need for Regulatory Strategies Beyond Oversight,' (2011) 111 *Colum. L. Rev.* 795, 809 – 24; and again in, 'The Political Economy of Dodd-Frank: Why Financial Reform Tends to be Frustrated and Systemic Risk Perpetuated,' (2012) 97 *Cornell L. Rev.* 1019, 1029 – 36; N. Taleb in *The Black Swan: The Impact of the Highly Improbable,* (London: Penguin Books Limited, 2010) the entire book is devoted to the 'predictive uncertainty' of events in the several areas of human life, including the financial services industry; G. Cooper, *The Origin of Financial Crises: Central Banks, Credit Bubbles and the Efficient Market Fallacy* (Petersfield: Harriman House Ltd, 2008) 91 – 106.

as mandatory financial regulatory capital in Nigeria. The fourth section concludes the chapter.

7.2 Pitfalls and Paradoxes of Nigerian Objectives-Based Triple Peaks Financial Regulatory Structure

This section addresses the pitfalls and paradoxes in some of the reform proposals canvassed in chapters 4, 5 and 6.[2] In three sub-headings below, we shall consider how to resolve the pitfalls and paradoxes which might be induced by: (a) the comparative lessons canvassed in Chapter 4; (b) the use of negligence liability negligence liability as a financial regulatory accountability tool; and (c) the replacement of the functional financial regulators with three objectives-based triple peaks regulators.

7.2.1 The Pitfalls and Paradoxes of Incorporating Comparative Lessons

The discussion under this sub-heading focuses on two major components of the comparative lessons canvassed in chapter 4 namely, the use of leverage cap and capital control. We have chosen to concentrate on these lessons because we consider them to be the most potentially problematic to transplant into the Nigerian regulatory context.

7.2.1.1 From Leverage Cap to Leverage Ratio

Leverage cap as a regulatory tool to curb excessive credit expansion in the Nigerian financial system, is a major component of the comparative lessons canvassed in chapter 4. This as we

2 The researcher conceives pitfalls as those implementation difficulties, which could that are likely to be induced either because some or all of the reforms canvassed in the thesis are perceived as revolutionary or fundamentally against the received regulatory orthodoxy. Paradoxes are the contradictions in the internal order of the reforms and how they fit into the peculiar circumstances of Nigeria as a capital importing emerging market with a less sophisticated and largely banking dominated financial services industry in comparison with advanced and sophisticated markets like Canada, UK and US.

argued in that chapter, worked well in Canada before the GFC because it included off-balance sheet exposures in its definition of assets and limited Canadian banks to a credit risk of only 20% of their Tier 1 Capital and Tier 2 Capital. Post GFC, leverage cap has moved beyond a Canadian solution and it is now in a modified sense conceived as an international financial regulatory best practice rule: *leverage ratio*. Basel III, the post GFC capital adequacy rules which the BCBS proposes for the regulation of banks, stipulates that leverage ratio shall be calculated by dividing a bank's Tier 1 (majorly its common equity) capital by the bank's average total consolidated assets (not risk weighted) or put differently, a bank's capital measure (the numerator) divided by the exposure measure (the denominator).[3] Banks are expected to maintain a leverage ratio in excess of 3% under the new capital adequacy rules.

In simple terms, leverage ratio is an indicator of how much a bank has lent out compared to the amount of money it has in reserve, its capital. This means that (using the 3% benchmark) for every ₦33.33 lent, banks should hold ₦1 in reserve in case the borrower defaults on the loan. The CBN adopted this tool from 2013 but with a 2% increase over the 3% proposed in Basel III. In the *Regulatory and Supervisory Framework for the Operations of a Mortgage Re-Finance Company* (MRC) introduced in 2013 a

3 BCBS, *Basel III: A Global Regulatory Framework for more Resilient Banks and Banking Systems* (Basel: Bank for International Settlements, December 2010) 12, 61 – 3; —, *Basel III Leverage Ratio and Disclosure Requirements,* (Basel: Bank for International Settlements, January 2014) 1.

bank or primary mortgage finance institution which operates as a mortgage Re-finance Company shall maintain at all times a leverage ratio not less than 5%.[4] The same ratio applies to Development Finance Institutions (DFIs).[5] Given that mortgage financing is area in which credit risk can build up in the financial system, the introduction of leverage ratio is commendable. Whether the same argument justifies the application of similar percentage of ratio to DFIs is questionable because the transactions (mostly infrastructures) they finance if soundly structured ought to be less susceptible to repayment issues induced by market volatility or interest rate movement.

At any rate and not to lose sight of our central point, we can assume on the basis of the general regulatory enthusiasm that followed the inclusion of leverage ratio in Basel III that it is, at least in principle, seen as a better improvement on leverage cap (but to be clear we are not saying that leverage cap and leverage ratio are the same thing). Leverage ratio theoretically enables investors, depositors, regulators and even politicians to compare banks' relative positions and prevent over exposure. Properly implemented, everyone will be able to see how prepared their bank is and guard against future bailouts. Improperly implemented, it can have a *paradoxical impact*. This is because as a tool that monitors banks against the total capital they hold

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4 CBN, *Regulatory and Supervisory Framework for the Operations of a Mortgage Re-Finance Company* (Abuja: CBN, March 2013) 19;

5 CBN, *Regulatory and Supervisory Framework for Development Finance Institutions* (Abuja: CBN, May 2014) 15.

irrespective of risk; it is a blunt tool. As a blunt tool it does not differentiate between risky and safe lending. This potentially distorts the incentive structure that promotes lending and economic activity. A typical Nigerian bank for instance, would have to hold back the same amount of capital for a risky business loan on a safe mortgage. It could therefore be incentivised to chase the higher risk and higher return businesses instead of giving customers with good credit histories affordable mortgages. Not only will the cost of mortgages increase for customers, it is the very scenario that the use of leverage ratio aims to counteract.

Leverage ratio can work well as leverage cap did in Canada if it is implemented as a fall back measure. If the risk modelling that goes into weighting banks' risk is deficient, we can still be confident that they have enough capital in reserve to withstand any shocks. But it is important that risk weighting remains the primary constraining factor on the banks' abilities to lend in Nigeria. Two suggested solutions to the paradox of leverage ratio as a financial regulatory tool (under the existing framework in Nigeria and the proposed objectives-based approach) should be to require banks to hold more capital against riskier loans; and to disclose all off-balance sheet exposures for thorough risk weighting, as was the approach with the use of leverage cap in Canada.

7.2.1.2 Capital Control

The use of capital controls to regulate the capital outflows and inflows as a comparative lesson from Malaysia is admittedly a paradoxical proposal. This is because Nigeria is a capital importing country that ought not to implement a regulatory measure that would discourage foreign investments. How therefore should capital controls be used to protect the surge and flight of foreign capital from inducing financial systemic meltdown in Nigeria without discouraging genuine foreign investments?

Broadly, capital controls can be either restraints on foreign exchange transactions or on capital account transactions and, if the latter, they can be placed on capital inflows or outflows. These restraints may in turn take the form of taxes or quantitative restrictions.[6] With the knowledge of the use of capital controls in China,[7] Chile[8] and Malaysia,[9] and in addition to the proposal for

6 R. Buckley and D. Arner, *From Crisis to Crisis: The Global Financial System and Regulatory Failure* (Alpena an den Rijn: Kluwer Law International, 2011) 213.

7 China introduced capital controls in the aftermath of the Asian crisis of 1997-8 to maintain the value of its currency as the increase in the competitiveness of its exports in the wake of devaluation would have devastated other teetering economies in the region: Buckley and Arner (n 6) 212 – 13.

8 Chile introduced its capital controls in 1991 modified them twice during the decade, and suspended them in 1998, because downturn in international capital flows obviated the need for controls. Two key highlights of the controls were that all portfolio flows including foreign loans and bond issues were subject to the requirement that an amount equal to a set proportion of the flow had to be put on interest-free deposit with the central bank for one year irrespective of the duration of the capital inflow; and share issuance by local companies was limited to companies with relatively high credit ratings and in a minimum amount of at least $10 million USD, while bonds issued abroad by local companies had to have an average minimum maturity of four years: *ibid*, 214 – 5.

9 Malaysia is best known for its outflow controls implemented on 1 September 1998 near the end of Asian crisis of 1997-8, which controls included restriction of trading in Malaysian stocks to

episodic capital controls in chapter 4 and reiterated in Chapter 5, this thesis contends that if properly calibrated with macroeconomic and macro-prudential measures, capital controls can give Nigeria a real measure of traction over its financial systems to reduce the possibility of cross-border transmission of financial 'boom and bust cycles.'

In terms of macroeconomic measures, our economic policy makers should ask whether the exchange at a given point in time is undervalued and should be allowed to float upwards as a first step. If not, they can work on accumulating the country's foreign reserves provided that doing so is adjudged to be desirable. If not and if there is an inflationary concern, they could sterilise interventions in the foreign exchange market.[10] If inflation were under control, another option would be to cut interest rates. As there are limits beyond which it might be less attractive to keep buying foreign currency, fiscal tightening may thus be an option to attenuate the external stimulus. If finally fiscal tightening has limited effect then capital controls can be used to deal with the situation.[11]

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the Malaysian Stock Exchange, foreign exchange controls prohibiting unofficial trading and import and export of the ringgit and punitive taxes if capital was withdrawn from the country under one year: ibid, 215 – 6.

10 M. Garcia, 'Can Sterilised FX Purchases under Inflation Targeting Be Expansionary,' (2011) cited in O. Canuto and M. Cavallari, 'Monetary Policy and Macro-prudential Regulation,' (2013) *Policy Research Working Paper 6310,* The World Bank Poverty Reduction and Economic Management Network, 18 (Garcia's work shows how sterilized interventions by the central bank in an inflation targeting regime tend to have an expansionary effect on aggregate demand).

11 For more on how macroeconomic measures can be used together capital controls, see Canuto and Cavallari (n 10) 17 – 20.

In parallel, if capital inflows cause prudential concerns, macro-prudential toolkits may be more efficient and should be used before capital controls. Illustratively, if the source of the concern is excessive borrowing from abroad by Nigerian banks or the impact of such borrowing on domestic credit growth, a regulatory stipulation that this borrowing should be on a long term developmental terms is arguably less counter-productive than taxing all foreign sources of funding. If the concern is about surge in short term speculative inflows, it should be considered first whether it would be less counter-productive to create a separate market entry point for foreign portfolio investments with higher capital requirements for intermediaries who mediate such investments. The second step could be to impose high capital gain tax if the surge turns to flight capital. In either scenario and in whatever form capital inflows might cause concern in Nigeria, it is suggested that controls should be last resort measure and as part of a package of policies whose target is financial stability and not as blunt instruments of 'economic nationalism.'

7.2.2 Quantum Issues in Liability for Negligent Supervision

The proposal in chapter 5 for the imposition of liability for negligent financial supervision and (or) regulation surely brooks formidable opposition not least because it is far from the regulatory norm. Arguably more serious than this normative issue is the likely debilitating effect of the quantum of damages that might be imposed on a regulator. It is arguable that the magnitude of damages could be such that might threaten the economic viability of the regulator. Where, as often is the case, the State underwrites the regulator's liability through a guarantee or indemnity this might also have significant liability implication for taxpayers. This quantum issue therefore demands closer discussion.

There are arguably two ways in which we can address this issue. The first is through an empirical research to obtain data on what the financial consequences of this liability could be and use that data to evaluate the acceptability of the proposal. The second is to explore strategies to meet the quantum of damages, regardless of its magnitude and to provide a permanent liability safety net for regulators.

