International Journal of Interdisciplinary Research Methods
Vol.7, No.2, pp. 23-42, May 2020
Published by ECRTD-UK
Print ISSN: ISSN 2398-712X, Online ISSN: ISSN 2398-7138

THE ROLE OF THE REGULATORY AND SUPERVISING AUTHORITIES IN PREVENTING BANK FAILURE AND ENSURING BANKING STABILITY IN THE ORGANISATION OF BANKING SECTOR IN NIGERIA

Dr Igbaekemen Goddy Osa
Department of Sociology,Faculty of Social & Manangement Sciences,Nigeria Police Academy,Wudil, Kano State.Nigeria.

ABSTRACT: *The word "prevention of failure" according to advance learner's dictionary connotes taking proactive measures in stopping something ugly from happening. A stable banking system means that the banks are making adequate profits from authorized banking business to justify their investment and at the same time bank failures are kept at a minimum within the country. By minimum failures is meant the number of failures whose solution cost would not exceed what the supervisory authorities could consider tolerable. It is therefore important to emphasize that failure is not necessarily synonymous with instability in the banking system. As a matter of fact, technically insolvent banks are expected to be resolved as they are detected so that the cost of such resolutions would not escalate. Also, if bank failure is not contagious, then the banking industry could be considered stable. Generally, it is agreed that an efficient banking system is a pre-requisite for an efficient economy in view of the importance of the banking sector*.

KEYWORDS; CBN, NDIC, banks, AMCON, FG

INTRODUCTION

Banking industry plays a vital role in the economic growth and development of a nation. The baking sector also in any economy serves as a catalyst for growth and development. It is the life wire of commercial and economic activities. Since it inception in the colonial period the banking industry in Nigeria has witnessed unprecedented growth and development in recent. After the implementation of the liberalization of the financial sector, which was part of the structural adjustment programme introduced in 1986, the banking industry in Nigeria witnessed a tremendous growth. Say in the conduct of the affairs of the company. Banking business therefore calls for caution, prudence and accountability on the part of the operations. Nwadibia G.U. (2001). Since the inception of banking activities in Nigeria, the sector has witnessed the liquidation of many indigenous banks.Many depositors known as customers have equally lost huge amount of money as a result of distress and liquidation of banks and other financial instruments. This development in the financial sector has made customers to loose confidence in that sector of the economy due to lack of safety their valuables kept in the banks. (The Nigerian banking and financial environment by Ogundina 1991).

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meant the The first indigenous bank in Nigeria was the industrial and commercial establishment in 1924 as a result of the patriotic Nigerians who decided to pool resources to establish the bank. After the generalized banking distress in the 1990s in Nigeria leading to the revocation of the license of 31 banks between 1994 and 1998, the CBN and NDIC have continued to grapple with isolated banking problems. The key problems suffered by a number of financial institutions during the period were inadequate capitalizations, insider dealings/abuses, executive capacity in the industry and debt overhang.Various governments have formulated several policies aimed at eliminating the problems or reduce it to the barest minimum, but yielded little or no effect. Due to the failure of several indigenous banks and other financial institutions, the federal government of Nigeria under the leadership of General Ibrahim Badamosi Babangida signed into law, Decree No 22, 1988 establish, the Nigerian Deposit Insurance Company (NDIC). The manifestation of the Decree re-echoed in the banking and financial sector as a welcome relief coupled with the discovery of World Bank team that examined the Nigerian Deposit Insurance Corporative began operation.

The observation spurned the supervising authority to look more rigorously into the safe-guiding of depositor's fund and soundness of banking business. New prudential standards were stipulated and implemented in order to restore public confidence in the banking and financial sector of the economy.

Statement of Problem

This study is basically to highlight the role of the regulatory and supervising authorities in preventing bank failure and ensuring banking stability. It will especially look into the proactive measures put in place by the NDIC under Decree No 22 of 1988 to stem banking failure in the banking sub sector of the economy.

LITERATURE REVIEW

The establishment of Nigeria Deposit Insurance Corporation in 1988 as an explicit deposit insurance corporation scheme under Decree No 22 of 1988 now Cap 301 Laaw of the federation 1990 amended Section (1) of NDIC as a body corporate with perpetual succession and a common seal conformed the corporation of the responsibility of regulating and supervising function of ensuring and preventing bank failure in Nigeria.

Historical Background of NDIC

The history of Nigeria Deposit Insurance Corporation has its origin of a committee set up in 1983 by the Board of Central Bank of Nigeria (CBN), to examine the operations of the banking system in Nigeria. The committee in it report recommended the establishment of a Depositors' Protection Fund. Consequently, the Nigeria Deposit Insurance Corporation was established through the promulgation of Decree No 22 of 15th June 1988. This was part of the economic reform measures taken by the then government to strengthen the safety for the banking sector following its liberalization policy and the introduction of the last Structural Adjustment Programme (SAP) in Nigeria. The will was originally set with an authorized capital of ₦100M. The capital was subscribed to by the CBN & federal government

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There were at least five major reasons for establishing a formal bank deposit insurance scheme in Nigeria:
-The first was the lesson of history connected with the experience of prior bank failures in Nigeria.
-In the 1950s, many small depositors suffered untold hardship as twenty one (21) out of the twenty five (25) indigenous banks operating in Nigeria closed doors.

