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BANKING METHODS AND PROCESSES

COURSE GUIDE

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MODULE 1

Unit 1 Evolution of Banking Methods and Processes

Unit 2 Types of Banking

Unit 3 Banking Methods of Payment

Unit 4 Instruments of Payment in Banking

UNIT 1: EVOLUTION OF BANKING METHODS AND PROCESSES

CONTENTS

1.0 Introduction

2.0 Objectives

3.0 Main Content

- **3.1 History of Banking**
- **3.2 The Concept of Banking**
- **3.3 Role of Banking**
- **3.4 Distinction between Banks and Money Lenders**
- **3.5 Growth of Banks in Nigeria**

4.0 Conclusion

5.0 Summary

6.0 Tutor-Marked Assignment

7.0 References/Further Reading

1.0 INTRODUCTION

The first question one may ask when reading this Unit is ‘What is so special about banks?’ this Unit aims to offer some insights into the evolution of banking and the growth of banks in Nigeria. A bank is a financial intermediary that offers loans and deposits, and payment services. Nowadays banks also offer a wide range of additional services, but it is these functions that constitute bank distinguishing features. Because banks play such important role in channelling funds from savers to borrowers, in this unit the history, concept and role of banking will be emphasized.

2. 0 OBJECTIVES

At the end of this unit, you should be able to:

- explain the concept of banking
- distinguish between banks and moneylenders
- outline the role of banking

3.0 MAIN CONTENTS

3.1 HISTORY OF BANKING

The roots of banking can be traced to the earliest civilizations. The Egyptians and early societies of the Middle East developed the prototype upon which modern banking is based. It is believed that the English word **"Bank"** derived from the Italian word **"Banco"** (long bench), A Banco was a table covered in green cloth where moneylenders completed their transactions in the marketplace. **"Bank"** may also trace its origins to the German word **"Banch"** meaning **"a pile",** the word Germans used to represent a kind of public debt. Regardless of how the word originated, banks have been important financial institutions linking the economies of the world. Historically, banks functioned to provide deposit, loan, and currency exchange services. With time, these banking services became increasingly important to a nation's economic advancement.

There is firm evidence that around 3,900 B.C., Egypt adopted a banking service utilizing cows as units of exchange. Deposited cows were assigned a value and exchanged for goods of equal value. Near Babylon, in modern-day Iraq, services to secure valuables and extend business loans were also emerging. At the Semitic red monastery of Uruk (thought to be the derivation of "**Iraq**"), one of the world's oldest cities, the priests leased land to farmers. The monastery also held a vast quantity of valuables donated by the faithful. The monastery earned extra income by lending these items to borrowers and charging rental fees. Later, they offered pawning services, paying farmers cash for their grain and cattle. As Uruk prospered, traders began depositing their valuables with the monasteries. They were issued clay tablets coloured with sienna as proof of deposit; with them, they could withdraw items at monastery branches. In addition to the monasteries, wealthy people offered banking services.

Once more, monasteries were the key players with priests, both male and female, acting as **"bankers".** They accepted deposits of cash and valuables against loans which were extended to people affected by disorders or wars. The **"bankers"** also provided currency exchange, loans, and

bills of exchange equivalent to the amounts deposited. These bills were debts payable and were accepted for use in other cities. Under strict government supervision, banking grew, attracting investors from the private and public sectors throughout the realm. As the Roman Empire began to disintegrate, trade and banking declined.

3.2 THE CONCEPT OF BANKING

Today, the term, bank, means different things to different people in different economies. In order to reconcile the divergent views on the meaning and characteristics of banks, the banking laws in each economy provides operational definition and functional classification which governs banking practices in the economy. In practical terms, a bank means what the operating banking law in an economy defines as a bank (Ezeuduji, 2000:8). To many people, a bank refers to an institution which accepts deposits from the public and in turn advances loans by creating credit. It is different from other financial institutions in that they cannot create credit though they may be accepting deposits and making advances. Economists on their part have defined a bank in various capacities, some emphasizing its various functions. However, a bank has been defined broadly as any financial institution that accepts, collects, transfers, pays, exchanges, lends, invests, or safe-guards moneyfor its customers. This broader definition includes many other financial institutions that are not usually thought of as banks but which nevertheless provide one or more of these broadly defined banking services. Summarizing these definitions a bank is simply an institution which accepts deposits from the public and in turns advances loans by creating credit.

SELF-ASSESSMENT EXERCISE 1

Explain the concept of banking.

3.3 ROLE OF BANKING

Banks provide funds for business as well as personal needs of individuals. They play a significant role in the economy of a nation. Let us know about the role of banking.

1. It encourages savings habit amongst people and thereby makes funds available for productive use.
2. It acts as an intermediary between people having surplus money and those requiring money for various business activities.
3. It facilitates business transactions through receipts and payments by cheques instead of currency.
4. It provides loans and advances to businessmen for short term and long-term purposes.

5. It also facilitates import export transactions.

6. It helps in national development by providing credit to farmers, small-scale industries and self-employed people as well as to large business houses which lead to balanced economic development in the country.

7. It helps in raising the standard of living of people in general by providing loans for purchase of consumer durable goods, houses, automobiles, etc.

3.4 DISTINCTION BETWEEN BANKS AND MONEYLENDERS

You may be thinking that a bank is like a moneylender who provides funds to borrowers and charges interest on the loan. But it is not so. A bank is quite different from a moneylender. A bank performs two main functions. Firstly, it accepts deposits, and on that basis it lends money. The moneylenders, on the other hand, advance money out of their own private wealth and usually do not accept deposits from others. The following table shows the distinction between a bank and moneylender.

	Basis	Banks	Moneylenders
1	Entity	Banks are organized institutions.	Moneylenders are individuals.
2	Activity	Banking activities include acceptance of deposit as well as lending of money.	Activities of moneylender may not include acceptance of deposits
3	Clients	Banks meet the needs of people in general and business community in particular.	Moneylenders meet the needs of agriculturist and poor people.
4	Security	Banks accept tangible and personal security against loan.	Moneylenders generally accept gold, jewellery or land as security for giving loans.
5	Process of recovery of loans	The process of recovery is flexible.	The process of recovery is rigid and strict.

SELF-ASSESSMENT QUESTION 2

Distinguish between banks and moneylenders.

