



Central Banks and Financial Stability

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Financial Sector Stability

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Introduction

- ***Financial Stability: -***

“Is a condition in which the financial system - comprising financial intermediaries, markets and markets infrastructures - is capable of withstanding shocks and unravelling of financial imbalances, thereby mitigating the likelihood of disruptions in the financial intermediation process which are severe enough to significantly impair the allocation of savings to profitable investment Opportunities” (2008)



Introduction (cont.)

- ***Until recently, the focus of most central banks was on price stability, which was thought would lead to financial stability.***
- ***Equally, supervision was centered on ensuring soundness of individual financial institutions in the expectation that this would ultimately guarantee the stability of the financial system.***
- ***The objective of financial stability was, therefore, taken for granted and compromised***



Introduction (cont.)

- ***The 2007-2008 Global Financial Crisis (GFC) was initially attributed more to a micro-prudential rather than macro-prudential failure.***
- ***With the benefit of hindsight, events after the crisis have shown clearly that financial stability cannot be achieved solely through the traditional monetary and micro-prudential policies.***



Introduction (cont.)

- ***Developments in the financial system have created the need for regulators to broaden their focus beyond micro prudential oversight to encompass measures aimed at ensuring the stability of the financial system in order to prevent systemic risk.***
- ***It is now widely accepted that a macroprudential policy framework relating to the stability of the financial system with focus on risk based supervision needs to form part of the overall economic and financial policy framework.***



Introduction (cont.)

- ***Many countries, including leading, emerging and developing economies have taken steps to review their financial stability frameworks***
 - ✓ ***by placing strong emphasis on the development of effective financial stability policies as well as practical implementation of the guiding principles.***



Central Bank of Nigeria's Experience

- ***As a consequence of the ripples caused by the GFC, it was very clear that a holistic approach was essential in Nigeria to avert recurrence of the crisis or mitigate its potential impact on the larger economy.***
- ***One of the principal mandates of the CBN is the 'promotion of sound financial system in Nigeria' (CBN Act S.2d).***



Central Bank of Nigeria's Experience (cont.)

Central Bank of Nigeria (CBN)

- Created the Board Financial System Stability Committee;
- Established Financial System Stability Directorate;
- Developed Early Warning Systems (EWS) to estimate probability of bank failure and to deepened the implementation of RBS;
- Set-up macro prudential regulation unit within Financial Policy & Regulation Department to monitor and analyse vulnerabilities in the financial system using various macro prudential tools;
- Established framework for managing Domestic Systemically Important Banks (DSIBs);





Central Bank of Nigeria's Experience



Central Bank of Nigeria (CBN)

- Developed macro prudential rules (forward looking capital requirements, counter-cyclical buffers, Net Open Position limits, dynamic provision etc.);
- Commenced consolidated examination of Holding Companies in conjunction with other sector regulators; and
- Commissioned Systemic Policy Partnership/Oliver Wyman (SPP/OW) an global consortium on financial stability issues to advice on enhancement of specific tools and framework for managing the stability of the Nigerian financial system