-The establishment of the ecorporation was also informed by the approach which some other countries adopted to ensure banking stability. For example, Czechoslovakia which was the first country to establish a nation-wide deposit scheme 1924, used the scheme to revitalize the country's banking system after ravages of the first World War. In addition, the scheme served to encourage savings by increasing the safety of deposits and ensuring the best possible development of banking practice in that country. Similarly, the United States of America (USA) established the Federal Deposit Insurance Corporation (FDIC) in 1933 in response to a banking collapse and panic

-The establishment of an explicit deposit insurance scheme with supervisory powers over insured institutions was expected to complement the supervising efforts of the CBN.
-Finally, prior to the establishment of the corporation, government had been unwilling to let any bank fail, no matter a bank's financial condition and/or quality of management. Thus, government establishment of the corporation to administer the deposit protection scheme on its behalf and to serve as a vehicle for implementing failure resolute option for badly managed insolvent banks.Since the establishment of the corporation in 1989, it has been possible for both institutions (IBBO and) to carry out routine and special examinations of licensed banks more frequently than before, despite the increase in the number of banks. The banks are now examined more frequently prior to the establishment of the corporation.

A collaborative study of distress in the Nigerian financial sector was conducted by the corporative and the Central Bank of Nigeria (CBN). Its finding corroborated the earlier held view that distress among the Nigerian Banks was precipitated by complex set of interrelated problems that had for long afflicted the industry. This includes poor management, inhibitive policy environment, capital inadequacy, ownership structure and political interface. In the management of government owned banks, wide-spread of non-performing loans arising from economic down turn and borrowing culture.

Ever since the inception of the insurance scheme, the Nigeria Deposit Insurance Corporation (NDIC) has been consistent with its mandate as provided in NDIC Decree. The prevention and the sanitization of the banking sector has remained the primary focus of the corporation's activities and effective implementation of various laws promulgated by federal government to stem down the tide of distress in the system.

However, the number of distressed banks has considerably declined reflectively the success of the concerted efforts to present bank failure. By 1997, the number has declined tto 43. In 1998, only 10 banks remained classified as distressed following the liquidation of 26 terminally distressed banks in January the same year.

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Functions, Objectives and Operations of NDIC

Functions of NDIC include the following:

i. To determine the state of health of insured bank
ii. To establish on international standard of technical solvency
iii. To monitor compliance with prudential guidelines of insured banks
iv. To assess quality of bank management of insured banks
v. To determine the bank's earnings dependability and profitability

Objectives of NDIC

The primary goal of Nigeria Deposit Insurance Corporation (NDIC) is to protect depositors fund, maintain stability and restore public confidence in banking sector through effective supervision of insured institutions (banks) provision of financial and technical assistance to eligible insured institutional, prompt payment of guaranteed sums and orderly resolution of failed insured financial institutions (banks).

Various Activities of the NDIC in Ensuring Stable Banking System

(i) Failure resolution activities:

In 2008, the corporation continued with the liquidation of the banks whose licenses were revoked in 2006 due to their inability to meet the N25 Billion Naira minimum recapitalization requirement as at December 31 2005 of Professor Charles era as CBN governor. It is also expedient to note that the recapitalization exercise was a landmark success which brought about tremendous growth, development, sanity and restored depositor's confidence in the banking sector. It is instructive to note that the banking license of Societe – Generale Bank of Nigeria (SGBN), which was one of the affected banks, was restored by a court order in April 2008 and the bank was handed over to its owners. That development brought the number of banks closed after the consolidation exercise to thirteen (13). As at the end of 2008, the corporation had obtained court winding-up orders for eleven (11) out of the thirteen (13) banks and was thus appointed official liquidator. The shareholders of the remaining two (2) banks namely: Fortune International Bank and Triumph Bank were still challenging the revocation of their bank's license in court. With that development total number of banks whose licenses were revoked by the CBN between 1994 and 2008 stood at 49. With respect to the banks closed prior to Jan. 2006, the corporation continued the liquidation of 34 out of 36 affected banks, as Savannah Bank and Peak Merchant Bank continued to challenge the revocation of their operating licenses in court.

(ii) Supervising Activities Of The Corporation

In discharging its mandate as a bank supervisor, the corporation conducted on-site examination of banks in 2008. Furthermore, it carried out 15 special investigations arising from petitions, complaints and other matters presented by the banking public and other stakeholders. All these were undertaken to ensure that depositors were adequately protected and that the system remained safe and sound.

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Reports of examinations and special investigations carried out in 2008 showed that some universal banks were still bedeviled with problems of weak board and management oversight: inaccurate financial reporting; poor book-keeping practices; non-performing insider-related credits; declining asset quality and attendant large provision requirements: inadequate debt recovery: non-compliance with banking laws, rules and regulations: and significant exposure to the capital market through share loans and margin loans while the industry exposure might appear tolerable, the exposures of some banks remained worrisome and was partly responsible to their recourse to the CBN's Expanded Discount Window to shove up their liquidity. All these and more supervisions and investigations is to ensure that bank failure/distress is minimized to a barest or tolerable stage of bank failure syndrome.

(iii) Insurance Activities

The corporation in the exercise of its powers to review the design features of Deposit Insurance Scheme (DIS) as may be necessary, the board of the corporation (before it was dissolved in 2009) approved the implementation of Differential Premium Assessment System (DPAS) beginning from 2008. The application of this system had enabled the corporation to achieve the twin objectives of (a) Ensuring fairness in deposit insurance pricing and (b) Reduction in the overall premium burden on banks.

Dual Roles of NDIC to Preventing Bank Failures in the Year 2008

The CBN and the NDIC has continued to collaborate on the on-site, off-site and deployment of Resident examiners to banks to curb the menace of bank distress in the following measures in recent times, they include the following:

A. ON-SITE SUPERVISION

The regulatory authorities continued to major their findings on examination were;

(i) Risk Assessment: Significant progress was made by most banks in the establishment of enterprise-wide risk management frameworks and appraisal of some of the frameworks showed that they were adequate indepth and coverage: where there were exceptions, the banks were advised to correct them as at year ended 2008.

(ii) Capital Adequacy: The banks had adequate capital to support their level of operations. This was due to the recapitalization of banks to the time of N25billion naira in 2005

(iii) Risk Asset Quality: This assessment is carried out to ascertain the adherence to the prudential requirement of 80 percent of loan to deposit ratio, credit administration and draw-down on facilities in banks.