3.5 GROWTH OF BANKS IN NIGERIA

In Nigeria, commercial banking pre - dates central banking and laid the foundation of the Nigerian financial system as far back as the late nineteenth century. The first commercial bank in Nigeria was the African Banking Corporation which opened its first branch in Lagos in 1892. The bank experienced some initial difficulties and eventually decided to transfer its interest to Elder Dempster and Co. in 1893. This led to the formation of a new bank known as the British Bank of West Africa (BBWA) in 1893 which is today known as the First Bank Nigeria PLC. Another bank known as the Bar Clays Bank DCO (Dominion, Colonial and overseas) opened its first branch in Lagos in 1917. This bank is known today in Nigeria as the Union Bank Nigeria Plc. British and French Bank, now called United Bank for Africa Plc was established in 1949 making it the third expatriate bank to dominate early Nigeria's commercial banking.

The foreign banks came principally to render services in connection with international trade, so their relations at that time were chiefly with the expatriate companies and with the government. They largely ignored the development of local African entrepreneurship. These three banks controlled almost about 90% of the aggregate bank deposits as at then. From 1914 to the early part of 1930s, several abortive attempts were made to establish locally owned and managed banks to break the foreign monopoly. This was as a result of the weakness of those indigenous banks in such areas as capitalization and management; and given the total absence of regulation by any government agency, the indigenous banks could not survive the hostile and unfair competition posed by the foreign banks. It was therefore not surprising that by 1954, a total of 21 out of 25 indigenous banks had failed and went into self – liquidation.

In a nutshell, historically, the Nigerian banking industry had evolved in four stages. The first stage can be best described as the unguided laisses – faire phase (1930-59), during which several poorly capitalized and unsupervised indigenous banks failed before their tenth anniversary. The second stage was the controlled regime (1960-1985), during which the Central Bank of Nigeria (CBN) ensured that only "fit and proper" persons were granted banking license, subject to a minimum paid – up capital. The third stage was the post Structural Adjustment Programme (SAP) or decontrolled regime (1986-2004), during which the Neo – liberal philosophy of "free entry" was over stretched and political authorities on the bases of patronage dispensed banking licenses. The emerging fourth stage is the era of consolidation (2004-to a foreseeable future), with major emphasis on recapitalization and proactive regulation based on prudential principles.

In the area of Central Banking, the West African Currency Board (WACB) carried out banking operations in the former British colonies in West Africa before independence. The problems of the WACB led to the establishment of Central Banks in these colonies. In Ghana, it came into being in 1957, in Nigeria 1959, SierreLeon in 1964, and in the Gambia 1964. The Central Bank of Nigeria (CBN) was established by the Central Bank Act of 1958. It was to replace the West African Currency Board (WACB) of the colonial government as part of the preparation for independent Nigeria.

4.0 CONCLUSION

In this unit, you have learnt the history of banking and how the roots of banking can be traced to the earliest civilizations and also, how the Egyptians and early societies of the Middle East developed the prototype upon which modern banking is based.

5.0 SUMMARY

In this unit, the growth and concept of banking has been explained, more light has also been shed on the differences between banks and moneylenders.

6.0 TUTOR-MARKED ASSIGNMENT

1. Explain the growth of Banking.
2. Distinguish between Banks and Moneylenders

7.0 REFERENCES/FURTHER READING

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UNIT 2 TYPES OF BANKING

CONTENTS

1.0 Introduction
2.0 Objectives
3.0 Main Content
    3.1 Central Bank
    3.2 Commercial Banks
        3.2.1 Deposit Banks
        3.2.2 Industrial Banks
        3.2.3 Savings Banks
        3.2.4 Agricultural Banks
        3.2.5 Exchange Banks
        3.2.6 Miscellaneous Banks

1.0 INTRODUCTION

This Unit outlines the main types of firms that undertake banking business and describes the Banking occupies one of the most important positions in the modern economic world. It is necessary for trade and industry. Hence it is one of the great agencies of commerce. Although banking in one form or another has been in existence from very early times, modern banking is of recent origin. It is one of the results of the Industrial Revolution and the child of economic necessity. Its presence is very helpful to the economic activity and industrial progress of a country.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- describe a central bank
- explain the functions of a commercial bank
- differentiate between an industrial and deposit bank

3.0 MAIN CONTENT

3.1 CENTRAL BANK

The core functions of central banks in any countries are: to manage monetary policy with the aim of achieving price stability, to prevent liquidity crises, situations of money market disorders and financial crises, and to ensure the smooth functioning of the payment system. A bank which is entrusted with the functions of guiding and regulating the banking system of a country is known as its Central bank. Such a bank does not deal with the general public. It acts essentially as Government's banker; maintain deposit accounts of all other banks and advances money to other banks, when needed.

The Central Bank provides guidance to other banks whenever they face any problem. It is therefore known as the banker's. The Central Bank maintains record of Government revenue and expenditure under various heads. It also advises the Government on monetary and credit policies and decides on the interest rates for bank deposits and bank loans. In addition, foreign exchange rates are also determined by the central bank. Another important function of the Central Bank is the issuance of currency notes, regulating their circulation in the country by different methods. No other bank than the Central Bank can issue currency.

3.1.1 FUNCTIONS OF A CENTRAL BANK

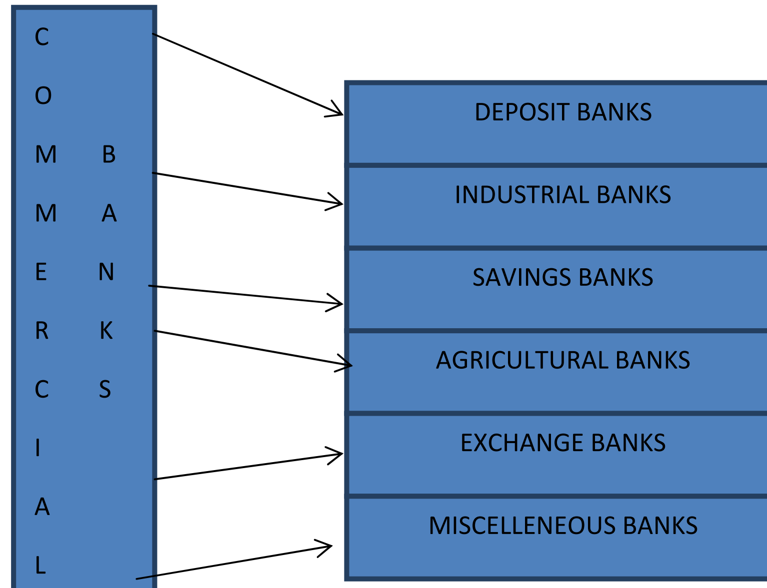
A central bank can generally be defined as a financial institution responsible for overseeing the monetary system for a nation, or a group of nations, with the goal of fostering economic growth without inflation.