Inter Agency Co-operation

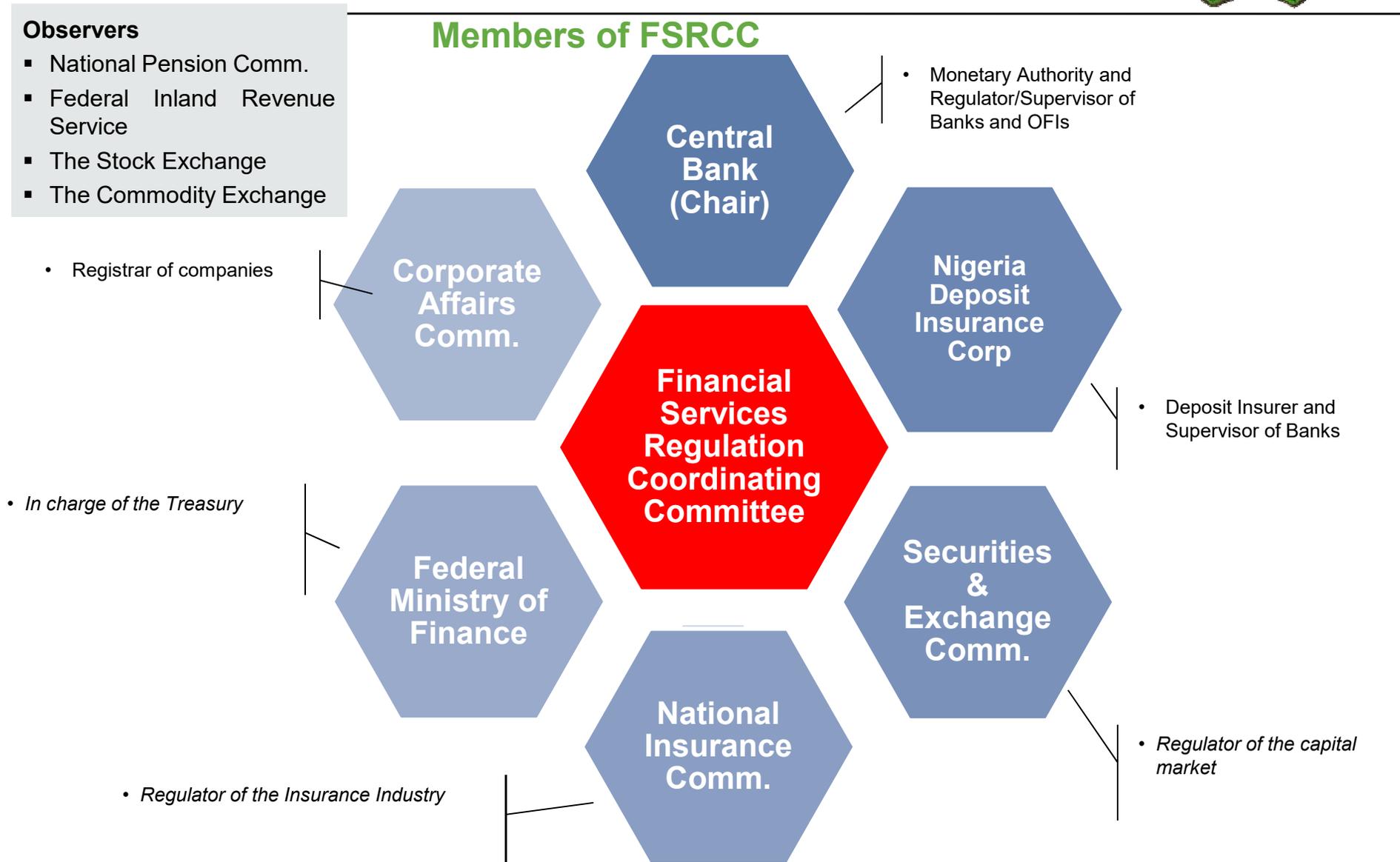


Financial System (Inter Agency)

- Financial Services Regulation Co-ordinating Committee (FSRCC)
 - ✓ To co-ordinate supervision of financial conglomerate
 - ✓ Eliminate regulatory arbitrage.
 - ✓ Articulate strategies for promoting safe, sound and efficient practices.
 - ✓ And deliberate on any other issue as may be specified from time to time.
- It has neither clear financial stability mandate nor enforcement powers, though members do comply with decisions of the body.



Inter Agency Co-operation





Framework for Financial System Stability



Financial System (Inter Agency)

- FSRCC considered and adopted the SPP/OW report
- A Framework for delivering financial system stability and a roadmap establishing institutional arrangements were to be developed
- An implementation programme with the full backing of the FSRCC was set up and has already submitted the framework for managing Nigeria's financial system stability which is ready for implementation subject to the enactment/amendments of the necessary legislations.