(iv) Board and Management: This is carried out in all the banks to examine Board and Management oversight, corporate governance and abuse of insider-related facilities.

(v) Earnings: This entails the supervision of banks earnings, profitability and business diversification.

The above routine examination of banks internal activities by the CBN and NDIC is to checkmate distress and make correct the measures where necessary in order to avert outright failures of banks nationwide.

B. OFF-SITE SUPERVISION OF BANKS

The CBN and NDIC applied appropriate measures in the supervision of banks activities especially in the year 2008 and was focused on the following major areas:

(i) **Statutory Returns:** The periodic condition of statutory returns of banks was done electronically through the Electronic Financial Analysis and Surveillance System (EFASS) in 2008. The returns were analyzed to ascertain the financial condition and performance of banks, using financial indicators such as asset quality, capital adequacy, earnings and loans to deposit ratios. Appropriate regulatory actions were taken to address areas of concern.

(ii) **Board and Management:** The CBN approved the appointment of 42 persons into the boards and top management positions of some banks it turned down the appointment of a few others on grounds of insufficient experience and unfavourable references from other regulatory and security agencies among other reasons. Nineteen resignations from boards and top management positions of some banks were also recorded in 2008.

(iii) **Banks' Branch Network:** Approvals were granted by CBN for the opening of branches and cash centres during the period and the total number of branches and cash centres in operation as at December 31, 2008, was 5,134 as against 4,574 in the preceding year. Branch expansion was closely monitored to ensure that banks did not utilize depositor's fund for such investments.

(iv) **Credit Risk Management System (CRMS):** As at end of 2008, the web enabled CRMS database has an outstanding balance of N3.11 trillion, involving 60,273 borrowers, as against N2.13 trillion with a total customer base of 51,696 in the preceding year.

(v) **Contraventions:** In line with the provision of BOFIA, the regulatory authorities continued to impose sanctions and enforce the payment of appropriate penalties on erring banks.

C. DEPLOYMENT OF RESIDENT EXAMINERS TO BANKS

As at Dec. 31, 2008, the regulatory authorities issued a circular to all deposit taking banks, on the deployment of resident examiners. Resident examiners are bank supervisors deployed by regulations (CBN and NDIC) to work at the operator's premises in order to monitor the observance of safe and sound banking practices and compliance with banking laws, regulations, guidelines and Grailers issued by the regulating authorities.

The primary objective of deploying resident examiners to banks is to provide real-time and continuous evaluation of the risks posed by the bank's operations. The programme places emphasis on the evaluation of a bank's risk management system and controls as opposed to performing transaction testing and asset valuation (e.g. loan reviews) that take place during conventional examinations. The REs would continually monitor and assess a bank's financial condition and risk management system through the review of management reports and meetings with banks' officials.

This continuous access to management and risk management system allows REs to respond more quickly to management and emerging problems than would be with an annual examination approach and would also checkmate distresses before hand in banking business.

RATING OF BANKS USING CAMEL PARAMETER

One of the on-site off-site examinations produced the (1994) manifestations and features of ill-health were given by the CBN's Economic Review (1994) to include: liquidation problems,

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distress borrowing and resort to risky and speculative activities as well as technical insolvency among banks.However, It was of the option that the determination of solvency of banks is an obstacle to prompt action since financial distress may not be apparent in the first instance they asserted that :Ordinarily as long as a bank can meet all its obligations over the long run, it is considered viable. Measuring such streams of income involves calculating the Net present value of the expected cash flows and it provides the economic measure of solvency.
However, such estimation can be very difficult to undertake and subjective at best. On the other hand, the reliance on book value solvency or the market value of the bank (share price) as a proxy for Net Present Value is a very imperfect measure of its arbitrary nature and the possibility that the bank can manipulate the manner in which such activities are presented.

That deficiency prompted the CBN and NDIC to develop a standard rating system for revealing the extent of distress in any bank is a composition measure categorized into sound, satisfactory, marginal or unsound. The parameter that enabled this categorization is called (CAMEL): Capital Adequacy, Asset Quality, Management Competence, Earning Strength and liquidity. The table below shows "CAMEL" parameters used in rating banks in the year 2001, 2002, 2003, 2004 respectively.

Table 1

Category	Number			
	2001	2002	2003	2004
Sound	10	13	11	10
Satisfactory	63	54	53	51
Marginal	8	13	9	10
Unsound	9	10	9	10
Total	90	90	87	87

The challenges of the Needs and Reforms of the Financial Service Sector / 94 / NDIC

THE CONCEPT OF BANK FAILURE IN BANKING SYSTEM

Banks' distress in any economy is a challenge that has at a time assumed an intractable dimension. However, it is difficult to be precise about the factors that cause failure generally because circumstances differ from bank to bank, place to place and at different historical periods.
A bank shows signals of distress when the bank is unable to meet its financial obligations that fall due. Nevertheless, available evidence has identified a long list of potential causes of failure in a financed/system. These includes: weak management, inadequate capital base, fraudulent self-serving and corrupt practices of owners and managers of financial institutions and other factors which shall be discussed below:

Print ISSN: ISSN 2398-712X, Online ISSN: ISSN 2398-7138

Fraud and fraudulent practices

Nigeria's financial system has suffered from fraudulent practices perpetrated by banks employees, owners, people outside the bank and by banks as corporate bodies.These fraudulent activities exist almost on yearly basis since the inception of banking business in Nigeria financial institutions. These malpractices have led to technical insolvency of and total collapse of some banks. On the basis of perpetrations, banks' fraud may be grouped into three broad categories:

i. Internal fraud – committed by members of staff
ii. External fraud – committed by those not connected with bank's staff.
iii. Mixed fraud – committed by outsider in collusion with bank's staff.