The main functions of a central bank can be listed as follows:

1. The central bank controls the issue of notes and coins (legal tender).
2. It has the power to control the amount of credit-money created by banks. In other words, it has the power to control, by either direct or indirect means, the money supply.
3. A central bank should also have some control over non-bank financial intermediaries that provide credit.
4. A central bank act as the government's banker.
5. The central bank should oversee the financial sector in order to prevent crises and act as a lender-of-last-resort.
6. The central bank also acts as the official agent to the government in dealing with all its gold and foreign exchange matters.

SELF-ASSESSMENT EXERCISE 1

Explain the concept of a Central Bank



3.2 COMMERCIAL BANKS

Commercial Banks are banking institutions that accept deposits and grant short-term loans and advances to their customers. In addition to giving short-term loans, commercial banks also give medium-term and long-term loan to business enterprises. Now-a-days some of the commercial banks are also providing housing loan on a long-term basis to individuals. Commercial banks are the major financial intermediary in any economy. They are the main providers of credit to the household and corporate sector and operate the payment mechanism. While commercial banking refers to institutions whose main business is deposit taking and lending it should always be remembered that the largest commercial banks also engage in investment banking, insurance and other financial service areas.

FUNCTIONS OF COMMERCIAL BANKS

The functions of commercial banks are divided into two categories:

i) Primary functions.

ii) Secondary functions.

i) Primary functions:

The primary function of a commercial bank includes:

a) Accepting deposits

b) Granting loans and advances

a) Accepting deposits

The most important activity of a commercial bank is to mobilise deposits from the public. People who have surplus income andsavings find it convenient to deposit the amounts with banks. Depending upon the nature of deposits, funds deposited with bank also earn interest. Thus, deposits with the bank grow along with the interest earned. If the rate of interest is higher, public are motivated to deposit more funds with the bank. There is also safety of funds deposited with the bank.

b) Grant of loans and advances

The second important function of a commercial bank is to grant loans and advances. Such loans and advances are given to members of the public and to the business community at a higher rate of interest than allowed by banks on various deposit accounts. The rate of interest charged on loans and advances varies depending upon the purpose, period and the mode of repayment. The difference between the rate of interest allowed on deposits and the rate charged on the Loans is the main source of a bank's income.

a) Loans

A loan is granted for a specific time period. Generally, commercial banks grant short-term loans. But term loans, that is, loan for more than a year, may also be granted. The borrower may withdraw the entire amount in lump sum or in instalments. However, interest is charged on the full amount of loan. Loans are generally granted against the security of certain assets. A loan may be repaid either in lump sum or in instalments.

b) Advances

An advance is a credit facility provided by the bank to its customers. It differs from loan in the sense that loans may be granted for longer period, but advances are normally granted for a short period of time. Further the purpose of granting advances is to meet the day to day requirements of business. The rate of interest charged on advances varies from bank to bank. Interest is charged only on the amount withdrawn and not on the sanctioned amount.

ii) Secondary functions

Besides the primary functions of accepting deposits and lending money, banks perform a number of other functions which are called secondary functions. These are as follows -

a) Issuing letters of credit, traveller's cheques, circular notes etc.

b) Undertaking safe custody of valuables, important documents, and securities by providing safe deposit vaults or lockers.

c) Providing customers with facilities of foreign exchange.

d) Transferring money from one place to another; and from one branch to another branch of the bank.

e) Standing guarantee on behalf of its customers, for making payments for purchase of goods, machinery, vehicles etc.

f) Collecting and supplying business information.

g) Issuing demand drafts and pay orders.

h) Providing reports on the credit worthiness of customers.

SELF-ASSESSMENT EXECRICE 2

Mention the functions of a Commercial Bank.

3.2.1 DEPOSIT BANKS

The most important type of deposit banks is the commercial banks. They have connection with the commercial class of people. These banks accept deposits from the public and lend them to needy parties. Since their deposits are for short period only, these banks extend loans only for a short period. Ordinarily these banks lend money for a period between 3 to 6 months. They do not like to lend money for long periods or to invest their funds in any way in long term securities.

3.2.2INDUSTRIAL BANKS

Industries require a huge capital for a long period to buy machinery and equipment. Industrial banks help such industrialists. They provide long term loans to industries. Besides, they buy shares and debentures of companies, and enable them to have fixed capital. Sometimes, they even underwrite the debentures and shares of big industrial concerns. The important functions of industrial banks are:

1. They accept long term deposits.
2. They meet the credit requirements of industries by extending long term loans.
3. These banks advise the industrial firms regarding the sale and purchase of shares and debentures.

3.2.3 SAVINGS BANKS

These banks were specially established to encourage thrift among small savers and therefore, they were willing to accept small sums as deposits. They encourage savings of the poor and middle class people. In India we do not have such special institutions, but post offices perform such functions. After nationalisation most of the nationalised banks accept the saving deposits.

3.2.4 AGRICULTURAL BANKS

Agriculture has its own problems and hence there are separate banks to finance it. These banks are organised on co-operative lines and therefore do not work on the principle of maximum profit for the shareholders. These banks meet the credit requirements of the farmers through term loans, viz., short, medium and long term loans. There are two types of agricultural banks,

(a) Agricultural Co-operative Banks.

(b) Land Mortgage Banks. Co-operative Banks are mainly for short periods. For long periods there are Land Mortgage Banks.

3.2.5 EXCHANGE BANKS

These banks finance mostly for the foreign trade of a country. Their main function is to discount, accept and collect foreign bills of exchange. They buy and sell foreign currency and thus help businessmen in their transactions. They also carry on the ordinary banking business.

There are some commercial banks which are branches of foreign banks. These banks facilitate for the conversion of Indian currency into foreign currency to make payments to foreign exporters. They purchase bills from exporters and sell their proceeds to importers. They purchase and sell "forward exchange" too and thus minimise the difference in exchange rates between different periods, and also protect merchants from losses arising out of exchange fluctuations by bearing the risk. The industrial and commercial development of a country depends these days, largely upon the efficiency of these institutions.

3.2.6 MISCELLANEOUS BANKS

There are certain kinds of banks which have arisen in due course to meet the specialised needs of the people. In England and America, there are investment banks whose object is to control the distribution of capital into several uses. American Trade Unions have got labour banks, where the savings of the labourers are pooled together. In London, there is the London Discount House whose business is "to go about the city seeking for bills to discount." There are numerous types of different banks in the world, carrying on one or the other banking business.