The first approach is arguably more theoretically convincing because it can yield empirically objective criteria with which we can test the quantum implications of a liability regime for negligent financial supervision. All the same, we respectfully argue that this approach would be impractical because it faces *four uncertainties.* First, damages in an action for financial supervisory negligence are most likely to be quantified by reference to the amount of the claimants' lost deposits or investments with interest where applicable calculated at rates contracted for.[12] Given this likelihood how can we accurately aggregate the entire deposits and investments in the

[12] This proposition is supported by Lord Kinkel's adoption of the case formulated by the plaintiffs in *Yuen Kun Yeu v A.G. of Hong Kong* (1998) 1 AC 175 at 187.

financial system and assume that the resulting figure will constitute the claim in a notional liability case against the regulator(s)? Second, and closely allied to the first, is the fact that not all present depositors and (or) investors will maintain deposits or have investments when the cause of action accrues. If this is so at least theoretically, how can we ascertain that percentage of the total deposits and investments that would constitute a negligent liability claim(s) *ex post* supervisory failure? The third uncertainty is that since the final quantum of damages in negligent litigation depends on several factors including particularly the court's assessment of the claimants' entitlement, contributory negligence and loss mitigating circumstances; how do we accurately deduct all of these including particularly loss mitigating pay-outs and recovery (i.e. from the deposit insurance fund, investor protection fund and hedging) from the value of potential recovery? Related to the third uncertainty is the fourth uncertainty on how do we putatively apportion damages for the purposes of joint and (or) several liabilities of two or more regulators. Accordingly it is strongly and respectfully submitted that the four uncertainties discussed above doom the empirical approach to *accuracy and validity attack* from the onset. Even so and arguably, an actuary may be able to calculate and quantify the impact of these uncertainties. However, this valuation and its methodology would require an approach that is outside the scope of the methodology chosen for this thesis. We therefore suggest that this should be a follow up empirical study to this research.

Under the second (exploring strategies) approach, a strategy and one which arguably provides a viable *ex ante* solution to the risk of regulators' insolvency in the Nigerian context is the creation of a permanent liability fund to defray the quantum of recovery against financial regulators for negligent supervision long before the recovery arises. This fund it is suggested can be termed Regulatory Liability Fund (RLF). In terms of how much should be in the RLF. This can be pegged to the total regulatory capital of financial intermediaries in the financial system calculated in the interval of at least five years to accommodate changes in the number of these financial intermediaries. It can also be pegged to the total number of deposits and investments in the financial system divided by the number of financial intermediaries and calculated in the interval of five years to accommodate changes in deposits, investments and the number of financial intermediaries. Either approach would enable a dynamic RLF. Finance for the RLF should come from three main sources. First, financial intermediaries should finance the fund through annual levies calculated as a percentage of their total credit risk assets and payable regardless of their financial state. This is suggested on the theory that malpractice(s) on the part of financial intermediaries would be the secondary cause of losses to depositors and investors and the culpable intermediary might be insolvent at the time when regulators are held liable. Also if levies are payable on the financial state of intermediaries, this could encourage them to use the excuse of poor financial state to avoid payment. Second, a stipulated percentage of the annual income of financial regulators should be paid into the fund. This payment is pursuant to a theoretical recognition of the financial regulators' primary liability on the ground of supervisory failure. For reasons of fairness regulators too should pay regardless of whether they declare surplus income. Third, the Federal Government should contribute a sum calculated as a percentage of the combined payments by intermediaries and regulators. This payment is pursuant to a theoretical recognition of the Government's failure to exercise its oversight powers over regulators. A part of the fund could be invested to increase yield. In the unlikely event that the fund is inadequate to totally defray the quantum of recovery against regulators, at a given time, the claimants can be paid with a *financial regulatory liability bonds* issued by the government and secured with future payments into the RLF. This payment strategy arguably obviates the need for a sudden and huge cash call obligation on the Federal Government to top up the RLF or underwrite the damages payable by the regulators.[13]

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13 The Resolution Cost Fund (RCF) that was meant to defray the cost of resolving insolvent banks in Nigeria after the crisis of 2008 – 09, provides support for this proposal. The RCF is financed through levies payable by banks starting at the end of 2011, with the CBN providing annual contribution of ₦50 billion as a public sector contribution. The banks' levies are a flat premium of 30 basis points of total assets. The total amount of funding is capped at ₦1.5 trillion (₦500

It can be questioned why similar funds should be not established in other areas of State's regulatory intervention (e.g. in education, health and energy sectors) where there might be regulatory failure. This we argue is a policy decision and it is open to the State to decide whether or not to establish liability funds in other areas or even a central liability fund to cover all its potential liability exposures.

7.2.3 From Functional to Objectives-based Triple Peaks Regulators

In the light of the regulatory issues and the reform approaches discussed in Chapter 2, the proposal in Chapters 3 and 6 for the establishment of three objectives-based financial regulators potentially faces three pitfalls. First, does the establishment of the FSSA, CFPA and OSFS effectively address inter-agency coordination under functional regulation or 'mere re-arrangement of the chairs on the deck of the Titanic?' Second, would the FSSA, CFPA and OSFS be necessarily more amenable to governmental oversight than CBN, SEC and NAICOM? Third, are the proposed regulators intrinsically impervious to capture by vested interests within the financial system and the larger Nigerian society? We shall in the three subsections that follow below explore complementary strategies to address the three pitfalls.

billion for the CBN and ₦1 trillion for the banks). See IMF, *Nigeria: Financial Sector Stability Assessment* (Washington D.C.: IMF, May 2013) 32 – 3.

7.2.3.1 Inter-agency Coordination

To address inter-agency coordination it is suggested that three rules should be included in the enabling law(s) for FSSA, CFPA and OSFS. The first rule should compel the three regulators to collaborate in the discharge of their respective regulatory duties. The second rule should stipulate that the regulators have joint and several statutory duties to prevent supervisory failure. The third rule should stipulate that each regulator is liable for supervisory failure that occurs within its remit.

7.2.3.2 Oversight Through Democratic Accountability

A central argument in financial regulation is that regulators should be independent statutorily and operationally.[14] The rationale for this argument is that if financial regulators are subject to political forces, politicians will manipulate monetary policy for their short-run advantage at a long-run cost.[15] But the independent Central Bank of Nigeria did not perform particularly well to prevent the crisis of 2008 – 09 and it has thus far not accounted for its performance before the crisis. This arguably suggests that independence is not a guarantee that the regulator will perform and be accountable for its conduct. To enhance the accountability of the FSSA, OSFS and CFPA and to complement the use of judicial accountability canvassed in chapter 5 it is suggested that the regulators should be made *democratically*

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[14] Basel Committee on Banking Supervision, *Core Principles for Effective Banking Supervision, Principle 2* (Basel: Bank for International Settlements, September 2012) 10, 22 – 24.

[15] J. Stiglitz, *The Price of Inequality* (London: Penguin Books, 2013) 311 – 2.

accountable through regular performance audit by a regulatory oversight committee composed of representatives of the Ministry of Finance, the National Assembly and interests groups in the financial system. The committee's report should always be published and should at least form the basis of budgetary allocation to each regulatory agency and where necessary for disciplinary action and overhaul of the governance of a regulator which performs consistently below the threshold the committee establishes for effective regulation.

To address the concern on whether the foregoing will not merely create an additional layer of bureaucracy to be paid for by taxpayers, it is suggested that committee members should be persons who hold governmental or private sector appointments. They should only be paid for out pocket expenses incurred in the performance of their work.

Properly used, democratic accountability can provide a mechanism to detect negligent regulatory conduct early and demand remedial actions before the conduct can create vulnerabilities for a systemic crisis. It also remedies the situation after the crisis of 2008 – 09 discussed in Chapter 5 in which senior officials of the CBN and SEC conducted themselves in disregard of the oversight powers of the National Assembly.[16]

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[16] Instances of this disregard are aptly documented in the *Report of Ad-hoc Committee on Investigations into the Near Collapse of Nigerian Capital Market* (Abuja: National Assembly, Resolution No HR70/2012).

Finally, democratic accountability can engender *high quality* financial regulation in Nigeria, by ensuring that financial regulatory actions are guided by eight interconnected criteria. The first is that they serve clearly identified policy goals, and are effective in achieving those goals. The second is that they have a sound legal and empirical basis. The third is that they produce benefits that justify costs and take economic, environmental and social effects into account. The fourth is that they minimise costs and market distortions. The fifth is that they promote innovation through market incentives and objectives-based approaches. The sixth is that they are clear, simple and practical for users. The seventh is that are consistent with other regulatory actions and policies. The eight is that they are compatible as far as possible with competition, trade and investment facilitating principles at the domestic and international levels.

7.2.3.3 How Do We Prevent Capture?

The FSSA, CFPA and OSFS might eventually be captured. This could be *regulatory capture* where the officials of three regulatory institutions come from and return to the very financial intermediaries they are supposed to regulate. Their incentives and those of the financial intermediaries would thus be aligned even if their incentives would not be aligned with those of other stakeholders in the financial system including financial consumers and the government.[17] Sustained regulatory capture can in turn lead to *cognitive capture* in which the continuous crossover of officials of regulated intermediaries to the three regulatory institutions could lead the latter to espouse and adopt policies that reflect the collective mindset of the former. It can also be *direct capture,* such as, when financial intermediaries lobby politicians to get their favoured candidates appointed into key positions within the three regulatory institutions. Lastly but by no means the least, it could be *pecuniary capture* where officials of the FSSA, CFPA and OSFS are induced materially to favour interests within or without the financial system.

To reduce the risks and cost of capture and more to address the political economy of the reforms proposed thus far, four strategies are canvassed namely: (i) non-recruitment of financial intermediaries' officials into regulatory institutions; (ii) availability of quality regulatory information; (iii) transparency and openness; and (iv) robust civil and criminal deterrence of regulatory perversion. We shall discuss each of these strategies as respective antidotes to the four types of capture highlighted above.

i. Recruitment of Regulatory Officials

[17] This mirrors the classic definition of capture as 'the control of the regulatory process by those whom it is supposed to regulate or by a narrow subset of those affected by regulation,' by W. Mattli and N. Woods, 'In Whose Benefit?: Explaining Regulatory Change in Global Regulation,' in W. Mattli and N. Woods (eds), *The Politics of Global Regulation* (Princeton: Princeton University Press, 2009) 13.