The commonest type of fraud/fraudulent practices against financial institutions include the following:

i. Presentation of forged cheques
ii. Conversion of banks funds
iii. Unauthorized overdraft and loans
iv. Fraudulent transfer and withdrawals
v. Posting of factitious credits
vi. Stealing bank's monies and customers' monies
vii. Suppression of cheques including clearing
viii. Corruption, including falsification of accounts and documents
ix. Raising of forged mails, defalcation of customers cheques, cash lodgments and
x. Loans fraud.

Table 2

The table below shows the number of frauds and forgeries in banks in the year 2005, 2006 & 2007 respectively.

BANKS' STAFF INVOLVED IN FRAUD AND FORGERIES

	2005	2006		2007		
Status	Number	%	Number	%	Number	%
Supervisors and Managers	169	44.70	118	35.64	84	30.76
Officers, Accountants & Executive Assistants	124	32.80	90	27.19	89	32.60
Clerks & Cashiers	54	14.28	50	15.10	34	12.45
Typist, Technicians & Stenographers	16	4.23	16	4.83	21	7.69
Messengers, Drivers, Cleaners, Security Guards & Stewards	12	3.17	7	2.11	-	-
Temporary Staff	3	0.79	50	15.10	45	16.48
Total	378	100.00	331	100.00	273	100.00

Source: NDIC 2007 Annual Report

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Incidence and types of frauds and forgeries reported
The ten (10) banks with the highest number of reported cases of fraud as presented in table above, were responsible for 25.93% of the total amount involved in 2007 compared to 51.77% in 2006. The table also shows that in absolute terms, the total amount involved which stood at N2,595.01 million in table below in 2007 was slightly higher than the 2006 figure

		2005	2006		2007	
Group	Amount involved (N' m)	% share	Amount involved (N 'm)	% share	Amount involved (N 'm)	% share
Total for 10 Banks	9,373.74	88.38	2,512.73	51.77	2,595.01	25.93
Total for all Banks	10,606.18	100.00	4,832.17	100.00	10085.81	100.00

Other fraud and forgeries perpetrated in banks during 1991 -1996 according to NDIC indide advanced free fraud (419), counterfeit securities money laundering fraud and computer fraud among others. This monumental fraud has caused distress.

Capital Inadequacy
Prior to the recapitalization of minimum capital of N25B of banks in 2005 by CBN followed by the CBN infection of N620bn of liquidity into (8) willing banks in the banking sector, capital inadequacy was distributed to the causes factors of local banks of the pre 90s. Available statistics for instance on the industry's capital shortages for 1994 and 1995 included that insured banks required an additional capital of 10.7billion and 38.8billion respectively, to support their volume of business as prudential guideline minimum capital funds required by bank supervisors. This was mainly due to the determination in the industry's loan portfolio. In a situation where capital shortage are as shown above, bank failures becomes inevitable.

Inept Management / Insider Abuse
The quality of management can make important difference between sound and unsound banks. From all available records, a major cause of distress in Nigerian banking industry is attributed to poor management. The takeover of the management of 18 banks in 1995 by the CBN & NDIC, for example, revealed the full extent of the poor mismanagement in the affected banks. Observed by Ebhodaghe (1996: 26) there are many instances where board members approve loans and disbursed even before loan applications reach the banks and even quoted company on the loan application because of the special interest and deep involvement in such loans. Moreover, loans are also granted on personal guarantees of board members even to person of questionable character in the

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society then adherence to laid down rules of prudential guidelines set out for granting of loans by regulating authorities could also be attributed to the warning signals observed by qualities of 8 banks in August 2009. On the over bearance of toxic and non-performing loans in their loan portfolio rescued by CBN's infection of 620bn by Sanusi Lamido Sanusi in 2009. Poor bank management results in excessive risk taking, this practices leads to distress in many banks

Problem of Unqualified and Inexperienced Personnel

That qualified and experienced personnel remain on important determinant in the successful running of any organization cannot be faulted. However, management of many banks undermine this by their actions and therefore go out of their way to employ people who are not only unqualified but inexperienced in the banking industry, simply because they are connected to members of the board worse still these people are put in positions in which they do not have the basic knowledge or skills to take far reaching policy decisions on vital issues or respond appropriately to the ever-changing business environment. This situation results in ineffective performance by the banks generally and as well results in loss of loans, in particular causing them to fail.

Ownership Structure / Political Interference

Ownership structure is one of the major variables that could be used to explain financial distress in Nigerian banks. Owners direct intervention and influences (most especially in government controlled banks) in the internal operations of the banks has contributed to distress. In private banks, the prevalence of boardroom quarrels and insider abuses are precarious cankerworms causing distress in some banks. In fact, boardroom has changed to bedrooms to show the extent of ownership interference.

In addition the causes of unhealthy deviation from set rules and regulations have been discussed at various times to include inadequate supervision, weak management and offensive government policies Ogunleye (2002) classified the causes of bank failure into institutional, economic and political factors as well as regulatory and supervisory inadequacies while Ebhodaghe (1995) attributed banks failure to economic downturn, inhibitive policy environment and management problems.

EXTENT OF BANKING CRISIS IN NIGERIA

The wave of banking crisis has inflicted many countries of the world in the last two, three or four decades. Banking crises has been protracted and systematic in such countries as Australia, Chile and Uruguay while Bolivia, Brazil, Ecuador, Perm and Venezuela have managed to defer or contain the problem.. Even the USA, which has a banking crisis in the 1990s and recently, the world economy was hit by an unprecedented financial and economic crisis in 2007 – 2009, tipped into recession by the sub-prime crisis in the United States of America in August 2007. This crisis led to the collapse of many world renowned financial institutions and even caused an entire nation to be rendered bankrupt. In Nigeria, the economy faltered and the banking system experienced a crisis in 2009, triggered by global events. The stock market collapsed by 70% in 2008 – 2009 and many Nigerian banks had to be rescued.