4.0 CONCLUSION

The above analyses indication the commercial banks are indispensable in the development process of an economy. Therefore, it is very essential for the government to provide the necessary conducive atmosphere for commercial banks to operate in the economy.

5.0 SUMMARY

In this unit, we have learnt what a commercial bank is, the functions of commercial banks and the various types of commercial banking.

6.0 TUTOR-MARKED ASSIGNMENT

Discuss the functions of commercial banks in Nigeria.

7.0 REFERENCES/FURTHER READING

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UNIT 3 BANKING METHODS OF PAYMENT

CONTENTS

1.0 Introduction

2.0 Objectives

3.0 Main Content

- **3.1 LARGE VALUE PAYMENT SYSTEM**
- **3.2 RETAIL PAYMENT SYSTEM**
  - **3.2.1 CASH**
  - **3.2.2 CHEQUE**
  - **3.2.3 DEBIT CARD**
  - **3.2.4 CREDIT CARD**
  - **3.2.5 DIRECT DEBT**

1.0 INTRODUCTION

Everyday people trade/exchange goods and services for money. With money being the major medium of exchange, payments systems were developed out of a need to facilitate growth of commerce and economic development. In this unit different types of payment systems are discussed.

To begin, let’s define Payment Systems. They are systems that facilitate businesses and consumers to transfer funds to one another. While cash is an important payment instrument that people use in their daily lives to purchase goods and services, other payment instruments are also available and widely used.

2.0 OBJECTIVES

At the end of this unit, you will be able to:

- mention the various payment instruments.
- list the advantages and disadvantages of a credit card.
- explain the large value payment system.

3.0 MAIN CONTENT

3.1 LARGE VALUE PAYMENT SYSTEM

This system typically processes high value critical payments. It is an essential payment system which ensures the smooth functioning of the economy and the financial system. If this system fails, it could trigger disruptions or transmit shocks within the economy. This system enables payments to be made electronically and transactions are settled in real time i.e. as it happens. Other advantages of value payment system are its fast, reliability, safety, convenience, cost and accuracy. The commercial banks also use SWIFT (Society for the Worldwide Interbank Financial Telecommunication) to facilitate transactions. SWIFT is also used by commercial banks to make large value payments on a daily basis both domestically and internationally. This enables banks to automate and standardize financial transactions, thereby reducing operational risk and eliminating inefficiencies.

3.2 RETAIL PAYMENT SYSTEM

This payment system is as important as the large value payment system and has a larger user group. A person with a payment card of any kind is part of the retail payment system. At the retail level most transactions involve cash, cheques or cards.

3.2.1 CASH

Cash refers to money in the form of banknotes and coins, of all the different payment methods cash is still the most commonly used for everyday purchases. Using it couldn't be simpler, it's almost always used face-to-face and you can physically see the money being handed over (and get any change straight away too). Cash is the preferred method for small payments because it involves no credit and therefore no promises. With cash, you can usually purchase goods and services easily as it widely accepted. Carrying too much cash is risky as it can lead to theft and other problems. However, people still carry cash for its convenience and flexibility. From the payee's point of view, transactions are completed immediately and this cash can be re-used for other transactions.

ADVANTAGES OF USING CASH AS A FORM OF PAYMENT

1. Cash is the most common way of payment around the globe when compared to all other types of payment. It does not involve third-party action for its immediate conversion into other forms value.

2. Cash requires no authorization for the person who carries it, thus it is convenient for those who desires small payment amounts to be used.
3. Cash payment does not require additional knowledge when a transaction occurs; whereas credit card payment may need the users to be taught beforehand in order to properly use it.
4. The use of cash does not involve any transaction fees for both ends, that is, the person who uses cash and the merchant does not have to worry about paying any fees when buying and selling goods and services.

DISADVANTAGES OF USING CASH AS A FORM OF PAYMENT

1. Cash payment is not suitable for larger purchases, such as car, or house, etc. As it becomes impossible when stacks of notes are used to make purchases.
2. Cash purchases are instant and have the tendency to be final and irreversible, unless seller agreed otherwise.
3. Cash can be easily purloined and anybody can claim its ownership, thus, it is insecure when compared to other forms of payment.
4. Cash can be forged; merchants without proper tool in aid could have a difficult time finding out.

WHAT WOULD I USE THIS FOR?

- Cash is used every day for all types of transactions such as in shops, restaurants, coffee shops and pubs. It's also the easiest way to transfer money between people – you can simply hand over banknotes or coins.
- Cash can also be used in vending machines to buy certain items – for example, parking tickets, train tickets, drinks, food, etc.

HOW DO I USE IT?

- **Cash machine:** Also known as an ATM. A self-service machine allowing cardholders with a PIN to withdraw cash from their account. Other banking services are also available on most machines. More than £185 billion was taken out at UK cash machines in 2010.
- **Cash Advance:** An advance that draws directly against a credit cardholders' credit line, where the service is available. Interest is usually charged when cash is obtained in this way, and there can be other fees too. Check with your card issuer if you aren't sure.

- **Cashback:** When purchasing goods with a debit card, some retailers (generally supermarkets), offer a cashback service. This enables a customer to add a cash value to the transaction and obtain the cash at the checkout, as an alternative to using a cash machine. The transaction value and the cash value will be debited directly from the cardholder's bank account. Cashback is only available on debit cards. (An alternative use of the expression 'cashback' refers to the feature offered on some credit card accounts of refunding a cash sum to cardholders based on a percentage of their spending. This is similar to other reward schemes such as Air Miles or points.)

3.2.2 CHEQUE

A cheque is a paper voucher linked to a current account. When you open a bank account you may be given a cheque book which contains a number of cheques. Each cheque will already be printed with your bank sort code and account number, your bank's name and address and a unique cheque number.A cheque is an order to transfer funds from the payer's bank to the account of the payee. Cheques are generally valid for six months after the date of issue. The use of cheques has traditionally dominated the world's non cash payments. Despite the development of other payment instruments, cheques remain an important form of payment. A cheque is effectively a future promise to pay the amount stated on it and needs to be presented to a bank in order to obtain the payment. Cheque clearance usually takes 3 - 4 working days.

ADVANTAGES OF A CHEQUE

1. Safer than cash e.g. a crossed cheque can only be deposited into the payee's account.
2. Preferable for large amounts and a large number of payments to avoid carrying large sums of cash.
3. Payments can be made at your convenience and posted to the payee.

DISADVANTAGES OF A CHEQUE

1. Can take up to 3 – 4 working days before funds are available to use.
2. There is no guarantee that the payer has sufficient funds and hence the cheque may become dishonoured (bounce) by the bank.
3. There are extra costs if the payee wants an immediate clearance of funds. Cheques also have other administrative costs associated to it.