To address the risk of regulatory capture persons who are working, have worked or affiliated with the financial sector should, as a rigorously enforced policy, not be recruited into the FSSA, CFPA and OSFS. Even if the three regulators are independent statutorily and operationally and are democratically accountable, as long as they are staffed or headed by the persons affiliated with financial intermediaries, there is a risk that they would make decisions that represent the beliefs and interests of the financial sector which decisions may not reflect what is best for the economy, financial consumers and the tax payers. Indeed, several countries do not allow those from the financial sector to crossover to financial regulatory institutions. They arguably see it as an obvious conflict of interest. The search for regulatory officials should focus on experts outside the financial sector as those in the sector are more attuned to making financial deals and are not experts in the complexities of macroeconomic interdependencies.

ii. Availability of Quality Information

Addressing the risk of cognitive capture requires first that regulatory capture be addressed in the manner canvassed above. If regulatory officials are not recruited from the financial sector, the chances of the regulatory policies reflecting the collective mindset of the financial sector can be managed. To further ensure that regulatory actions and policies reflect the interests of all stakeholders in the financial system the regulators should as matter of statutory duty make quality information on the cost and benefits of their actions and policies available to the public. Information that reveals the cognitive capture to the society may generate a demand from the wider public for remedial regulation or a change of policy and (or) reversal of regulatory action(s) where possible. The information should be accessible and timely to have a chance of motivating a large and sustained segment of the pubic to ask for change. This is because inaccessible information either because it is written in a technical language or can only be accessed through a complicated bureaucratic process means that only a small circle of experts can assess the level of cognitive capture in the work of regulators.

iii. Transparent and Open Appointment Process

Direct capture of regulatory institutions by controlling the choice of their senior officials arguably poses one of the most serious challenges to the implementation of the reforms canvassed thus far in the thesis. This, as we argued in Chapter 1, is because ascriptive considerations (such as, the religion, ethnicity, political leaning and social affiliations) much more than merit, mostly determine the choice of who heads the regulatory institutions. Dealing with direct capture of regulatory institutions requires that this scenario be recognised and confronted. Ordinarily a legal approach in terms of adhering to clear statutory criteria on who can head the financial regulatory institutions should suffice. For the existing regulatory institutions, such as, the CBN, SEC, NAICOM and NDIC, these criteria already exist in their enabling laws and can be adapted where suitable for the FSSA, CFPA and OSFS.[18]

What does not exist and on which we shall focus attention is how transparency and openness can prevent direct capture of the FSSA, CFPA and OSFS. Transparency and openness in the selection of senior officials of financial regulatory institutions do not presently exist. This is because anecdotal evidence generally speaks to the generally acknowledged secretiveness behind the selection of senior officials of the CBN, SEC, NAICOM and NDIC. Our main argument therefore is that the selection of senior officials of the three proposed regulatory institutions should be done transparently and openly. Transparency in this context requires that all qualified and capable candidates excluding those from the financial sector should be invited or allowed to apply and be subjected to rigorous screening guided by three considerations namely: *character, academic qualification and professional competence*.

The selection screening should be conducted by a *mixed ad hoc committee* that comprises of representatives of all stakeholders in the financial system including the labour organisations in the financial sector and at least three leading academic experts, each in economics, banking, and financial regulation. The predicate cause for this suggestion is to enable

[18] Reference the relevant provisions of the *CBN Act, ISA, NAICOM Act* and *NDIC Act.*

all those who have interest in better financial regulation in Nigeria to exercise a delegated influence on the choice of who heads regulatory institutions.

Specifically and in relation to openness, it should be possible for the committee to head hunt suitable non-Nigerian candidates as was done recently in the UK, with the appointment of Mr. Mark Carney as the Governor of the Bank of England, from his former position as Governor of the Bank of Canada.[19] Openness also requires that ultimately, public opinion should count and be considered in the choice of who heads each of the three regulatory institutions canvassed in the thesis. An unpopular candidate by public opinion may not necessarily be professionally incompetent or unsuitable for the role. The unpopularity could speak to the candidate's character flaw. It may thus be best to prevent potentially corrupt candidates from heading the proposed financial regulatory institutions than to let them do so and thus be in a position to exhibit their corrupt inclinations.

Overall, transparency and openness in the selection of regulatory officials will create fewer opportunities for direct capture because the public is more readily able to determine whether interest groups are interfering in the choice of who heads

[19] Of course this appointment is not totally free of capture insinuations as Mr. Carney had worked for thirteen years at Goldman Sachs and a considerable part of that time was at the London office of the bank: On Mr. Carney's career history see generally his Wikipedia profile available online at: <http://en.wikipedia.org/wiki/Mark_Carney accessed on 4 November 2014> accessed on 13 December 2014.

the regulatory institutions. Secretiveness and exclusiveness in the selection process may create opportunities for interest group interference without the public being aware. Transparency and openness could also *democratise* the selection and screening of regulatory officials in terms of strengthen the participation of all stakeholders in the financial sector in the selection process.

iv. Robust Civil and Criminal Enforcement

To induce regulatory officials with pecuniary rewards to secure regulatory favours as a form of capture, manacles the conscience of induced officials and perverts the regulatory process. It is a perversion because it distorts the sanctity of the regulatory process and skews it inequitably against those who are either unaware of such favours or even when they are aware, who do not have sufficient means to secure such favours. The distortion creates an asymmetry of advantage among financial intermediaries (rich and well-connected intermediaries being able to buy their way through the regulatory process) that could be used to suppress malpractices by financial intermediaries.

A requisite precondition for preventing pecuniary capture is for regulatory officials to be provided with resources proportionate to the regulatory task allotted to them. Linked to this and considering their sensitive and strategic role in the financial system, they ought to be remunerated above the average pay of their counterparts in regulated financial institutions to address the possibility of occupational inferiority and the temptation to demand or accept inducements. Arguably, it is after the resources and remuneration issues are addressed that we can credibly deploy the two strategies we propose to address pecuniary capture, namely civil ‘whistleblowing’ actions and robust criminal prosecution of financial regulatory perversion.

‘Whistleblowing’ actions require an enabling statutory framework that allows and protects ‘whistleblowers’ within and without the FSSA, CFPA and OSFS to expose pecuniary capture to the mass media for public knowledge. The opprobrium from the exposure could compel remedial actions by the affected regulatory institution. Where a whistleblower reasonably perceives that a regulatory official has been materially induced for the purposes of capture, the statutory framework should allow the whistleblower to file a civil claim against those he suspects to have partaken in the capture. The claim should be compensated by a percentage of the disgorged inducement received by the regulatory official. The United States *False Claim Act,* which allows *qui tam* claims to be brought by a relator who has information about fraud against governmental programmes is a precedent for the statutory strategy.[20]

The second strategy requires a robust criminal prosecution of financial regulatory perversion. This should be in terms of a

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[20] A *qui tam* claim is derived from the law Latin *qui tam pro domino rege quam pro se ipso in hac parte sequitur,* which means he who brings a case on behalf of our lord the King and for himself. The United States *False Claims Act 1863* (31 U.S. Code §§ 3729 - 3733) allows persons who are not affiliated with the government, called ‘relators’ under the law to file actions on behalf of the government (informally called whistleblowing especially when the relator is not employed by the organisation accused in the suit). Persons filing under the Act stand to receive a portion (usually about 15–25 percent) of any recovered damages.

strong political will by government and support for the EFCC and the ICPC to investigate and prosecute suspected regulatory officials no matter how highly placed. Specifically, robust prosecution of perversion of the financial regulatory process is demonstrated more by *certainty of swift and thorough enforcement* than by the *severity of the penal sanctions* that follow a protracted or poorly conducted prosecution. This means that every potential offender should be have no doubt that if caught, he will be prosecuted surely, expeditiously and with due process. An awareness of this eventuality among regulatory officials, employees of financial intermediaries and users of financial services could gradually deter collusive perversion of the regulatory process. With such gradual deterrence there is a viable scope for the return of public confidence in the sanctity of the financial regulatory process.

Even so and notably, criminal prosecutions should not be disconnected from the civil *qui tam* claims canvassed above. A disconnect could create a muddled enforcement regime in which both civil and criminal proceedings are instituted simultaneously on similar facts and evidence. It can also encourage 'litigation lottery' in which frivolous, vexatious and parasitic civil claims are filed mainly for material gains and on the basis of evidence disclosed in the course of a criminal trial.

To address the risk of confusion and (or) abuse of judicial process in the use of civil and criminal enforcements, four procedural screening mechanisms are proposed. First, a civil action on similar facts and evidence with criminal prosecution should not be filed after that criminal prosecution has commenced or been concluded, except the claim is meant to redress personal pecuniary loss such as may have been caused by negligent financial supervision. Second as with all civil claims, the claim should be filed within the applicable statutory limitation period. Alternatively, a special rule can be introduced to the effect that a civil claim should be filed within a reasonable time from when the claimant knows the facts of the regulatory perversion. Third, the claimant should file all the evidence he possesses against the defendant(s) at the pre-trial stage for the court to make a preliminary merit finding on whether the claim should proceed to trial or not. Fourth, if the claimant succeeds at the trial stage and the defendant(s) appeals, the relevant appellate court should determine the question of cost and the fact that the claim was successful at the trial stage should be factored into that determination. These four screening mechanisms are suggested for two reasons: to prevent unmeritorious *qui tam* claims and to prevent a successful *qui tam* claim from being frustrated by the cost of appellate litigation.

In the next section we shall canvass a strategy to address the risk that a financial institution's business model and (or) corporate practice could exacerbate the inherent fragility of the financial system and thus induce either the collapse of a financial intermediary or a systemic crisis.

7.3 A STRATEGY FOR ENHANCING THE PROSPECTS OF NIGERIAN OBJECTIVES-BASED FINANCIAL REGULATION

Even if as we have canvassed thus far in this thesis, financial regulatory norms are implemented decisively and robustly; and the regulatory institutions are structured to perform effectively in Nigeria; there remains one difficult challenge: how can post financial crisis regulatory reforms that are often *remedial* (addressing the causalities of that crisis) *prevent* future crises that can be unpredictable? The *problem of prognosis* in terms of how accurately one can predict the nature of future crises casts a shadow of indubitable conjecture on those reforms that are intended to stave off future financial upheavals. This is all the more so, because such upheavals can arrive with a suddenness that outpaces the regulators' cognitive assessments, crises modelling and their capacities to respond effectively before serious damage is done to the financial system and the economy.[21]

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[21] The idea that financial crisis are ultimately inevitable and almost unpreventable sounds pessimistic and antithetical to the preventive outlook of this thesis, but it is a distillation of what financial historians have repeatedly argued. From the classic work of Kindleberger to a more recent work by Reinhart and Rogoff one recurring theme is undeniable: human beings have bounded rationality and will predictably be blindsided by a new crisis. See generally, C. Kindleberger and R. Aliber (Sixth Edition), *Manias, Panics and Crashes: A History of Financial Crises* (Basingstoke: Palgrave Macmillan, 2011); C. Reinhart and K. Rogoff, *This Time is Different: Eight Centuries of Financial Folly: History of Financial Crisis,* Fifth Edition (New York: John Wiley & Sons Inc, 2009).

In Nigeria as well as in most financial systems, therefore, the challenge of how remedial and preventive financial regulation can address the 'historical inevitability' of financial crises is an inescapable point—inescapable because there are always: (a) the inherent fragility of the financial system (the perpetually risk prone business operations—asset and liability mismatch—of financial intermediaries;[22] (b) the political economy of financial regulation and a regulatory sine curve under which a period of rigorous regulatory scrutiny after a financial crisis is followed by increasing relaxation of the rules and typically capture of the regulator (or at least to some degree) by the industry and (or) vested interests outside the industry; and (c) the cognitive limitations on the ability of both private gatekeepers (i.e. the financial press) and public regulators to perceive new financial system risks accurately, before it is demonstrably too late. We reason that an advocacy for financial regulatory reform such as the present effort, should at its closing phase engage with these three concerns to reflect its acknowledgment and preparation for the historical inevitability of financial crisis. A part of this task was accomplished in the preceding section, where we explored strategies for dealing with capture.

This section takes up the reminder of the task. It proposes the adoption of a regulatory capital rule according to which

22 For standard accounts of this mismatch, see generally, C. Calomiris and J. Mason, 'Fundamentals, Panics, and Bank Distress During the Depression,' 93 (2003) *Am. Econ*. Rev. 1615; D. Diamond and P. Dybig, 'Bank Runs, Deposit Insurance and Liquidity,' 91 (1983) *J. Pol. Econ*. 401.