Source: Sanusi Lamido Sanusi, Feb. 2010

What Went Wrong By Sanusi Lamido Sanusi Feb. 2010

The following factors interpedently contributed to the creation of an extremely fragile financial system tipped into crisis the global financial crisis and recession.

1. Macro-economic Instability caused by large and sudden capital inflow
2. Major failures in corporate governance at banks
3. Lack of investor and consumer sophistication
4. Inadequate disclosure and transparency about financial position of banks
5. Critical gaps in regulatory framework and regulations
6. Uneven supervision and enforcement
7. Unstructured governance and management processes at the CBN / NDIC weaknesses within the regulatory authorities
8. Weaknesses in the business environment

Each of this factors is serious on its right. Acted together they brought the entire Nigeria financial system to the bank of collapse. The above factors also indicated that crisis in the Nigerian financial system was triggered by the un-preparedness of the industry regulators and government fiscal policy makers to sustain and monitor the dramatic post-consolidative growth witnessed by the sector. It also showed that rapid finalization and prevailing sentiment and economic orthodoxy all encouraged this rapid growth, creating a blind spot to the risks building up in the system.

Implication of Bank Failure

Banking crisis where it occurs could result in serious economic disequilibrium and distortion which if not well managed could portend doom and even lead to economic depression. The economic distress fostered by the collapse of the payment system, at sometime in history, on the big economies like USA, Britain and Japan were instructive. In the specific instance of Nigeria, the country had witnessed two painful eras of bank failures. The pre-1950s when 21 out of 25 indigenous banks folded up. The distressed syndrome also resurfaced in the late 80s, such that by December 1995, 60 out of 115 banks in operation were known to be distressed. Between 1994 and 2002 a total of 33 banks were closed. Recently those that could not meet the minimum capital requirement 25bn in the consolidation exercise post 2005 were closed. While any legal entity could fail, bank failure on the contrary is an issue because of the financial intermediation role of banks which makes failure in the sector borating a great concern both to the depositors, investing public operators, regulatory authorities and government. It is therefore expedient to adopt a resolution strategy that will help to ensure a stable banking system and engender public confidence in the industry. The following are the adverse effects of banking crisis:

(1) Erosion of Public Confidence: Banking business is built on trust and confidence. The misplacement of its role of fiduciary duties will result in inefficient role of intermediation.

(2) Economic Effects: Banks are central to an efficient and effective payments system to any country. With banking crisis, the payment system would be perilous and at great risk as the link between the real sector and the financial sector including international settlement would be greatly inspired. Banking crisis can hinder effective competition and lead to undue concentration and inefficiency in the delivery of banking services.

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(3) Global Effects: With bank distress, the international perception of the banking system would be that of suspicion and undoubtedly compromise foreign investment and lead to crisis in other nations of the world.

The Role of NDIC in Preventing Bank Failures

The prevention and ensuring banking stability in the banking sector from the on set has been collaboratively carried out by a host of regulatory authorities namely: Central Bank of Nigeria (CBN), Nigeria Deposit Insurance Corporation (NDIC), and the Federal Ministry of Finance (FMF) among others.

However, distress resolution which is the core of the prevention and sanitization exercise is legally a primary responsibility of the NDIC going by the amendments to its decree and incorporation into Nigeria constitution.The corporation has therefore a number of initiatives in this regard leading to the evolution of a coordinated approach for distress resolution.

In this review of the role of the NDIC in prevention efforts, it is note worthy to distinguish between normal or ordinary supervisory actions of the corporation that have had impact on the prevention efforts and those more or less one-off actions taken to sanitize the system and ensure stability. The first set of actions refers to the normal on-site examination and off-site supervisory activities of the corporation which have been discussed earlier. These actions provide the diagnosis for updating the trend in distress as well as indicating the next possible line of actions in the prevention drive.The second set of actions conceptualized and implemented to sanitize the banking system are expectedly corrective as well as preventive of further deterioration in the financial condition of the distressed banks. These measures include moral suasion, imposition of holding actions, financial assistance, supervisory intervention and outright liquidation. These are explained below:

Moral Suasion: As a first step in distress management, the CBN and NDIC would hold regular discussion and consultations with the owners and management of the affected banks with the view to make them embrace healthy practices that would enhance their performances as well as taking prompt and timely decisive steps to revitalize their banks. Although, this approach had helped in making the owners and management of most problem banks to refocus greater attention in certain areas of operational problems, such as the recapitalization from 2billion in 2002 to 25billion by December 2005 and their ability to recover non-performing loans.

Imposition of Holding Actions: Banks that were identified to be in distress after special examination were placed under close supervision and restrictions through the imposition of holding actions. The aims of the Holding Actions were to allow the troubled banks to undergo self-restructuring measures as first line of self-salvaging actions and to arrest further deterioration in their financial condition. The approach is anchored on the belief that given determined management and boards, the declining fortunes of the troubled banks could be revered. Holding Actions imposed on distressed banks require them to do the following:

i. Inject further capital funds
ii. Stop further advertisement for deposits taking without prior consent to the CBN

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iii. Not grant further loans and advances until the regulatory activities were satisfied with the bank liquidity position
iv. Take necessary steps to ensure adequate internal control measures to safeguard its books, records and assets
v. Engage in aggressive debt recovery drive
vi. Not to embark on new projects without clearance from CBN
vii. To segregate all dormant accounts with specific time limit
viii. To take steps to perfect all collateral securities pledged for loans and advances and keep them in protective custody
ix. Not to dispose off any fixed assets of the bank without prior consent of the CBN
x. To reconcile all long standing items within a given deadline
xi. To embark upon possible rationalization exercise of staff and branches as a measure of cost reduction.