WHAT WOULD I USE THIS FOR?

- You can write a personal cheque to a business or an individual for any amount, but it's up to you to make sure you have enough money in your account to allow the payment to go through.
- Cheques are most commonly used to pay bills, tradesmen who come to the house or to pay a friend or another person face-to-face.

HOW DO I USE IT

- When you write a cheque to someone else you fill in the name of the person or business you are paying and the amount in both words and numbers. The other person then pays the cheque into their account and the respective banks arrange for the money to be moved from one account to the other.
- If you pay someone a cheque it will only start to be processed when they pay it into their account, which might not be straight away. If you want to avoid going overdrawn you'll need to make sure you have adequate funds in your account to cover any cheques you write (and until they are paid in).
- Once a cheque has been paid in to an account it will usually be debited from the account of the person who wrote it three working days later, with the person receiving the funds the same day.
- Additional set timescales cover when someone paying in a cheque receives interest (after two days), can withdraw the funds (after four days) and can be absolutely sure that the cheque won't bounce (after six days). These are known as the 2-4-6 rules.
- Not all businesses accept cheques so if you intend to pay with one it's always worth checking they are accepted in advance.

3.2.3 DEBIT CARD

Is a payment card where the transaction amount is deducted directly from the card holder's bank account upon authorization. A debit card is linked to your current account and is used to pay for goods and services anywhere in the world, online and abroad. The amount of the purchase is debited from your available balance on the same day. However it can take several days for the funds to be debited from your account. Debit cards also allow you to withdraw money at cash

machines or get cashback in shops that offer that service. More than 90% of all debit cards in the UK are Visa branded, but there are also maestro cards.

ADVANTAGES OF A DEBIT CARD

1. Debit card payments will only be accepted if the card holder has sufficient funds in his/her account.
2. Debit card can be used for mail order or online purchases.
3. Less risk than holding cash. The risk of theft is mitigated by having pin codes.

DISADVANTAGES OF A DEBIT CARD

1. Takes up to three days for money to be received and acknowledged.
2. Operated at a fee payable to the bank.

WHAT WOULD I USE THIS FOR?

- More than one million places around the world, including online and over the phone accept debit cards. Debit cards badged Visa or MasterCard can be used worldwide – though in some countries you'll still be asked to sign when you pay rather than giving a PIN.
- Debit cards are useful for everyday spending and are generally free to use, providing you have enough money in your account to cover the purchase. On average we use our debit cards nearly six times a week, for everyday shopping, withdrawing cash and paying bills or businesses.
- If you use your debit card in a cash machine (or ATM) there are other things you can do as well as getting cash. These include getting an account balance or mini-statement, changing your PIN, or in some cases topping up credit on your mobile phone.
- Some shops, like supermarkets, offer the option of "cash back" when you make a debit card purchase above a minimum value. This means the retailer will give you the amount of cash you ask for (up to a £50 limit) and the money will be debited from your account straightaway. It's useful when you need cash but there isn't an ATM nearby.

HOW DO I USE IT?

- When you make a transaction using a debit card the funds are taken from your account straightaway. You need to be sure there is sufficient money in your account to make the

purchase – otherwise your card might be declined by the retailer or you could be charged for an unauthorized overdraft.

- When you use your debit card in person, you will be asked to enter your PIN to confirm the transaction. Once you have successfully entered your PIN into the keypad, information is sent electronically to your bank to arrange for the money to be taken to your account and paid to the business.
- Chip and signature cards are available as an alternative to chip and PIN for people who aren't able to use a PIN – you should contact your bank to request one if needed. Card terminals in shops are designed to automatically prompt shop staff to ask for a signature when one is needed and both the business and customer benefit from the same protections from liability for fraud losses offered by chip and PIN.
- Debit cards are also commonly used to buy things online or over the phone. To buy something in this way, you need to provide the 16-digit card number and the name on the card. You will also be asked for the expiry date, an issue number (if there is one) and the three-digit security code on the back of your card. Businesses accepting payments in this way have to meet standards to ensure your information is stored safely, but you should always make sure the company you are dealing with is trustworthy, as this information can be valuable to fraudsters. You should NEVER give your PIN to anyone either online or over the phone.
- There's usually no charge for paying by debit card but your bank may charge you for using your card overseas, and some internet retailers levy a charge too. Some ATMs also charge for cash withdrawals, but you will always be told upfront on the screen before withdrawing cash if you are to be charged, so you have the choice to stop the transaction.

SELF-ASSESSMENT EXERCISE 1

Outline the advantages and disadvantages of a debit card.

3.2.4 CREDIT CARD

A credit card is used to buy goods or services on credit. When you use a credit card to buy things, you are borrowing money from the credit card company who will have advised you of your credit limit – the maximum amount you can borrow. You'll have to repay the money and pay any interestdue. If you pay your bill off in full each month you won't pay any interest.Credit cards are issued through commercial banks and/or other issuers.

ADVANTAGES OF A CREDIT CARD

1. Guaranteed payment up to an approved limit.
2. Can be used for mail order and online purchases.

DISADVANTAGES OF A CREDIT CARD

1. A fee is paid to the bank for this service.
2. High interest rates make credit cards an expensive mode of borrowing.
3. Theft – if the card is stolen or if internet payment sites are not secure.

WHAT WOULD I USE THIS FOR?

- Credit cards are now almost universally accepted to pay for goods and services both at home and abroad and to shop online. You should think carefully before withdrawing cash on a credit card as you will be charged a fee and will you will pay interest from the date of the withdrawal.
- Credit cards can be an effective way of budgeting if used properly – but interest charges can mount up if bills are not paid in full. Credit cards can be handy in emergencies, allowing you 'instant accesses to a borrowing facility up to your pre-agreed credit limit. If you pay off the bill in full each month – you won't pay any interest so credit cards can be a very useful way to borrow over the short term.
- Credits cards are increasingly used for regular shopping but many people use them mainly for larger cost items such as holidays or household goods, helping them to spread the cost of these items over a longer period of time.
- Credit cards provide unique consumer protection. Should the goods you buy fail to arrive, they are faulty or the company you are buying from goes bust you may be able to claim your money back from your credit card company. This protection is provided by Section 75 of the Consumer Credit Act for purchases over £100 and less than £30,000.
- Some credit cards will give you cash back or air miles for using your card. Others will make a donation to a charity every time you use it.

HOW DO I USE IT?