Nigeria's systemically significant financial institutions are compelled to issue *Irredeemable Convertible Debentures* (ICDs) as a strategy to manage financial fragility; augment the potential cognitive limitation of the three proposed financial regulators; and to serve as a *latent corporate governance disciplinary tool* that kicks in as soon as a financial institution's business model and (or) corporate practices exacerbate its fragility in a manner that poses a risk to its solvency and the safety of the financial system.[23]

7.3.1 Irredeemable Convertible Debentures

As proposed, ICDs are debt instruments to be mandatorily issued by Nigerian systemically significant institutions. They are to be irredeemable (cannot be bought back by the issuer) and should convert to equity (preference shares as would be argued) in the issuing institutions on the occurrence of predetermined events to which we can give the shorthand name of 'conversion kickers.' In

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[23] For the inspiration on the ideas and strategies to be proposed in the discussion of ICDs, the researcher drew from and is indebted to earlier pioneer works in this area including the following (though not in order of importance): M. Flannery, 'No Pain, No Gain? Effecting Market Discipline via Reversible Convertible Debentures' in H. Scott (ed.) *Capital Adequacy Beyond Basel: Banking Securities and Insurance* (Oxford: OUP, 2005) 171 – 7; R. McDonald, 'Contingent Capital with a Dual Price Trigger (2010) available online at: http://ssrn.com/abstract=1553430 accessed on 13 October 2013; J. Coffee, 'Systemic Risk After Dodd-Frank: and the Need for Regulatory Strategies Beyond Oversight,' (2011) 111 *Colum. L. Rev. 795, 825 – 34.* The researcher also drew inspiration from the positions of FSB and BCBS notably from, FSB: *Reducing Moral Hazard Posed by Systemically Important Financial Institutions: FSB Recommendations and Timelines 3* (2011) available online at: http://www.financialstabilityboard.org/publications/r_101111a.pdf, accessed on 13 October 2013 (listing 'a quantitative requirement for contingent capital instruments' among recommended measures to improve stability of systemically important financial institutions); Press Release, 'Basel Comm. on Banking Supervision, Group of Governors and Heads of Supervision Announce Higher Global Minimum Capital Standard' (12 Sept. 2010) available online at: http://www.bis.org/press/p100912.pdf, accessed on 13 October 2013 (reporting that the BCBS and FSB are developing a well integrated approach to systemically important financial institutions which could include a combination of capital surcharges, contingent capital and bail-in debt).

principle, the potential for the ICDs to convert to shares and thus dilute the shareholding of the institution could serve as a counterweight to corporate governance excesses and excessive leverage that often precipitate the collapse of most Nigeria financial institutions and the risk of systemic meltdown with the latter risk in turn justifying public bailouts. Arguably and with minimal amendments the provisions of *CAMA* relating to debentures can serve as an enabling statutory framework for this proposal.

Part VII of the *CAMA* regulates the issuance of corporate debentures. It empowers incorporated companies in Nigeria to borrow money, to charge their properties and to issue debentures.[24] Specifically, an incorporated company in Nigeria, can lawfully issue perpetual debentures and a condition contained in any debentures, or in any deed for securing any debentures shall not be invalid by reason only that the debentures are made irredeemable or redeemable only on the happening of a contingency, however remote, or on the expiration of a period, however long, any rule of equity to the contrary notwithstanding.[25] For the purposes of ICDs, it should be stipulated as a matter of financial regulation that a condition that confers a right of redemption on the issuer shall not be included in the debentures or the deed which secures the debentures; and if such condition is included it shall have no effect.

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[24] See *sections 166, 168(e) 169 and 171* of *CAMA.*

[25] *Section 171, CAMA.*

Further, it is the law in Nigeria that debentures may be issued upon the terms that in lieu of redemption or repayment, they may at the option of the holder or the company, be converted into shares in the company upon such terms as may be stated in the debentures.[26] Again as a matter of financial regulation it should be stipulated that in the case of convertible debentures mandatorily issued by a systemically significant financial institution as regulatory capital, such debentures shall be irredeemable by the issuer and convert to preference shares on terms and on the occurrence of events as shall be stipulated in the debentures or the deed which secures the debentures. For the purposes of consistency, this and the previous provision should be reflected in *BOFIA, ISA* and the *Insurance Act.* Consequentially, systemically significant financial institutions should be directed to submit to the CAC, altered Articles of Association (AoA) that empower them to issue ICDs and the CAC should issue them corresponding certificates of incorporation.[27] The reminder of this section discusses how ICDs should operate and how to address potential implementation pitfalls.

7.3.2 Potential Implementation Objections and Pitfalls

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[26] *Section 172, CAMA.*

[27] Under *CAMA,* the Articles of Association (AoA) of an incorporated public company limited by shares may contains regulations dealing inter alia with classes of shares, alteration of capital and voting. The AoA can be amended by a special resolution passed by members of the company. The Certificate of Incorporation (CoI) is issued by the CAC to duly registered companies. For the contents and the statutory significance of AoA and CoI in Nigeria, see generally, *sections 33, 34, 35, 37, 38, 48* and *Part 1, Table A* of the *First Schedule of CAMA.*

We anticipate potential implementation objections and pitfalls to the use of ICDs as canvassed above and would address below four of these potential objections and pitfalls.

7.3.2.1 ***Can ordinary shares avert insolvency better than ICDs?***

It can be objected that if the goal is to avert the insolvency of financial institutions that goal can be achieved by mandating these institutions to issue more ordinary shares rather than ICDs. This is a plausible objection because in theory the unissued part of a financial institutions authourised share capital can be issued to raise more capital so as to avoid insolvency. However and in practical terms this alternative is potentially problematic in that the sale of equity shares by an issuer that the market perceives to be financially distressed would most likely be approached cautiously, if it were approached at all. The issue may thus only be possible at considerable discount which in turn may deter the management from making equity issuances that would be in the interest of the taxpaying public which bears the cost of bailouts.

In any event, avoidance of insolvency is not the sole motivation for the issuance of ICDs and their subsequent conversion to preference shares. Another and a key motivation is to co-opt a set of stakeholders into the financial institution, whose influence can counter corporate governance excesses and shareholders' pressure on management to accept greater risk. Of course in all likelihood and in the absence of a rule to the contrary, the holders of the ICDs and ordinary shares of the issuing financial institution would virtually be identical. Thus a rule should be introduced that precludes existing shareholders from holding the ICDs. This should be preferred to the alternative of bringing in more ordinary shareholders at the twilight of insolvency with the risk these new shareholders could accentuate the pressure on the management in the future when the pall of insolvency may have lifted.

7.3.2.2 *If the Goal is to Empower Creditors, Why not Authourise Creditors to Vote?*

Presently, *CAMA* does not expressly confer the right to vote to elect the board of directors on debenture holders.[28] But of course there is no reason why a contract could not give debenture holders or indeed any creditor the right to nominate a director to any board subject to any required regulatory approval. Even so, the regulatory goal here is at least twofold: to avoid default and insolvency as well as to create a new voting constituency. These twin goals may not be fully realised if we simply give debenture holders contractual rights to elect directors in limited circumstances. Such a voting power might theoretically check corporate excesses, but the prospect of default and a potentially distabilising insolvency remains if the ICDs do not convert into equity. Conversion of ICDs to preference shares can therefore

[28] *Section 176 of CAMA* which enumerates the rights of debenture holders does not provide for this right.

achieve the two regulatory goals. Moreover, limiting the voting rights to the preference shareholders effectively restricts the creditors' voice to times when the financial institution is in financial distress. This minimises the natural conflict between the creditors and shareholders over issues of risk and uses the preference shareholders as a late-stage failsafe device.

7.3.2.3 *Is there a market for ICDs in Nigeria?*

Given the general crisis of confidence that followed the Nigerian capital market crash and banking insolvencies of 2008 – 09 and the relative less sophisticated depth of Nigerian financial market compared to those of advanced economies such as Canada, United States and United Kingdom, one may ask if there is a market for ICDs in Nigeria. However, if we consider the fact that the ICD's investors need not necessarily be Nigerian based; and the fact that the financial sector has consistently topped the list of traded instruments on the NSE before and after the Nigerian financial crisis: the answer of course is that *in principle there is a market for ICDs in Nigeria.*[29] A fortiori, ICDs could offer investors who have shown sustained interest in financial sector equities a more secured and influential stake in this sector. The market can even be widened for *corporate governance disciplinary purposes* by a strongly promoted regulatory policy to encourage 'activist'

[29] This information is from the researcher's perusal of the information on trading on the NSE as published in SEC's *Capital Market Report* from 1st Quarter 2010 – 2nd Quarter 2014. The reports are available online at: <http://www.sec.gov.ng/capital-market-report.html> accessed on 4 November 2014.

groups such as labour and manufacturers' associations to invest in the ICDs.

Even if the market does exist in principle or can be created, one question still remains: would investors not read a financial institution's decision to issue ICDs as a signal that it has private knowledge that it is approaching the 'vicinity of insolvency?' This question can be addressed if the issuing financial institution has little choice because of regulatory requirements. In that case, the decision to issue ICDs would be seen as based on regulatory stipulation.

7.3.2.4 *Could Conversion be called off?*

A financial institution could seek ways to avoid an approaching conversion by negotiating a postponement or even a cancellation. Either of these two could be achieved if the issuer redeems or amends the debentures or if it could conduct a debt tender offer that exchange new nonconvertible debt securities at a premium for the outstanding ICDs.

A scenario such as the foregoing strengthens the case for an incremental conversion approach. If conversion is incremental and the debentures are irredeemable, then the issuer's management would most likely have less reason to seek to redeem, cancel or delay conversion. The enabling regulation should also preclude post issuance amendments or delays. Extrinsic market developments may trigger conversion for non-bank financial institutions, but a dual price trigger that requires an industry (insurance or securities sectors) stock market index to decline relative to the financial sector index as a whole before conversion is triggered could address this problem.

7.4 CONCLUSION

This chapter has presented the second and complementary level of the reform proposals and strategies comprised in the advocacy for the adoption of an objectives-based triple peaks financial regulation in Nigeria. It has addressed the pitfalls, paradoxes and prospects of the proposed financial regulatory framework. It addressed the pitfalls in terms of how leverage ratio; capital controls; liability for negligent financial supervision; and the triple peaks regulatory architecture should be implemented in a nuanced and less counter-productive way that does not induce new regulatory fault lines or constitute insurmountable financial burden for the Nigerian state.

The chapter also contended with the 'historical inevitability' of financial crisis by proposing the adoption of a mandatory capital rule under which systemically significant financial institutions in Nigeria are required to issue Irredeemable Convertible Debentures that convert to preference shares in these institutions. The issuance and conversion of the ICDs is meant to achieve at least three regulatory goals: to serve as latent corporate governance disciplinary tool for the prevention of excessive leverage that could induce the institution’s insolvency and systemic crisis; to obviate the need for future public bailouts of these institutions; and to augment the potential cognitive limitation of the FSSA, CFPA and OSFS in terms of their preparedness for the ‘historical inevitably’ of financial crises.

The next and final chapter presents the overall summary, conclusions and recommendations of the thesis.

CHAPTER EIGHT

Conclusion, Recommendations and Further Research

8.1 Introduction

This chapter concludes our advocacy for the adoption of an objectives-based triple peaks financial regulation in Nigeria. It restates our overall research thematic thrust; highlights our reform recommendations; and presents the areas in which we think the research creates opportunities for further study.