Furthermore, each troubled bank on which there is holding action will be required to furnish the CBN and NDIC within 30 days of being served the holding actions, details of strategic plan for the revitalization and effective management of the such as turnaround plan which is expected to be creditable and to include proposal for debt recovery, rationalization of cost and staff, injection of additional capital. Also, each bank on which the holding actions were imposed was expected to notify its staff of the measures and ensure that adequate steps were taken to comply with them and officials of the regulatory authorities monitor compliance from time to time. The effects of the holding actions on the distressed status of the affected banks would normally suggest next line of supervisory measures to adopt.

The experiences of the regulatory authorities had revealed that the holding actions had not practically reversed the distressed status of most banks because the heavy accumulated losses made the recapitalization requirement to be beyond the means of the shareholders. The debt recovery efforts on the other hand had not been successful either because the chronic debtors were mainly insiders to the affected banks who were usually not willing to repay their debts neither could they provide adequate collateral that could facilitate the recovery (NDIC Management Committee on Distress Banks, 2002).

Financial Assistance: NDIC in collaboration with the CBN extended accommodation facilities of help to eight (8) banks with serious liquidity crisis to the tune of N2.3billion in 1989 following the withdrawal of public sector funds from commercial and merchant banks to CBN during the year. Also in 2009 the CBN injected N620billion of liquidity into banking sector in order to stabilize the system and return confidence to the markets and investors following a crisis in 2009 triggered by global events. In recent years, the corporation has received appraised applications for liquidity support from some banks which were later found that the problems of those banks transcended liquidity to include insolvency hence CBN could adequately resolve the issue by mere provision of liquidity though a few of the applications were approved. The regulatory activities, therefore, decided to directly intervene by taking over the chronically distressed banks numbered 46 and 8 in 2009.

Vol.7, No.2, pp. 23-42, May 2020
Published by ECRTD-UK
Print ISSN: ISSN 2398-712X, Online ISSN: ISSN 2398-7138

Assumption of Control and Management: Early 1992, the CBN took over temporarily 24 banks to safeguard their asset and six of the banks were in distress. These banks are National Bank of Nigeria (NBN), African Continental Bank Plc., New Nigerian Bank Plc, Broad Bank Limited, Mercantile Bank Plc, owned by a state government. The control was handed over to the NDIC as a management agent as well as proposing a failure resolution option consistently with the circumstances of each bank. The corporation in turn appointed on Interim Management Board (IMB) for each bank to assist in working out appropriate restructuring plans. In 2009 – 2010 the leadership at (8) Nigerian banks was replaced and rescued by CBN in order to stabilize the system.

Restructuring and Sale of Distress Banks: Following the amendment to NDIC Decree No 22 of 1988 which gave the corporation a functional autonomous status to address distress through the design and administration of effective resolution options, the corporation with effect from September, 1997 reconstituted the management team of the 25 distressed banks. Each management team was made up of at least one NDIC staff and a senior staff of the affected banks. Two Management Supervisory Boards (MSBs) were established and a committee on Distress Banks was also established to take executive decision on the distress based on the reports from the MBS, 7 distressed banks were acquired, restructured and sold to new investors.

Suspension of Banking License: In February 1994, the CBN suspended the licenses of 2 Commercial Banks namely; Republic Bank Limited and Broad Bank Nigeria Limited following the discovery of serious malpractices perpetrated by the management of these banks in the inter-bank clearing system. While the suspension of Broad Bank Limited was subsequently lifted, the Republic Bank could not meet the conditions for the restoration of its operating license. Likewise, in 2003 many of the banks were caught in the same act and were suspended by CBN for one (1) year. Also in December 2005 the banks which were not able to meet the recapitalization from N2billion to N25billion minimum requirement of emerging or acquisition were closed. This exercise gave birth to 25 mega banks.

Liquidation of the Distressed Banks: Between 1994 to date, thirty five (35) terminally distressed banks were closed with minimal disruption to the banking system. The closure of these banks was because of their inability to respond to all the various regulatory supervisory initiatives put in place to resolve their problems and the continued deterioration in their financial conditions.

Therefore, NDIC was appointed provisional liquidator of the closed banks. Recently in 2010, the Nigerian dailies (Newspaper) published agent banks by the corporation paying depositors minimum of N200,000 compensation of the closed banks.
The corporation dual role of insurer and liquidator ensured that the losses suffered by the bank depositors as well as the economy at large due to banking failure.

FINANCIAL CONDITIONS AND ANALYSIS OF INSURED BANKS AS AT DECEMBER, 2007

The financial condition and performance of insured banks in 2007 relative to 2006 are shown below:

International Journal of Interdisciplinary Research Methods
Vol.7, No.2, pp. 23-42, May 2020
Published by ECRTD-UK
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INDICATORS	**YEAR** 2006 (N billion)	**YEAR** 2007 (N billion)
Profit before tax	181.04	397.75
Interest Income (Net)	306.18	524.24
Non-interest Income	233.02	408.97
Interest Expenses	178.21	361.17
Operation Expenses	367.67	519.2
Yield on Earning Assets (%)	3.47	5.27
Return on Equity (%)	17.36	23.07
Return on Assets (%)	2.65	3.64

INSURED BANKS' CAPITAL ADEQUACY

CAPITAL ADEQUACY INCATORS	**YEAR** 2006 (₦'M)	**YEAR** 2007 (₦'M)
Total Qualifying Capital	1000.03	1000.07
Capital to Risk Weighted Asset Ratio (%)	22.57	21.09
Number of Banks	25	24

Source: NDIC 2007 Annual Report

ASSETS QUALITY OF INSURED BANKS

ITEM	**YEAR** 2006 (₦'B)	**YEAR** 2007 (₦'B)
Total Credit	2,840.10	5,250.00
Non performing Credit	225.08	387.99
Shareholders' Fund	1,000.04	1,650.00
Ratio of Non-performing Credit to Total Credit (%)	7.92	7.39
Ratio of Non-performing Credit to Shareholders' Fund (%)	22.5	23.98