- Credit cards are issued by banks, building societies and retailers but most are branded either MasterCard or Visa. Other credit card brands include American Express.

- If you use a credit card in a shop you will have to enter a PIN (or sign in some countries) and if you use it online you'll need the three-digit security number on the back of the card. You can also use your credit card to withdraw cash from ATMs although this can be expensive. Credit cards are generally accepted worldwide.
- Credit card users receive a monthly bill detailing what they have spent on the card and any interest charged. You can pay off as much of the bill as you want each month but you must pay the stated minimum payment or you will incur a fee.

3.2.5 DIRECT DEBIT

A Direct Debit is a regular payment debited from your account that you have previously authorized. The transaction is 'pulled' from your account by the company who's provided you with a service, but only because you know in advance the amount you will be debited and the date the payment will happen. Direct Debits are typically used to make regular payments for life, car and home insurance, council tax, utility bills and subscriptions. Amounts can vary but you will always know in advance what the amount will be.

ADVANTAGES OF A DIRECT DEBIT CARD

1. Businesses are guaranteed payment.
2. Customers don't have to remember payment dates.
3. Customers don't have to write cheques and post them.
4. Businesses can change amount and payment dates.

DISADVANTAGES OF A DIRECT DEBIT CARD

1. Monies are paid even if there is no money in the customer's account. Therefore the customer can incur a bank overdraft at a high interest rate.
2. Customers may fail to check price increases and budget according.

WHAT WOULD I USE THIS FOR?

- Direct Debits are typically used to make payments for regular financial commitments, for example mortgage payments, or utility and mobile phone bills. Businesses like Direct Debits as they have more certainty about when they get their money and it makes their administration more efficient. As a result customers willing to pay by Direct Debit can often find cheaper deals, particularly for their energy supply.

- You can also set up a Direct Debit to pay your credit card each month – either the full balance, a set amount or the minimum amount required by your credit card company. In addition you can use a Direct Debit to pay less frequent bills, for example an annual insurance policy.
- You can sign up to a Direct Debit agreement over the phone or online, not just on paper. In those cases, the company you have agreed to pay must provide you with evidence of your agreement for your records.

HOW DO I USE IT?

- You will need to have a bank or building society account capable of making Direct Debit payments; most accounts have this option.
- The company you are paying will need to have an arrangement with their own bank that allows them to collect payments by Direct Debit and ensures they have been rigorously checked.
- You will need to supply the company you are paying with your account details, including name of bank, sort code and account number. They will either take this information over the phone or online, or by using an instruction that you sign and return to them. This will set out the terms of what you are agreeing including the date and frequency of payment (monthly, quarterly, annually etc.)
- The company will then send this information on to your bank either electronically or by paper and your bank will then set up the Direct Debit for you.

SELF-ASSESSMENT EXECRISE 2

Mention the process of using a direct debit card.

4.0 CONCLUSION

These days, there are more payment options than ever to choose from when parting with your money. This unit has given us an explanation of the different methods you may come across from credit cards to direct debits, and cheques. There's Information on where and how you can use each payment type as well as relevant security has been discussed above.

5.0 SUMMARY

Payment methods address a domestic economy or have been specifically developed for electronic commerce and the payment systems are generally supported and operated by local banks. Each alternative payment method has its own unique application and settlement process, language and currency support, and is subject to domestic rules and regulations.

6.0 TUTOR-MARKED ASSIGNMENT

Mention and Discuss 4 Banking Methods of Payment.

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UNIT 4 INSTRUMENT OF PAYMENT IN BANKING

CONTENTS

1.0 Introduction
2.0 Objectives
3.0 Main Content
- **3.1 Bankers Draft**
- **3.2 Standing Orders**
- **3.3 Traders Credit**
- **3.4 Salary Payment**
- **3.5 Dividend and Interest Warrants**

4.0 Conclusion
5.0 Summary
6.0 Tutor-Marked Assignment
7.0 References/Further Reading

1.0 INTRODUCTION

Besides payment of customers' cash instrument over the counter, there are a number of methods and instrument used in carrying out customers' payment instrument. In this unit, we shall discuss these systems under bankers draft, standing order, trader's credit, salary payment and dividend/interest warrants. This is to enable you have a clear understanding of their meanings.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- define and explain the term banker's draft
- explain the procedures of issuing bankers draft
- list the advantages of standing order

3.0 MAIN CONTENT

3.1 BANKERS' DRAFT

A banker's draft may be defined as a payment instrument drawn by a branch of the same bank as drawn by a branch of a bank as drawer on another branch of the same bank as drawee. A bankers

draft is not a cheque because the same bank is drawer and drawee; whereas a cheque can be defined as an unconditional order in writing addressed by one person (party) to another which must be a bank requiring payment of specified amount to or to the order of a named payee or bearer.

ADVANTAGES OF BANKERS DRAFT

i. To the customer is reduces the risk of carrying cash since a draft is as good as cash.
ii. To the third party payee it provides almost 100% certainty of payment since it is drawn by a bank.
iii. To the bank it provides greater security as coding and decoding may be required particularly for large amounts.

PROCESS OF ISSUING BANKERS DRAFT

A customer who requires a bankers draft must complete a draft request form. Information to be given in the form includes:

i. Date of request
ii. Name of customer and account number
iii. Value of draft
iv. Payee of draft
v. Place of payment i.e. branch on which draft is to be drawn.
vi. Signature of customer requiring issue of the draft. It is important to state that the person who signs the draft request form must be an authorised signatory to the account or must be duly authorised in writing by a signatory to the account.

After the completion of the draft request form, which must be backed with customer's cheque covering the value of the draft plus bank charges, the bank staff proceeds to verify signatures on the draft request form and to pay the cheque issued.

1.STANDING ORDER

A standing order is an instruction you give to your bank or building society to authorize a payment for set amount, usually on a regular basis, to be made to another bank or building society account. On the day specified, your account will be debited and the money transferred to the person or business receiving the money. Standing orders are typically used to make rent payments, pay magazine subscriptions, monthly charity donations or if you want to make a regular payment into a savings account. A standing order amount remains the same, unless you amend your instruction.

ADVANTAGES OF A STANDING ORDER

i. They provide cheap transmission services.
ii. They are convenient means of payment as customer is spared the need to write cheques and keep tract of outstanding payments.
iii. The onus of making payment at the correct time rests with the bank.
iv. The customer is provided with good record of payment.

DISADVANTAGES OF A STANDING ORDER

i. You have to make sure that there is enough money in your account to pay the bill or the payment will be refused.
ii. You have to be careful to remember when the money will be taken out by the bank.
iii. You may also get charged by your bank if you don't have enough money for the standing order.