While this chapter is lesser in length than the previous seven chapters, it is still structurally organised into four sections mainly for the purposes of clarity. This introduction is the first section. The second section restates the thesis' thematic thrust, its different sub-themes and how we pursued each sub-theme in the past seven chapters. The third section summarises our reform recommendations. The fourth section discusses those issues and areas which can be the subject of further research.

8.2 Thematic Thrust, Sub-themes, Arguments and Conclusions

We have explored in this research the legal and institutional framework required to address the creeping crisis of financial regulation in Nigeria—a crisis that is arguably most reflected in the past incidence of banking insolvencies in the country and the financial crisis of 2008-09. To guide our research exploration and as a thematic thrust we posed two broad questions in the Overview contained in Chapter 1. We asked first: what are the financial regulatory issues responsible for and accentuated by the Nigeria financial crisis of 2008-09 and how should the financial regulatory framework be reformed to address these issues, including the question of supervisory failure implicated in that crisis? Our second question relates to the potential paradoxes, pitfalls and prospects of adopting an objectives-based triple peaks financial regulation as the guiding framework for the reform. To study these two questions and the four specific research questions we later posed in Chapter 1, we broke the thematic thrust of this thesis into five sub-themes. A summary of the arguments and conclusions under each of these sub-themes is presented below.

8.2.1 The Financial Regulatory 'Crisis' Sub-theme

Chapters 1 and 2 focused on this sub-theme. In chapter 1, we defined the financial regulatory crisis in Nigeria as a perceived inability of the current financial regulatory framework to effectively address the issues that characterised the previous cases of insolvencies of financial institutions in Nigeria, the regulatory deficiencies, supervisory failure that substantially induced the financial crisis of 2008-09 and the new regulatory issues that the crisis has thus far accentuated. We argued that the crisis has manifested in: (a) those general issues that have perennially impeded the emergence of an effective financial regulatory framework in Nigeria; (b) the regulatory deficiencies and supervisory failure implicated in the Nigerian financial crisis of 2008 - 09; and (c) the regulatory issues thrown by the CBN's insolvency resolution measures post 2009. We focused on arguments (a) and (c) in Chapter 1. In Chapter 2, we focused extensively on argument (b) and there we discussed the perceived deficiencies in the implementation of four regulatory objectives of: financial system stability, consumer financial protection, financial market integrity, and financial market competition.

We concluded our analysis under this sub-theme to the effect that there are two alternative reform avenues to address the financial regulatory 'crisis' in Nigeria: through piecemeal reforms or a regulatory overhaul and institutional redesign. We debated the pros and cons of each option and argued in favour of the second alternative on the grounds that: (a) it offers an opportunity for far reaching financial regulatory reforms; (b) the reforms can be insulated from the vicissitudes of tenure of regulatory officials; and (c) that financial regulatory overhaul can prevent the likelihood of regulatory dissonance and uncertainty which piecemeal and sporadic reforms often engender.

8.2.2 The Theoretical Justification Sub-theme

Chapter 3 focused on this sub-theme and there we presented the theoretical assumptions that underpin our advocacy for the adoption of an objectives-based triple peaks financial regulation in Nigeria. This we did by accomplishing four connected tasks. We situated this research within a public interest account of financial regulation and corrective justice theory in the (private) law of obligations. We connected the public interest account with the four financial regulatory objectives discussed in Chapter 2. We evaluated the strengths and weaknesses of the four recognised regulatory models for the implementation of these objectives. We articulated the reasons why an objectives-based triple peaks financial regulatory framework fits the Nigerian financial context.

We argued that the objectives-based triple peaks approach potentially fits the Nigerian financial regulatory context theoretically and practically. We argued that the approach has the theoretical potentials to maximise regulatory synergies on five levels: the regulatory policy objectives level, the regulatory instruments level, in the use of regulatory information, at the expertise level and the administrative level. We argued that the objectives-based triple peaks approach provides an unprecedented independent seat consumer financial at the financial regulatory table.

8.2.3 The Comparative Financial Regulatory Failure and Success Sub-theme

Chapter 4 focused on this sub-theme and it was the first in the two-part comparative analysis at the mid-point of this research. In that chapter, we used the experience in four comparator jurisdictions (Canada, Malaysia, United States of America and United Kingdom) to discuss the reasons why financial regulatory systems fail or succeed and the regulatory lessons that a Nigerian objectives-based triple peaks financial regulation can draw from the failure and success scenarios. We approached the discussion from the perspectives of the financial regulatory design factor and the financial regulatory context factor.

We argued (with support from the Otto Khan Freud School of legal transplant) that a Nigerian objectives-based triple peaks financial regulation could draw seventeen regulatory lessons from the four comparator jurisdictions. We reduced these lessons to two ideas: that the reform of financial regulation in Nigeria should be structured to achieve a more effective implementation of the objectives of financial regulation; and that structure should accommodate the cross-border and long term implications of financial regulation in Nigeria.

8.2.4 The Financial Regulatory Accountability Sub-theme

Chapter 5 focused on this sub-theme and it was the second of the two-part comparative analysis started in chapter 4. Under this sub-theme, we examined how to address the issue of supervisory failure implicated in the Nigerian financial crisis of 2008-09 and strengthen the proposed objectives-based triple peaks financial regulation through regulatory accountability. We examined the utility of the five main types of accountability control instruments over financial regulators namely: parliamentary accountability, ministerial accountability, market-based accountability, financial accountability and judicial accountability. We aligned with the greater use of judicial accountability; debated the pros and cons of imposing negligence liability on financial regulators; and argued in favour of the use of this (negligence) liability as a financial regulatory accountability mechanism.

8.2.5 The Reform Implementation Sub-theme

Chapter 6 focused on this sub-theme and there we addressed two questions: what principles, strategies and institutions are comprised in the proposal for the adoption of objectives-based triple peaks financial regulation in Nigeria; and how should they be implemented? Consistently with our analyses in chapters 1,2 and 3 we approached the two questions in terms of how to better implement financial system stability, consumer financial protection, financial market integrity and financial market competition. For the purposes of financial system stability, we advocated three normative approaches: (a) a comprehensive redefinition of the perimeters of financial system stability in Nigeria including the creation of FSSA (b) a streamlined systemic liquidity management approach, (c) the use of pro-active crisis management toolkits for the financial services industry. Concerning consumer financial and investor protection we advocated the adoption of five measures: (a) a holistic and institutionally centralised approach to consumer protection through the establishment of the CFPA, (b) an aggressive consumer and investor activism, (c) imposition of liability for negligent financial regulation, (d) implementation of a national financial literacy policy, and (e) the application of behavioural economics to consumer protection. In relation to financial market integrity we argued for the adoption of four strategies: (a) the consolidation of existing rules in banking, securities, and insurance sectors into a coherent financial market rule book, (b) the establishment of OSFS as a specialist market integrity regulator, (c) the need to empower the OSFS to administratively adjudicate both civil and criminal infractions of market integrity rules, and (d) the implementation of market conduct risk management framework by financial intermediaries. Lastly and for the purposes of financial market competition, we canvassed the adoption of three strategies: (a) a market centered approach to competition regulation; (b) a dynamic and analytical approach to competition regulation; and (c) imposition of sanctions for anti-competitive practices.

8.2.6 The Reform Challenges Sub-theme

Chapter 7 focused on this sub-theme and there we canvassed strategies to address the pitfalls, paradoxes and how to enhance the prospects of the objectives-based triple peaks financial regulation in Nigeria, the implementation of comparative regulatory lessons from Canada, Malaysia, United States and United Kingdom and the use of negligence liability as a financial regulatory accountability mechanism.

We also contended with the historical inevitability of financial crises by proposing the adoption of a mandatory capital rule under which systemically significant financial institutions in Nigeria are required to issue ICDs as a strategy to manage their financial fragility; augment the potential cognitive limitation of the proposed FSSA, OSFS and CFPA; and as a latent corporate governance disciplinary mechanism.

For the purposes of clarity and to show the linkage between the foregoing sub-themes and the gamut of the reform recommendations comprised in this thesis, the next section aggregates and presents these recommendations under three headings.

8.3 HIGHLIGHTS OF REFORM RECOMMENDATIONS

From Chapter 4 though Chapter 7 we canvassed several reform lessons, normative regulatory principles and strategies. For the purposes of clarity and to show the linkage between the five sub-themes in section 8.3 and the gamut of the reform recommendations comprised in this thesis, this section aggregates and presents these recommendations under three headings: transplant recommendations, institutional reform recommendations and normative regulatory principles.

8.3.1 Transplant Recommendations

The primary recommendation under this heading argued for the transplant of those comparative regulatory lessons that are consistent with the level of financial market sophistication in Nigeria. Using this primary recommendation as a background we canvassed a series of secondary recommendations including significantly the following: (a) that Nigeria should aim for an objectives-based triple peaks financial regulation; (b) that this approach should be crafted to prevent institutional regulatory gaps and regulatory turf wars, incorporate an effective framework for the supervision of the entire financial system and monitoring of financial innovation; (c) that the proposed financial regulators should have statutory and operational independence; and (d) that financial regulatory reform in Nigeria should incorporate a robust framework to monitor foreign short term speculative inflows, credit expansion through margin loans, and incorporate a mechanism to provide long term liquidity and solvency assistance to illiquid but solvent financial institutions.

8.3.2 Institutional Reform Recommendations

The primary recommendation here argued for the abolition of SEC, NAICOM and the relocation of financial regulatory functions (and not monetary policy functions) from the CBN; and that the functions of the three regulators should be re-organised under the four regulatory objectives discussed in chapter 2 and 3. The secondary but no less significant recommendation argued for the establishment of the FSSA, CFPA and OSFS. The FSSA is to comprehensively enforce financial system stability; enforce systemic stability measures particularly with respect to financial intermediaries whose failures can induce crisis; and implement the financial system stability reforms canvassed in Chapters 6 and 7. The CFPA would coordinate the implementation of all consumer and investor protections reforms canvassed in Chapter 6. The OSFS would have combined regulatory remit for financial market integrity and market competition as well as implement the market integrity and competition reforms canvassed in Chapters 6 and 7.

8.3.3 Normative Regulatory Principles

The normative regulatory principles that we recommended can be grouped into categories namely: those intended to facilitate the adoption of objectives-based triple peaks financial regulation in

Nigeria and those meant to address implementation challenges and enhance the prospects of the proposed regulatory framework.

Under the first category we recommended inter alia: (a) the adoption of a systemic risk monitoring approach that is not based on the status of financial intermediary (as a bank, insurer, or capital market operator) but on its risk level as measured by how the size of its business operations affect the stability of Nigerian financial system; (b) the use of CoVAR for the analytical measurement of the relative and correlative risks of financial intermediaries; (c) the power to override shareholders' rights for the purposes of accelerated resolution of an insolvent financial intermediary; (d) non-suspension or reversal of insolvency resolution actions; (e) the use of quantitative and qualitative regulatory intervention triggers; and (f) a market centered approach to market competition regulation.

Under the second category we recommended inter alia: (a) a rule that requires banks to hold more capital against riskier loans and to disclose all off-balance sheet exposures for thorough risk weighting; (b) a systematic approach to use of capital controls; (c) the establishment of a regulatory liability fund to address the quantum implications of our proposal for the imposition of liability for negligent financial supervision; (d) the imposition of mandatory inter-agency regulatory coordination; (e) the use of democratic accountability; (f) non-recruitment of persons connected with financial intermediaries as regulatory officials; (g) availability of quality regulatory information; (h) transparency and openness in the recruitment of regulatory officials; (i) certainty of enforcement; and (j) the use of *qui tam* claims to detect and prosecute financial regulatory perversion.