Source: NDIC Annual Report

LIQUIDITY RATIO OF INSURED BANKS AS AT 2006 AND 2007

ITEM	**2006**	**2007**
Average Liquidity Ratio (%)	62.19	61.98
Loans and Advances to Deposit Ratio (%)	75.60	91.75
Number of Banks with less than 40% Minimum Liquidity Ratio	3	2

Source: NDIC 2007 Annual Report

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Insured Banks Reported Frauds/Forgeries and Facility Bond Insurance Cover

In compliance with the requirements of section 35 and 36 of the NDIC Act 2006, banks render monthly returns on frauds and forgeries and also notify the corporation of any staff dismissed or terminated on the ground of fraud or financial malpractices. Similarly, by the provision of section 35 of the Act, Insured banks are mandated to provide facility bond insurance cover frauds and forgeries committed with staff connivance or collusion.

Returns on Insured Banks on Frauds And Forgeries
Source: NDIC 2007 Annual Report

Quarter	Year	Total No of Fraud Cases	Total Amt Involved (N 'm)	Total Expected Loss (N 'm)	Proportion of Expected Loss to Amt Involved %
1st	2007 2006	397 268	4,128 740.12	858 422.94	20.78 57.89
2nd	2007 2006	335 284	1,083.94 1,429.06	562.53 824.17	51.89 57.67
3rd	2007 2006	398 334	2,196.00 843.82	615.6 547.86	28.03 64.94
4th	2007 2006	423 307	2,597.87 1,819.35	834.72 973.69	32.13 53.52
Average	2007	1553	10,005.81	2,870.85	28.69
Total	2006	1,193	4,832.17	2,768.67	57.29

The table above shows there was a total of 1,553 reported cases of attempted frauds and forgeries involving over 10.0 billion (that is 8.8 US$ 591,487.8, GDP 12,410 and £35,390.76) in 2007 compared to 1,193 reported cases of fraud and forgeries involving 4,832.17 billion (that is, 4.6 billion, US$ 1.8 million and GDP 14,399.74) in year 2006.

Out of the number of reported cases of attempted fraud and forgeries, 825 cases resulted in losses to the banks amounting to 2.870 billion (that is, 2.7billion, US$ 238,621.50, GBP 12,410 and #390) in year 2007 compared to 612 cases involving 2.768billion (that is, 2.6billion, US$ 1.3million and GBP 14,399.7) in 2006.

Contributions and Achievements of the NDIC in Ensuring Stable, Safe And Sound Banking System in Nigeria

Deposit Guarantee

As a deposit insurer, the corporation guarantees payment to depositors in the event of failure of an insured bank. In that regard the corporation had paid about N23.4billion on insured deposit as against N16.97billion total insured amounts as at end of December 2007, representing about 89% of the total insured claims to the depositors of 34 banks in liquidation. The development has no doubt boosted the confidence of depositors (especially small savers) in the nation's banking system.

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Also, after operating the scheme for over a decade, information revealed that Deposit Insurance Scheme (DIS) was reviewed in 2006, the inadequacy of the level of deposit insurance coverage which is in 1988 at N50,000 to be inadequate as a result of inflation, depreciation of the local currency and charges in per capita income level of the country. In this regard, the corporation proposed an upward review of the insurance limit to N200,000 was fixed for claimants from universal banks while depositors of other insured institutions will enjoy an NDIC of N100,000 per depositor.

Depositors' Protection Through Supervision

The corporation enhancement of supervisory capacity through focused training and acquisition of relevant tools is being vigorously pursued in recent years. More staff in the on-site and off-site supervision departments of the corporation have been exposed to new techniques of banking supervision. Similarly, the existing tools for off-site surveillance Bank Analysis System (BAS) has been enhanced to mitigate some of the problems associated with off-site supervision in the system. Furthermore, in 2000 Annual Bank Examiners Conference was introduced as a forum for NDIC examiners to brainstorm on emerging challenges in the financial services industry and to design strategies for meeting such challenges.

Payment of Liquidation Dividend to Depositors

Through the corporation's efforts to settle insured depositors of the closed banks, more uninsured depositors have also been paid liquidation dividends. As at the end 31st December 2007 the corporation had declared an aggregate dividend of N11.6billion for 32 out of 34 banks in liquidation and paid N5.9billion. The balance is with agent banks which names were published in the tabloid which are yet to be collected by uninsured depositors. Out of 32 banks, a final dividend of 10% of total deposits had been declared for a bank indicating that all the depositors had fully recovered their deposits. These banks are:

1. Nigeria Merchant Bank Plc;
2. Alpha Merchant Bank Plc;
3. ABC Merchant Bank Limited;
4. Amiccable Bank of Nigeria Limited;
5. Premier Commercial Bank Limited;
6. PAN African Bank Limited;
7. RMS Merchant Bank Limited;
8. Kapital Merchant Bank Limited;
9. ICON Limited (Merchant Bankers)

Liquidation Dividend To General Creditors

Liquidation dividend had also been paid to some general creditors of some of the closed banks. As at 31st December 2007 some of the banks listed above general creditors had been paid about 90% of total amounts declared as dividend to the creditors of the banks. Successfully closed 34 banks whose licenses were revoked without any adverse effect paid total of 6.03billion to uninsured depositors declared 100% dividend to depositors of 10 (ten) banks realized both risk and physical assets of failed banks.

Debt Recovery
Consequently, the corporation had offered incentives to encourage debtors to repay their debts. Interest waivers had been granted on a case-by-case basis to encourage payment. As at the end of December 2007, the sum of N12,581.73 million had been recovered from debtors of 34 banks in liquidation. Peak Merchant Bank as well as twelve (12) out of the fourteen (14) failed banks closed in 2006 that is pre-consolidation. That contrasted positively with the sum of N8,603.11 million reported as at December 31, 2006.