Framework for Financial System Stability



- Establishment of an Institutional focus of authority to provide leadership for conducting financial stability policy

- Establish components Policies to deliver financial stability:
 - ✓ Macro prudential policy
 - ✓ Micro prudential policy
 - ✓ Crisis management continuum



Framework for Financial System Stability



Institutional focus of Authority

- Oversees and provides leadership on on-going basis, for the formulation and effective implementation of policy(ies) for delivering financial stability.
- Set and oversee the delivery of detailed objectives for each of the three component policy areas and ensure cohesion and consistency
- Take high level decisions in relation to each of the three component policy areas
- Ensuring that adequate preparations and arrangements are put in place and tested for the handling of transition to crisis (trigger arrangements) and of crises themselves
- Conduct regular macroprudential policy reviews



Component Policy for Managing Financial System Stability

1

Macroprudential policy

- Macroprudential policy is the use of prudential and other macroeconomic tools to limit systemic risk, prevent disruptions to key financial services in the economy and safeguard financial stability.
- Provide early warning system in relation to both conjunctural and structural issues, monitor and analyse risk and vulnerabilities.
- Propose possible remedies and subject to agreed decision making process ensure that the remedies are put in to effect
- It also interacts with monetary, fiscal and other types of public policies that have impact on financial stability



Component Policy for Managing Financial System Stability (Cont.)

2

Microprudential policy

- Providing structural strength by ensuring high quality supervision of individual entities
- Contributing to macroprudential and crisis management policies through:
 - ✓ data sharing amongst micro-prudential supervisors and authorities entrusted with macro-prudential policy
 - ✓ assessment process

Extensive interaction is thus required between the macro and micro prudential regulation to align supervision and ensure there are no gaps or overlaps



Component Policy for Managing Financial System Stability (cont.)

3

Crisis management continuum

- Prepare and test in the most effective manner, arrangement for handling activities involved in:
 - early intervention and recovery,
 - triggers for moving into crisis mode, and
 - resolution and crisis handling.



Indicators of Financial System Vulnerabilities

Macro prudential

- Capital adequacy
- Asset Quality (lending and borrowing institutions)
- Management soundness
- Earnings and profitability
- Liquidity
- Sensitivity to market risk
- Market based indicators (yields, equity prices etc)
- etc

Macro economic

- GDP
- BOP
- Inflation
- Interest and exchange rate
- Oil price
- Contagion
- etc



Tools used in managing risks and vulnerabilities

Prudential tools

- Capital buffers
- Dynamic provisioning
- Net open position limits
- Liquidity ratio
- Loan to value ratio
- Large exposure limits
- Sectoral capital requirement in terms of risk weights
- Reserve requirements
- etc.

Stress Testing, Early warning Systems, and Trend analysis

- To proactively detect vulnerabilities and draw-up policies to strengthen financial stability/create a basis for new Macroprudential rules

Others

- Enforcement of sound risk management practices



Cross border arrangements

CSWAMZ

- The College of Supervisors of the West African Monetary Zone (CSWAMZ) was aimed at, among other, facilitating exchange of information and assessment among supervisors to enhance efficiency and effectiveness of supervision.

MoUs and Cross Border Reporting

- We have executed MoUs on supervisory co-operation and information sharing with 16 supervisory authorities involving 23 countries covering things like licensing, off site and on site supervision, corporate governance, capacity building and bank resolution.

Cross Border Reporting

- Nigerian banks render monthly returns on the activities of their offshore subsidiaries for review and appropriate timely regulatory intervention.



Conclusion

- **Effective financial system stability does not happen by accident. It can only be as a result of conscientious and collaborative efforts by the relevant stakeholders.**
- **I would like to encourage all stakeholders to rise up to the challenges of ensuring financial system stability. It is through effective collaboration that we will ensure better outcome for our financial systems.**



- **Thank you for listening**



References

- The ECB and IMF indicators for the macro-prudential analysis of the banking sector: a comparison of the two approaches” by A. M. Agresti, P. Baudino and P. Poloni, November (2008) <http://www.ecb.europa.eu>