Lastly and considering that time, space and resource limitations have impacted on this research we have had as a result to leave out some relevant areas and issues that would have further enriched our narrative. The next section of this chapter considers and argues for further research in these areas and on these issues.

8.4 AREAS FOR FURTHER RESEARCH

This research has been carried out within three major constraints: time, space and resources. The time allowed for this research (3 years) has meant that we have had to scale down its initial expansive focus. Equally, the permissible space for what we can write (100,000 words maximum) has required us to select the most cogent issues for our discussion. Lastly but by no means the least, the need to manage the limited resources available for this research has meant that we have had to use cost effective and appropriate research methodologies such as content analysis, historiography and comparative analysis. We eschewed expensive but potentially helpful research methodologies such as survey and wide ranging evidence gathering including interviews and the distribution of questionnaires in Nigeria and the research comparators jurisdictions. Accordingly, this section presents and argues for further research in those areas that we could not study deeply. These are: (a) how does corporate governance operate in the Nigerian financial services industry and that of the comparator jurisdictions and what can they learn from one another? (b) How do we prove causation for the purposes of establishing a financial regulator's liability for supervisory negligence? (c) How can 'living wills' be used as a financial regulatory tool in an emerging market such as Nigeria? (d) Is there a correlation between high executive compensation and risky business practices in the Nigerian financial services industry? If so, how can we reform the trend? (e) How can institutional investors enhance good corporate governance in the Nigerian financial services industry?

8.4.1 Comparative Corporate Governance

Considering that corporate governance infractions have been generally acknowledged as 'veritable nuisance and bane' of the Nigerian financial services industry we reason that further research is necessary in this area. This can be in terms of how a focused and comparative study of financial services corporate governance in Nigeria and the comparator jurisdictions, to discover areas of convergence and divergence in law and practice and what the comparators can learn from one another.

8.4.2 Causation in Financial Supervisory Negligence

We consider that one issue which would most likely have significant influence on whether or not to hold a financial regulator liable for losses resulting from supervisory negligence is the proof of the causal connection between the alleged negligent act and (or) omission of the regulator and the losses suffered by the potential claimant(s). We consider that this would have significant influence not only in terms of how to determine the viability of this liability but also because there might be cases in which as between the alleged supervisory negligence and the losses pleaded, there are potential intervening causes (i.e. wrong investment advice and fraudulent conduct by a financial intermediary among others) that could 'break the chain of causation.' Thus in such cases where it is difficult to prove how and to what extent the regulator's negligence caused the claimant's loss, should we still hold the regulator liable? If yes, why and what causal principles should form the basis of that liability? We reason that the contentions here and the tensions that are likely to be generated where the regulator is held liable in the absence of an unbroken chain of causation and without a convincing basis in principle (on why that should be the case) would question the justice of the liability. How then should the contours of common law of causation be navigated in this potentially complex and controversial area? We regard this question as requiring further study beyond the time, space and resources available for this research.

8.4.3 The Use of 'Living Wills' in a Developing Financial System

Since the GFC one of the regulatory reforms introduced in advanced financial markets such as the UK and the US is the requirement that systemically significant financial institutions draw up plans that would dictate how they would unwind their operations and financial contracts in an orderly way that avoid panic. This is known as resolution plans or 'living wills.' The idea behind the reform is mainly that it would prevent a repeat of the devastating bankruptcy of Lehman Brothers or a repeat of government bailouts of banks.[1] We anticipate that the introduction of resolution plans in a market such as Nigeria can further enhance the stability of the country's financial system, in terms of providing an orderly resolution of failed systemically significant financial intermediaries. Whether this would necessarily be the case in practice and how the measure should operate are questions to which we are unable to provide answers in this research. Thus we suggest that this area should be further studied.

8.4.4 Executive Compensation and Risky Financial Business Practices

Is there in theory a correlation between high executive pay and risky business practices in the Nigerian financial services industry? If yes, how and to what extent? If not, why? We can consider that answers to these questions (which time, space and resources limitations did not permit us to study in this research) would enhance the prospects of our systemic stability and market integrity reform proposals. This would be so because a proven direct link between high executive pay and risky business practices in the financial services industry would assist the OSFS for instance to introduce relevant rules and monitor executive compensation. To establish this link would require most appropriately an empirical study of the pay pattern in the

[1] G. Chon and T. Braithwaite, 'US Watchdogs Rejects Banks' "Living Wills", ' *Financial Times* 5 August 2014 available online at: < http://www.ft.com/cms/s/0/5ae158d6-1cdd-11e4-88c3-00144feabdc0.html#axzz3O3bqStpF> accessed on 23 December 2014.

Nigerian financial services industry before the crisis of 2008-09 and particularly in those financial institutions which CBN declared insolvent in 2009. How and to what extent did high executive compensation contribute to their insolvencies are questions that we also suggest for further research.

8.4.5 Institutional Investors and Corporate Governance

Can institutional investors exercise corporate governance influence in the Nigerian financial services industry? What influence have they exercised thus far and how can this be improved to enhance good corporate governance in this industry? We consider that answers to these questions would strengthen the contributions of this research and because we could not provide these answers, we suggest that they should be studied further.

THE NIGERIAN STOCK EXCHANGE				
TRADE DATE	SYMBOL	CLOSING PRICE	MARKET CAPITALIZATION	VOLUME
31/01/2005	AFRIBANK	6.63	14,641,249,997.79	41,764.00
31/01/2005	INTERCONT	7.81	28,027,356,500.00	5,000.00
31/01/2005	OCEANIC	6.3	37,800,000,000.00	191,812.00
31/01/2005	SPRINGBANK			
31/01/2005	UBN	20.34	91,009,296,000.00	2,727,008.00
28/02/2005	AFRIBANK	6.63	14,641,249,997.79	283,332.00
28/02/2005	INTERCONT	7.81	28,027,356,500.00	392,503.00
28/02/2005	OCEANIC	4.94	46,009,210,182.00	4,826,600.00
28/02/2005	SPRINGBANK			
28/02/2005	UBN	19	85,013,600,000.00	1,501,125.00
31/03/2005	AFRIBANK	6.63	14,641,249,997.79	71,245.00
31/03/2005	INTERCONT	7.81	28,027,356,500.00	1,040.00
31/03/2005	OCEANIC	5.33	49,641,516,249.00	6,485,015.00
31/03/2005	SPRINGBANK			
31/03/2005	UBN	21.5	96,199,600,000.00	7,996,626.00
29/04/2005	AFRIBANK	6.63	14,641,249,997.79	118,705.00
29/04/2005	INTERCONT	7.81	28,027,356,500.00	65,170.00
29/04/2005	OCEANIC	6.32	58,861,985,496.00	11,000.00
29/04/2005	SPRINGBANK			
29/04/2005	UBN	24.59	110,025,496,000.00	431,869.00
31/05/2005	AFRIBANK	6.63	14,641,249,997.79	160,659.00
31/05/2005	INTERCONT	7.81	28,027,356,500.00	107,460.00
31/05/2005	OCEANIC	6.32	58,861,985,496.00	10,000.00
31/05/2005	SPRINGBANK			
31/05/2005	UBN	24.59	110,025,496,000.00	495,069.00
30/06/2005	AFRIBANK	6.63	14,641,249,997.79	842,155.00
30/06/2005	INTERCONT	5.99	43,894,696,040.00	520,945.00
30/06/2005	OCEANIC	6.32	58,861,985,496.00	9,000.00
30/06/2005	SPRINGBANK			
30/06/2005	UBN	24.59	110,025,496,000.00	461,473.00
29/07/2005	AFRIBANK	6.63	14,641,249,997.79	131,782.00
29/07/2005	INTERCONT	6.12	44,847,335,520.00	972,400.00
29/07/2005	OCEANIC	6.32	58,861,985,496.00	43,800.00
29/07/2005	SPRINGBANK			
29/07/2005	UBN	27.1	121,256,240,000.00	1,316,787.00
31/08/2005	AFRIBANK	6.63	14,641,249,997.79	625,629.00
31/08/2005	INTERCONT	6.75	49,463,973,000.00	7,701,823.00
31/08/2005	OCEANIC	6.32	58,861,985,496.00	6,161,200.00
31/08/2005	SPRINGBANK			
31/08/2005	UBN	25.53	152,308,575,982.98	3,952,661.00
30/09/2005	AFRIBANK	9.1	42,845,833,330.30	1,283,363.00
30/09/2005	INTERCONT	9.17	67,197,723,320.00	3,739,650.00
30/09/2005	OCEANIC	6.32	58,861,985,496.00	5,617,061.00
30/09/2005	SPRINGBANK			
30/09/2005	UBN	25.86	154,277,311,982.76	2,803,920.00
31/10/2005	AFRIBANK	9.1	42,845,833,330.30	638,288.00
31/10/2005	INTERCONT	10.34	110,881,879,240.00	2,694,324.00
31/10/2005	OCEANIC	6.32	58,861,985,496.00	908,627.00
31/10/2005	SPRINGBANK			
31/10/2005	UBN	25.1	149,743,253,316.60	4,225,482.00
30/11/2005	AFRIBANK	9.1	42,845,833,330.30	1,334,874.00
30/11/2005	INTERCONT	10.11	108,415,454,460.00	13,623,549.00
30/11/2005	OCEANIC	6.32	58,861,985,496.00	6,401,120.00
30/11/2005	SPRINGBANK			
30/11/2005	UBN	25.48	152,010,282,649,68	465,522.00