Consumer Protection
Establishment of a deposit insurance system (DIS) that offers consumers the greatest protection through its contribution to financial system stability. Instilling confidence in insured institutions by supporting and contributing to an orderly or proper functioning of the payment system, and assuring the public that a naira in their bank accounts is the same as a naira in their pockets.

Challenges Facing The NDIC
While the corporation has recorded reasonable achievements in ensuring stability in preventing bank failure since its inception in 1988, the implementation of the scheme has not been without some challenges which include the following;

1. **Issues Confronting NDIC as a Deposit Insure:** Public perception of the DIS being confused with those of conventional Insurance business. Also the incidence of distress in other deposit-taking institution, inadequate information disclosure by insured banks, depositors apathy and ignorance, prompt settlement of guaranteed depositors, level of deposit insurance coverage and others. Another major challenges is non-achievement of desired target for settling insured deposit claims in many banks that closed their doors to the public longer period of time before their licenses were revoked. This had made the compilation of information very difficult and protracted due to some of the banks were not fully computerized and had wide branch network. E.g. Savannah Bank of Nig. Plc with its multiplicity of legal actions.
2. **Issues Confronting NDIC as a Liquidator:** Delay in taking Resolution/Action; legal challenges which include inadequate legal provisions is that NDIC had to apply to the Federal High Court to be appointed as a liquidator subject to the general companies winding-up rules which among others required notice to be issued and advertised before appointment. Also the issues of legal Actions by owners of closed banks, Recovery debts owed failed banks.

Some of the challenges in the Nigeria's experience include: low level public awareness of the Deposit Insurance System DIS, the fiscal responsibility act which requires that 80% of the corporation's operating should be remitted to the Federal Account Constrains rapid build up of DIF. Long draw-out litigation by erstlolile shareholder/directors of closed banks and cumbersome judicial process. Poor corporate governance of insured institution among others.

The Failed Banks' Act and Its Implementation
The promulgation and implementation of the failed banks (Recovery of debts) and financial malpractices Act No 18 of 1994 was in response to the inadequacies of the existing laws, court processes and procedures with respect to debt recovery and prosecution of perpetrators of financial crimes in the banking industry. Thus the main trust of the law was to facilitate the recovery of

debts owed to failed banks and to subject individuals involved in the monumental incidence of financial malpractice in the distressed banks to due process.

The highly acclaimed successful implementation of the failed bank Act which was facilitated by the corporation was a good platform in addressing distress and promotes the soundness of the Nigerian banking system. It was recorded that a total of 3,714 cases were filled before the tribunals; N8.99 billion was recovered, while judgment in respect of N2.3 billion 7.04 million dollars and 5.021 million pounds had been delivered in 1999, the tribunal was abolished and all undecided cases were transferred to the federal high court. The abolishment of the tribunal has been a major setback in debt recovery and had made the problem intractable.

Source: NDIC Quarterly, volume 12 December 2002.

Prospects

In spite of the challenges enumerated above, the prospects for a better and stronger deposit insurance scheme, robust, sound and stable financial system in Nigeria are quite bright. These prospects are hinged on the following developments among others:

(a) The expected benefits of continuous reforms of macro-economic programme embarked upon by federal government.

(b) The proposed amendments of the enabling laws for conducting banking business are expected to address the inadequacies of enforcement powers with respect to bank closure and liquidation.

(c) The on-going banking sector reform programme that will regulate and facilitate code of ethics and professionalism for bank employees which will aim also at evolving responsive corporate governance in the banking sector.

(d) The continuing effort at improving the corporate governance of banks especially the continued encouragement of banks by the regulatory supervisory authorities on the need to always adopt employment policy which will guarantee that staff recruitment satisfy the fitness and properness interia especially board members and top management positions.

(e) The automation of rendition of prudential returns by license banks through a computerized banking analysis system

(f) The increased awareness campaign to enlighten depositors on their respective claims and promotion of banking habit on the general public.

All of which are geared to enhance stability, prevent failures, safety and confidence in the financial system. Also with the signing of NDIC amended bill into law, the corporation will be armed with enhanced enforcement powers to carry out its mandate for the benefit of the Nigerian financial system and the economy.

CONCLUSION

The Nigeria deposit Insurance Corporation (NDIC) has a positive role in the prevention of banks failures in Nigeria..The corporation since its establishment in 1988 and commenced operation in march 1989 under decree No. 22 now CAP 301 law of the federation 1990 has played that role wonderfully with factors and figures contained in this research work.

In conclusion, it could be said that there was prevalence and widespread existence of distress condition in the Nigeria Banking industry between 1980's and early 1990's but between 1994 to 2008 the number reduced to industry has barely witnessed any distress due to intervention of CBN in 2009 the injection of N620 bn of liquidity into the banking sector and replaced the leadership at 8 Nigerian Banks coupled with establishment of AMCON to absorb loans.In terms of causes, the study confirmed that the distress condition has been due to a wide range of institutions factors. The most critical factor was widely acknowledge to be bad management which manifested itself in various forms such as bad lending policy, poor internal controls and wide ranging fraudulent practices industry insider abuses. The preventive control and detection of failure should be collaborative efforts of of regulatory bodies, banks and the customers, their public and the government industry relevant agencies.

There is optimism on the future of the NDIC and the safety of depositors' fund. Many plans and contribution are underway towards revamping the nation's banking industry. " prevention is better than cure" and "an ounce of prevention is better than a pound of cure" in other words the authorities banks, customers and the entire public should be proactive in dealing with possible problem which may eventually lead to future. With all hands on deck significant and political changes and improvement are no doubt realizable in the years ahead.

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