SELF-ASSESSMENT EXERCISE 1

Outline the advantages and disadvantages of a standing order.

3.3TRADER'S CREDITS

This system is used by multinational companies such as oil companies and conglomerates to make payment to their numerous creditors. A list of creditors is forwarded to the banks showing their names, banks where accounts are domiciled, their account numbers and amounts to be paid. A single cheque is drawn to cover the total amount involved. On receipt, the document is authenticated, cheque paid and credit transfers carried out accordingly. The paying bank customers' accounts are credited immediately while payment instruments are prepared and forwarded to other branches of the same bank or other banks with list of beneficiaries attached.

ADVANTAGES OF TRADER'S CREDITS

i. Reduced capital requirements, this means that if a new business setting up has trade credit, they will obviously require less money in capital to start up the business.
ii. Trade credit with improve the cash flows and therefore provide smoother operation for the business.
iii. Businesses can look to grow without having to worry of needing to make immediate payments which may set them back.

iv. Businesses can buy now and pay later which means even if they don’t have the money at first they can purchase items, sell them as a business and then make the payments at the end of the month when the products have been sold and a profit has been made.

DISADVANTAGES OF TRADER’S CREDITS

i. If repayments are not made by certain deadlines, the business will receive a poor credit history which will be a big blow to any business as they will not trusted in the future if they require any loans, trade credit, credit cards or leasing.
ii. Only companies with a good credit history will get trade credit and these can often be hard to build up, especially for new businesses.

1. SALARY PAYMENT

Similar to trader’s credit is the system used by employers to pay their staff salaries. Rather than issue cheques to individual staff, the corporate customer or institution forwards a list of its staff with details of banks used, account numbers and net salary payable and covers total amount with a single cheque. In some cases the customer’s major bank receives salaries and in turn forwards credit transfers to other banks together with their respective customers lists. In other cases the employer forwards separate lists to different banks where the staff operate covering them with cheques drawn on their major bank. The cheques are sent for clearing and staff accounts subsequently credited.

ADVANTAGES OF SALARY PAYMENT

i. Saving- The biggest benefit of salary packaging is the potential tax saving. You may be able to incorporate items you would normally buy from your take-home pay into your salary.
ii. Flexibility- You can structure your salary to best meet your needs.
iii. Budgeting- You don’t have to sacrifice the whole amount at once. Your sacrifice is spread over a period as specified in your Company’s salary packaging policy.

DISADVANTAGES OF SALARY PAYMENT

i. Less take-home pay- Salary sacrifice may save you money overall but your take-home pay will probably reduce. You need to plan for this when you are deciding how much of your salary to package.

2. DIVIDEND AND INTEREST WARRANTS

Holden (1982) defines dividend warrant as an unconditional order in writing, addresses by or on behalf of a company to its bankers, ordering them to pay on demand a sum of money to a member of the company or his agent, in respect of a dividend due to the member arising out of his holding of shares or stock in the company. Similarly interest warrant is defined as 'an unconditional order in writing addressed by a borrower to its bankers, ordering them to pay on demand a sum of money to a lender or his agent, in respect of interest due to the lender.

Dividend and interest warrants are made in favour of and forwarded by mail to individual shareholders and creditors who in turn lodge these instruments in their bank accounts. In some cases, dividend and interest mandates are executed authorizing the company or creditor to make dividend or interest payment direct to the shareholders' bank.

ADVANTAGES OF DIVIDEND

i. They provide a way for investors to place a large amount of capital that can then be used as a source of income, since it regularly brings in money.
ii. Dividends allow investors to profit from their investment in the company without selling their stock. This means you can look forward to regular returns.
iii. An investor can continue to receive dividend payments from the company as long as the investor continues to hold stock. This can lead to significant dividend payments for a long-term investment, even though you're seeing results over a short-term time frame.

DISADVANTAGES OF DIVIDEND

i. Dividends are not universally available – The Board of Directors is responsible for deciding whether or not a dividend is to be paid out to its investors. However, even if a company makes a significant profit, it is under no obligation to pay a dividend.
ii. Tax repercussions – Dividends are often criticized as being subject to double-taxation, as the company is taxed on its income and the individual shareholder is also subject to paying taxes on the dividend pay-out.

SELF-ASSESSMENT EXERCISE 2

Explain the term Traders Credit.

4.0 CONCLUSION

In this unit, you have learnt the various instrument of payment in banking. Payment systems are used in lieu of tendering cash in domestic and international transactions and consist of a major service provided by banks and other financial institutions.

5.0 SUMMARY

The payment system is an operational network – governed by laws, rules and standards – that links bank accounts and provides the functionality for monetary exchange using bank deposits. The payment system is the infrastructure (consisting of institutions, instruments, rules, procedures, standards, and technical means) established to effect the transfer of monetary value between parties discharging mutual obligations. Its technical efficiency determines the efficiency with which transaction money is used in the economy, and risk associated with its use.

6.0 TUTOR-MARKED ASSIGNMENT

1. Outline the advantages and disadvantages of Salary Payment.
2. Discuss the Dividend and Interest Warrant.

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UNIT 5 ELECTRONIC BANKING SYSTEM

CONTENTS

1.0 Introduction

2.0 Objectives

3.0 Main Content

3.1 Electronic Banking Using Personal Computers

3.1.1 Internet Banking

3.1.2 Home Banking

3.1.2 WAP (Wireless Application Protocol)

3.2 Electronic Banking Using a Telephone Connection

3.2.1 Phone Banking

3.2.2 Automated Telephone System

3.2.3 SMS Banking

3.3 The Problems Associated with the Development of Electronic Banking in Nigeria

3.4 Negative Impact of Electronic Banking in Nigeria

3.5 Positive Impact of Electronic Banking in Nigeria

4.0 Conclusion

5.0 Summary

6.0 Tutor-Marked Assignment

7.0 Reference/Further Reading

1.0 INTRODUCTION

An electronic banking system is a set of services provided to customers in order to ensure comprehensive management of accounts. Besides traditional "Internet-banking" functions, this system also introduces an option for a centralized access to account management of several enterprises, financial monitoring and assignment of roles when working with different types of documents, controlling budget execution by reporting units and many other things. E-banking involves information technology based banking. Under this I.T system, the banking services are delivered by way of a Computer-Controlled System. This system does involve direct interface with the customers. The customers do not have to visit the bank's premises.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- explain internet banking.
- discuss the automated telephone system.
- analyse the wireless application protocol

3.0 MAIN CONTENT

3.1 ELECTRONIC BANKING USING PERSONAL COMPUTERS

Along with significant growth in the usage of mobile phones in banking practice, personal computers have also come to the fore, which to an even greater extent facilitate and modernize banking service provision. In an information society this communication instrument plays an irreplaceable role and is indispensable for the present day banking sphere. The area of electronic banking realized through personal computers can be divided into home banking, internet banking and mail banking.