30/12/2005	AFRIBANK	9.1	42,845,833,330.30	2,229,234.00
30/12/2005	INTERCONT	9.25	99,193,170,500.00	6,329,155.00
30/12/2005	OCEANIC	6.49	60,445,298,397.00	1,722,598.00
30/12/2005	PLATINUM	2.6	28,531,718,222.80	212,057.00
30/12/2005	SPRINGBANK			
30/12/2005	UBN	25.48	152,010,282,649.68	340,583.00
31/01/2006	AFRIBANK	9.1	42,845,833,330.30	441,134.00
31/01/2006	INTERCONT	8.45	90,614,301,700.00	2,417,424.00
31/01/2006	OCEANIC	5.8	54,018,910,740.00	1,426,876.00
31/01/2006	PLATINUM	2.6	28,531,718,222.80	520.00
31/01/2006	SPRINGBANK			
31/01/2006	UBN	25.48	152,010,282,649.68	186,840.00
28/02/2006	AFRIBANK	9.1	42,845,833,330.30	4,389,821.00
28/02/2006	INTERCONT	10.93	117,208,794,980.00	40,809,025.00
28/02/2006	OCEANIC	5.69	52,994,414,157.00	1,853,397.00
28/02/2006	PLATINUM	2.6	28,531,718,222.80	100,000.00
28/02/2006	SPRINGBANK			
28/02/2006	UBN	25.48	152,010,282,649.68	1,622,023.00
31/03/2006	AFRIBANK	9.1	42,845,833,330.30	21,140,933.00
31/03/2006	INTERCONT	10.1	108,308,218,600.00	5,996,810.00
31/03/2006	OCEANIC	6.08	56,626,720,224.00	832,000.00
31/03/2006	PLATINUM	2.6	28,531,718,222.80	61,500.00
31/03/2006	SPRINGBANK			
31/03/2006	UBN	25.48	152,010,282,649.68	4,307,899.00
28/04/2006	AFRIBANK	9.1	42,845,833,330.30	227,593.00
28/04/2006	INTERCONT	10.11	108,415,454,460.00	11,230,641.00
28/04/2006	OCEANIC	6.4	59,607,073,920.00	2,397,107.00
28/04/2006	PLATINUM	2.6	28,531,718,222.80	15,500.00
28/04/2006	SPRINGBANK			
28/04/2006	UBN	25.48	152,010,282,649.68	3,487,983.00
31/05/2006	AFRIBANK	7.5	38,313,249,997.50	1,937,521.00
31/05/2006	INTERCONT	10.7	122,668,296,128.70	26,219,924.00
31/05/2006	OCEANIC	7.81	72,739,257,393.00	1,178,991.00
31/05/2006	PLATINUM	2.6	28,531,718,222.80	750,600.00
31/05/2006	SPRINGBANK			
31/05/2006	UBN	25.48	152,010,282,649.68	999,798.00
30/06/2006	AFRIBANK	6.9	35,248,189,997.70	937,055.00
30/06/2006	INTERCONT	10.55	120,948,647,117.55	1,162,503.00
30/06/2006	OCEANIC	7.3	67,989,318,690.00	411,064.00
30/06/2006	PLATINUM	2.6	28,531,718,222.80	105,000.00
30/06/2006	SPRINGBANK			
30/06/2006	UBN	30.55	182,257,226,646.30	1,927,290.00
31/07/2006	AFRIBANK	6.6	33,715,659,997.80	555,741.00
31/07/2006	INTERCONT	13.19	151,214,469,713.79	9,602,248.00
31/07/2006	OCEANIC	9.2	85,685,168,760.00	2,542,957.00
31/07/2006	PLATINUM	1.98	19,305,074,800.00	4,748,328.00
31/07/2006	SPRINGBANK			
31/07/2006	UBN	27.8	165,851,093,314.80	3,262,606.00
31/08/2006	AFRIBANK	7.93	40,509,876,330.69	1,417,485.00
31/08/2006	INTERCONT	16.13	184,919,590,332.33	240,238.00
31/08/2006	OCEANIC	12.46	116,047,522,038.00	10,525,266.00
31/08/2006	PLATINUM	2.65	33,890,641,462.62	4,520,922.00
31/08/2006	SPRINGBANK			
31/08/2006	UBN	29.35	202,420,761,816.65	4,907,198.00
29/09/2006	AFRIBANK	11.51	58,798,067,662.83	950,829.00
29/09/2006	INTERCONT	16.13	200,452,869,595.75	312,986.00
29/09/2006	OCEANIC	12.85	119,679,828,105.00	3,305,641.00
29/09/2006	PLATINUM	2.31	44,594,722,788.00	2,241,632.00
29/09/2006	SPRINGBANK			

29/09/2006	UBN	24.1	232,560,287,992.10	2,904,197.00
31/10/2006	AFRIBANK	11.51	58,798,067,662.83	550,759.00
31/10/2006	INTERCONT	16.13	200,452,869,595.75	1,414,748.00
31/10/2006	OCEANIC	14.18	132,066,923,154.00	5,255,660.00
31/10/2006	PLATINUM	2.39	46, 139, 128,772.00	6,643,526.00
31/10/2006	SPRINGBANK			
31/10/2006	UBN	24.5	236, 420,209, 784.50	3,018,483.00
30/11/2006	AFRIBANK	11.51	58,798,067,662.83	138,306.00
30/11/2006	INTERCONT	14.53	180,569,137,955.75	978,561.00
30/11/2006	OCEANIC	13.63	126,944,440,239.00	5,162,993.00
30/11/2006	PLATINUM	3.05	58, 880,478, 140.00	34,617,461.00
30/11/2006	SPRINGBANK	7.16	81,059,385,763.08	3,050,260.00
30/11/2006	UBN	22.03	212, 585, 192, 716.43	3,470,160.00
29/12/2006	AFRIBANK	11.51	58,798,067,662.83	604,537.00
29/12/2006	INTERCONT	13.6	169,011,718,940.00	5,432,516.00
29/12/2006	OCEANIC	15.39	143,336,385,567.00	21,539,699.00
29/12/2006	PLATINUM	3.12	60, 231, 833, 376.00	28,222,694.00
29/12/2006	SPRINGBANK	7.16	81,059,385,763.08	
29/12/2006	UBN	22.91	221, 007, 020, 659.71	7,695,449.00
31/01/2007	AFRIBANK	11.51	58,798,067,662.83	18,095,578.00
31/01/2007	INTERCONT	18.92	235,125,126,643.00	15,112,624.00
31/01/2007	OCEANIC	15.39	179,170,481,958.75	17,151,660.00
31/01/2007	PLATINUM	3.7	71, 428, 776, 760.00	10,291,772.00
31/01/2007	SPRINGBANK	3.8	43,020,344,399.40	731,811.00
31/01/2007	UBN	27.6	266, 334, 603, 675.60	6,720,938.00
28/02/2007	AFRIBANK	11.51	58,798,067,662.83	1,981,007.00
28/02/2007	INTERCONT	20.99	260,849,704,452.25	10,434,716.00
28/02/2007	OCEANIC	19.53	227,368,389,386.25	60,225.00
28/02/2007	PLATINUM	5.43	104, 826, 556, 164.00	108,884,673.00
28/02/2007	SPRINGBANK	5.59	63,285,190,840.17	
28/02/2007	UBN	29.94	288, 915, 146, 161.14	5,906,502.00
30/03/2007	AFRIBANK	11.51	58,798,067,662.83	125,081,030.00
30/03/2007	INTERCONT	23.01	285,952,915,647.75	16,361,019.00
30/03/2007	OCEANIC	19.53	227,368,389,386.25	2,735,911.00
30/03/2007	PLATINUM	5.43	104, 826, 556, 164.00	108,884,673.00
30/03/2007	SPRINGBANK	5.59	63,285,190,840.17	
30/03/2007	UBN	30	289, 494, 134, 430.00	7,139,529.00
30/04/2007	AFRIBANK	11.51	58,798,067,662.83	1,619,182.00
30/04/2007	INTERCONT	24.5	304,469,640,737.50	7,757,683.00
30/04/2007	OCEANIC	19.53	227,368,389,386.25	5,356,089.00
30/04/2007	PLATINUM	17.95	115,508,697,547.35	557,196.00
30/04/2007	SPRINGBANK	5.59	63,285,190,840.17	
30/04/2007	UBN	33.51	323,364,948,158.31	6,481,231.00
31/05/2007	AFRIBANK	11.51	58,798,067,662.83	1,376,926.00
31/05/2007	INTERCONT	29	360,392,635,975.00	12,828,090.00
31/05/2007	OCEANIC	22.59	262,992,929,658.75	518,256.00
31/05/2007	PLATINUM	25.13	161,712,176,566.29	12,656,664.00
31/05/2007	SPRINGBANK	5.59	63,285,190,840.17	
31/05/2007	UBN	39.49	381, 070, 778, 954.00	40,247,411.00
29/06/2007	AFRIBANK	11.51	58,798,067,662.83	1,388,998.00
29/06/2007	INTERCONT	28.4	352,936,236,610.00	14,805,103.00
29/06/2007	OCEANIC	26.4	307,348,974,900.00	5,641,116.00
29/06/2007	PLATINUM	31.38	201,931,082,397.54	25,757,200.00
29/06/2007	SPRINGBANK	5.59	63,285,190,840.17	
29/06/2007	UBN	41.4	399, 501, 905, 513.40	5,302,324.00
31/07/2007	AFRIBANK	22.68	115,859,267,992.44	2,057,112.00
31/07/2007	INTERCONT	25.99	322,986,365,827.25	9,731,043.00
31/07/2007	OCEANIC	27	314,334,178,875.00	7,588,983.00
31/07/2007	PLATINUM	29.45	189,511,484,276.85	23,892,176.00

31/07/2007	SPRINGBANK	5.59	63,285,190,840.17	
31/07/2007	UBN	46.09	444, 759, 488, 529.29	26,382,565.00
31/08/2007	AFRIBANK	30.49	186,907,358,769.51	1,676,125.00
31/08/2007	INTERCONT	23.5	292,042,308,462.50	6,048,280.00
31/08/2007	OCEANIC	28.4	330,632,988,150.00	2,853,383.00
31/08/2007	PLATINUM	28.45	183,076,459,343.85	6,534,083.00
31/08/2007	SPRINGBANK	5.59	63,285,190,840.17	
31/08/2007	UBN	37.8	364, 762, 609, 381.80	6,324,850.00
28/09/2007	AFRIBANK	30.49	186,907,358,769.51	785,757.00
28/09/2007	INTERCONT	25.02	435,777,999,574.68	26,881,970.00
28/09/2007	OCEANIC	30.36	353,451,321,135.00	31,396,813.00
28/09/2007	PLATINUM	35.26	226,898,979,137.58	48,668,453.00
28/09/2007	SPRINGBANK	5.59	63,285,190,840.17	
393, 519, 026, 735.18	UBN	40.78	393, 519, 026, 735.18	6,727,815.00
31/10/2007	AFRIBANK	30.49	186,907,358,769.51	163,101.00
31/10/2007	INTERCONT	27	470,264,028,318.00	23,451,210.00
31/10/2007	OCEANIC	28.5	331,797,188,812.50	2,117,477.00
31/10/2007	PLATINUM	25.51	205,196,857,544.66	148,355.00
31/10/2007	SPRINGBANK	5.59	63,285,190,840.17	
31/10/2007	UBN	42	405, 291, 788, 202.00	7,231,427.00
30/11/2007	AFRIBANK	30.49	186,907,358,769.51	23,584.00
30/11/2007	INTERCONT	31.5	565,565,732,676.00	20,150,678.00
30/11/2007	OCEANIC	29.6	344,603,396,100.00	10,030,133.00
30/11/2007	PLATINUM	25.51	205,196,857,544.66	620,647.00
30/11/2007	SPRINGBANK	5.59	63,285,190,840.17	
30/11/2007	UBN	41.01	474, 886, 178, 110.77	12,794,514.00
31/12/2007	AFRIBANK	30.49	186,907,358,769.51	28,396.00
31/12/2007	INTERCONT	40.6	729,445,319,897.00	107,742,738.00
31/12/2007	OCEANIC	37.4	435,411,047,775.00	14,075,396.00
31/12/2007	PLATINUM	25.51	205,196,857,544.66	11,487.00
31/12/2007	SPRINGBANK	5.59	63,285,190,840.17	
31/12/2007	UBN	43.06	498, 624, 697, 133.62	16,291,899.00
31/01/2008	AFRIBANK	26	159,383,119,974.00	5,445,785.00
31/01/2008	INTERCONT	40.97	736,092,974,290.15	45,394,828.00
31/01/2008	OCEANIC	27	599,976,968,751.00	36,339,064.00
31/01/2008	PLATINUM	28.99	233,189,216,002.34	8,128,403.00
31/01/2008	SPRINGBANK	5.59	63,285,190,840.17	
31/01/2008	UBN	43.01	498,045,708,864.77	8,162,640.00
29/02/2008	AFRIBANK	26.98	165,390,637,573.02	19,193,115.00
29/02/2008	INTERCONT	45	808,498,507,275.00	80,962,634.00
29/02/2008	OCEANIC	28.51	633,531,236,262.63	27,384,387.00
29/02/2008	PLATINUM	31.86	256,274,867,948.76	7,971,202.00
29/02/2008	SPRINGBANK	5.59	63,285,190,840.17	
29/02/2008	UBN	44	509,509,676,588.00	4,267,705.00
31/03/2008	AFRIBANK	26.5	162,448,179,973.50	11,521,144.00
31/03/2008	INTERCONT	45.5	817,481,824,022.50	68,693,995.00
31/03/2008	OCEANIC	27.3	606,643,379,514.90	45,046,287.00
31/03/2008	PLATINUM	28.8	231,660,897,580.80	4,368,339.00
31/03/2008	SPRINGBANK	5.59	63,285,190,840.17	
31/03/2008	UBN	43.5	503, 719, 793, 899.50	5,003,045.00
30/04/2008	AFRIBANK	25.94	159,015,312,774.06	23,830,646.00
30/04/2008	INTERCONT	45.54	818,200,489,362.30	17,307,974.00
30/04/2008	OCEANIC	25.35	563,311,709,549.55	29,243,093.00
30/04/2008	PLATINUM	28.51	229,328,201,042.66	12,263,778.00
30/04/2008	SPRINGBANK	5.59	63,285,190,840.17	
30/04/2008	UBN	36.98	428, 219, 723, 641.46	3,654,000.00
30/05/2008	AFRIBANK	25.1	153,866,011,974.90	9,246,101.00
30/05/2008	INTERCONT	44.65	802,210,185,551.75	3,293,936.00
30/05/2008	OCEANIC	24.71	549,090,033,253.23	18,398,175.00

30/05/2008	PLATINUM	23	348,564,878,675.00	25,158,033.00
30/05/2008	SPRINGBANK	5.59	63,285,190,840.17	
30/05/2008	UBN	38.06	440, 725, 870, 248.62	3,774,654.00
30/06/2008	AFRIBANK	24.24	148,594,108,775.76	1,392,945.00
30/06/2008	INTERCONT	34.06	611,943,536,839.70	14,135,566.00
30/06/2008	OCEANIC	25.01	555,756,444,017.13	20,025,687.00
30/06/2008	PLATINUM	29.92	453,437,442,172.00	95,846,363.00
30/06/2008	SPRINGBANK	5.59	63,285,190,840.17	
30/06/2008	UBN	36.36	421, 040, 269, 107.72	2,334,687.00
31/07/2008	AFRIBANK	25.5	156,318,059,974.50	5,879,941.00
31/07/2008	INTERCONT	32.71	587,688,581,621.45	22,774,793.00
31/07/2008	OCEANIC	23.8	528,868,587,269.40	17,927,656.00
31/07/2008	PLATINUM	20.98	317,951,789,330.50	9,016,695.00
31/07/2008	SPRINGBANK	5.59	63,285,190,840.17	
31/07/2008	UBN	42	486, 350, 145, 834.00	599,291.00
29/08/2008	AFRIBANK	25.7	157,544,083,974.30	13,872,450.00
29/08/2008	INTERCONT	28.94	519,954,373,345.30	2,951,052.00
29/08/2008	OCEANIC	20.46	454,649,214,097.98	5,847,354.00
29/08/2008	PLATINUM	17.75	269,001,156,368.75	23,712,432.00
29/08/2008	SPRINGBANK	5.59	63,285,190,840.17	55,227,580.00
29/08/2008	UBN	42	486, 350, 145, 834.00	324,770.00
26/09/2008	AFRIBANK	21.77	294,043,616,497.05	486,328.00
26/09/2008	INTERCONT	24.73	444,314,846,331.35	194,477.00
26/09/2008	OCEANIC	20.03	445,094,025,336.39	4,755,667.00
26/09/2008	PLATINUM	16.41	330,743,463,453.66	10,951,031.00
26/09/2008	SPRINGBANK	5.59	63,285,190,840.17	116,366,968.00
26/09/2008	UBN	42	486, 350, 145, 834.00	791,988.00
31/10/2008	AFRIBANK	15.48	209,085,676,774.20	1,304,440.00
31/10/2008	INTERCONT	17.06	320,441,995,019.82	280,776.00
31/10/2008	OCEANIC	13.7	304,432,758,218.10	4,289,981.00
31/10/2008	PLATINUM	11.58	233,394,838,927.08	24,169,804.00
31/10/2008	SPRINGBANK	5.59	63,285,190,840.17	5,835,266.00
31/10/2008	UBN	29.79	344, 961, 210, 580.00	488,552.00
28/11/2008	AFRIBANK	11.01	148,710,161,581.65	1,104,868.00
28/11/2008	INTERCONT	12.9	242,303,735,976.30	5,549,323.00
28/11/2008	OCEANIC	13	288,877,799,769.00	5,110,476.00
28/11/2008	PLATINUM	8.89	179,177,903,114.14	2,230,429.00
28/11/2008	SPRINGBANK	5.59	63,285,190,840.17	28,343,691.00
28/11/2008	UBN	17.1	231, 016, 319, 268.30	5,219,436.00
31/12/2008	AFRIBANK	9.61	129,800,604,250.65	26,792,362.00
31/12/2008	INTERCONT	12.94	243,055,065,390.18	3,413,657.00
31/12/2008	OCEANIC	12.05	267,767,499,016.65	3,290,375.00
31/12/2008	PLATINUM	10.24	206,387,145,994.24	9,275,522.00
31/12/2008	SPRINGBANK	5.59	63,285,190,840.17	9,797,805.00
31/12/2008	UBN	15.2	205, 347, 839, 349.60	1,256,891.00
30/01/2009	AFRIBANK	6.3	85,093,007,989.50	3,457,669.00
30/01/2009	INTERCONT	5.55	104,246,956,175.85	990,221.00
30/01/2009	OCEANIC	6.04	134,217,070,046.52	2,911,049.00
30/01/2009	PLATINUM	6.2	124,960,967,301.20	9,195,526.00
30/01/2009	SPRINGBANK	5.59	63,285,190,840.17	598,326.00
30/01/2009	UBN	9.78	132, 125, 122, 949.94	2,578,682.00
27/02/2009	AFRIBANK	7.74	104,542,838,387.10	1,111,305.00
27/02/2009	INTERCONT	7.22	136,169,308,141.16	12,788,140.00
27/02/2009	OCEANIC	8.04	178,659,808,472.52	10,355,489.00
27/02/2009	PLATINUM	7.53	151,767,110,286.78	8,838,535.00
27/02/2009	SPRINGBANK	5.59	63,285,190,840.17	1,024,760.00
27/02/2009	UBN	13.28	179, 409, 164, 905.44	3,123,436.00
31/03/2009	AFRIBANK	5.61	75,773,297,590.65	1,835,965.00
31/03/2009	INTERCONT	6.3	118,818,094,361.40	234,558,214.00

31/03/2009	OCEANIC	6.5	144,438,899,884.50	5,497,242.00
31/03/2009	PLATINUM	5.73	115,488,119,779.98	1,443,734.00
31/03/2009	SPRINGBANK	5.59	63,285,190,840.17	2,000.00
31/03/2009	UBN	10.1	136, 448, 235, 357.30	1,085,603.00
30/04/2009	AFRIBANK	5.18	69,965,362,124.70	2,904,225.00
30/04/2009	INTERCONT	8.2	154,652,122,819.60	5,849,559.00
30/04/2009	OCEANIC	6.9	153,327,447,569.70	8,493,146.00
30/04/2009	PLATINUM	5.23	105,410,622,416.98	11,432,330.00
30/04/2009	SPRINGBANK	5.59	63,285,190,840.17	1,586.00
30/04/2009	UBN	11.4	154, 010, 879, 512.20	2,462,079.00
28/05/2009	AFRIBANK	8.97	121,156,235,185.05	1,870,376.00
28/05/2009	INTERCONT	12.65	238,579,189,471.70	2,327,898.00
28/05/2009	OCEANIC	10.46	232,435,521,967.98	13,415,510.00
28/05/2009	PLATINUM	8.87	178,774,803,219.62	6,628,481.00
28/05/2009	SPRINGBANK	5.59	63,285,190,840.17	3,894,242.00
28/05/2009	UBN	18.82	254, 253, 048, 457.86	1,485,235.00
30/06/2009	AFRIBANK	7.56	102,111,609,587.40	2,856,310.00
30/06/2009	INTERCONT	9.1	171,626,136,299.80	5,544,554.00
30/06/2009	OCEANIC	7.18	159,549,430,949.34	32,465,197.00
30/06/2009	PLATINUM	6.27	126,371,816,932.02	20,725,609.00
30/06/2009	SPRINGBANK	5.59	63,285,190,840.17	20,008,828.00
30/06/2009	UBN	17.02	229,935,541,166.46	9,245,730.00
31/07/2009	AFRIBANK	6.5	87,794,373,322.50	3,581,305.00
31/07/2009	INTERCONT	6.45	121,647,096,608.10	4,410,511.00
31/07/2009	OCEANIC	6.27	139,327,984,965.51	18,418,739.00
31/07/2009	PLATINUM	5.47	110,247,821,151.22	4,288,365.00
31/07/2009	SPRINGBANK	5.59	63,285,190,840.17	2,039,706.00
31/07/2009	UBN	13.98	188, 865, 973, 296.54	1,954,990.00
31/08/2009	AFRIBANK	5.22	70,505,635,191.30	51,539,786.00
31/08/2009	INTERCONT	6.93	130,699,903,797.54	69,195,888.00
31/08/2009	OCEANIC	4.94	109,773,563,912.22	102,994,263.00
31/08/2009	PLATINUM	3.42	68,930,081,962.92	2,071,170.00
31/08/2009	SPRINGBANK	5.59	63,285,190,840.17	1,100.00
31/08/2009	UBN	12.6	170, 222, 551, 039.80	49,984,336.00
30/09/2009	AFRIBANK	3.28	44,302,391,461.20	2,066,559.00
30/09/2009	INTERCONT	3.79	71,479,456,766.62	4,475,338.00
30/09/2009	OCEANIC	3.24	71,997,236,250.12	28,387,129.00
30/09/2009	PLATINUM	3.5	70,542,481,541.00	7,166,810.00
30/09/2009	SPRINGBANK	3.07	34,755,909,817.41	3,762.00
30/09/2009	UBN	7.15	96, 594, 542, 851. 95	22,958,126.00
30/10/2009	AFRIBANK	2.53	34,304,070,744.79	2,777,251.00
30/10/2009	INTERCONT	2.8	52,808,041,938.40	2,726,078.00
30/10/2009	OCEANIC	2.39	53,109,072,419.07	5,525,952.00
30/10/2009	PLATINUM	2.18	43,937,888,502.68	4,558,480.00
30/10/2009	SPRINGBANK	1.48	16,755,292,029.24	132,304.00
30/10/2009	UBN	7.28	98, 350, 807, 267.44	2,395,612.00
30/11/2009	AFRIBANK	2.12	28,744,913,035.16	3,281,490.00
30/11/2009	INTERCONT	2.28	43,000,834,149.84	2,415,315.00
30/11/2009	OCEANIC	2.1	46,664,875,347.30	4,087,454.00
30/11/2009	PLATINUM	1.96	39,503,789,662.96	5,449,010.00
30/11/2009	SPRINGBANK	1.02	11,547,566,128.26	367,392.00
30/11/2009	UBN	6.07	82, 004, 038, 477.11	2,636,603.00
31/12/2009	AFRIBANK	2.55	34,575,249,169.65	2,378,540.00
31/12/2009	INTERCONT	1.61	30,364,624,114.58	2,447,595.00
31/12/2009	OCEANIC	1.69	37,554,113,969.97	1,330,209.00
31/12/2009	PLATINUM	1.32	26,604,593,038.32	6,982,704.00
31/12/2009	SPRINGBANK	0.76	8,604,068,879.88	144,793.00
31/12/2009	UBN	6	81, 058, 357, 638.00	1,897,613.00

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