3.1.1INTERNET BANKING

Internet banking can be used from the home or the office, as well as an internet café, although the latter is not recommended for security reasons. In order to handle his account a user just needs an internet browser (such as Explorer, Firefox, Google chrome etc.). A client cannot avoid visiting the bank though, because he must first ask for an identification code. After opening the bank's web site the client simply selects internet banking and, further to proper identification, can perform passive or active operations. Safety for concrete applications is assured by client authentication, verification of data and data protection by encryption.

Client identification is done using passwords or codes. The client chooses some of these and the bank assigns others. It is recommended to choose a password made up of various types of characters, which can be a combination of numbers, lower case and capital letters, and special symbols. Banks usually protect large volume transactions with additional security means, such as an encryption (authentication) calculator, or a token, which generates nonrecurring random passwords, which a client types on confirming an order. The token itself is protected by certain security features. Work with it is only enabled after the client types a four-digit PIN code, whereby the user can change the PIN at any time. In the event of three failed attempts to type the correct PIN the token blocks itself. After 60 seconds of inactivity a token automatically switches itself off and once switched back on, it again requests the PIN.

3.1.2 HOME BANKING

Home banking is a service that enables a bank client to handle his accounts from a computer from a place selected in advance, at home or in the office. The main features of home banking systems are the high level of security, comfort, simplicity of use, openness of the system, wide communication possibilities, networking, definition of users and their rights, automated data transmission and the option to define a combined signature specimen.

A home banking system usually consists of two parts: a bank computer program and a program in the client's computer. The bank program works as a communication server. It receives calls from clients, verifies their identity, receives data from them, authenticates digital signatures, generates digital receipts and sends data to clients. A home banking computer system is a multi-user application, meaning that several of the client's employees can work with it, in particular:

a) Administrator – can define new employees, change rights.

b) Sender – ensures communication with the bank and transmission of prepared data.

c) Accountant – can type payment orders and orders for collection.

b) Viewer – can browse through statements and announcements received.

SELF-ASSESSMENT EXERCISE 1

Explain the home banking system.

3.1.3 WAP (WIRELESS APPLICATION PROTOCOL)

WAP is often compared to web pages, although this is a simplification. Unlike pages appearing on a computer monitor, WAP presents its output on a small mobile phone display, therefore concentrating on text information. It is a form of gateway to various services prepared by a mobile network operator or another firm. One condition for using the service is that the client must have a mobile phone supporting WAP technology. Security is again provided by an electronic key. WAP banking has not caught on very well so far, some banks however continue to offer it despite the relatively low number of users.

3.2ELECTRONIC BANKING USING A TELEPHONE CONNECTION

Telephone banking and the first banking services using classic telephone lines for communication date back to the turn of the sixties and seventies of the last century. These services grew very rapidly and at the close of the 20th century mobile phones also started to be used in banking with the development of information and communication technologies. In this period banks quickly responded to the dawning of a new era in using mobile telephones world-wide and began

communicating with their clients by SMS messages, with GSM banking later becoming a natural component of electronic banking. Each financial institution offers this under a different name, but the essential product remains the same.

3.21PHONEBANKING

Phone banking is the provision of banking services using a classic telephone line. A bank client can obtain the necessary information on dialing a telephone number specified in advance. Before the requested banking service information is provided, the client's identity is determined using contractually agreed terms. Using this banking service enables bank clients to obtain information concerning active and passive banking products, but a client can also actively use the bank payment system and request, for example, a payment order or a collection order, open or cancel a term deposit or a current account. In this case a fax connected to the telephone serves as an output communication channel. The client advisor or so-called telephone banker is a bank employee capable of providing any information about products and services and, following verification that he is speaking with an authorized person, can also perform any passive or active operation. He can provide advice to the client and offer further banking products.

3.2.2 AUTOMATED TELEPHONE SYSTEM

The technical means necessary to use this system are the same as for communication with a client advisor. A telephone is required, which must have tone dialing1 or be equipped with an accessory adaptor (tone dialer). An automated telephone system works on the basis of a menu through which clients can move around using buttons on the telephone. The service menu tree is usually designed to be simple so that a choice does not take too long.

More extensive information is sent to the client by fax either to a telephone number agreed in advance or to a number requested by the client. Cost efficiency is the advantage. Some banks offer this service to client's free-of-charge because costs are negligible and comfort is significant. One disadvantage is that problems can sometimes arise when the client cannot choose a menu item that corresponds with his wishes or the computer responds to an instruction in a way that differs from what the client wanted.

SELF-ASSESSMENT EXERCISE 2

Discuss the automated telephone system.

3.2.3 SMS BANKING

SMS banking uses short text messages sent through the client's mobile phone. SMS text messages can be used for both passive and active operations similarly as with classic telephone banking. A client can automatically receive information about his account balance: an SMS is sent to the client immediately after a certain operation is performed, or on request: a client sends the bank a correctly formatted message which processes it and answers the client's request by SMS.

Information sent on request mostly concerns current interest rates or currency exchange rates. Providing these is simple for the bank because this is publicly accessible information that needs no protection. A client however can request information about the balance in his account, which is not public information and must be protected when it is provided. Passwords are used for this purpose or technologies based on the principle of an electronic key.

3.3THE PROBLEMS ASSOCIATED WITH THE DEVELOPMENT OF ELECTRONIC BANKING IN NIGERIA

The development of an efficient monetary transfer system in Nigeria has been hampered by so many factors. These problems are infrastructural deficiency such as erratic power supply and communication link. In this case government should endeavour to provide stable and efficient power supply and telecommunication system.

Another problem is inadequate skilled managers and requisite tools on end users and client systems, here efforts should be done in provision of infrastructure and skilled man power, another problem is the large accumulation of cash in the country so the government should compel legislation that would charge the dominance of cash usage to electronic payments. Also there is high charge or cost for the e-payment terminals (ATMs) so the banking legislation should set out standard charges for e-payment services.

Another problem is non-provision of adequate security for fraud prevention, banks should endeavour to provide stand-by-camera in every ATMs machine for confirming identify of operators account and employ a good computer wizard in dictating and preventing frauds committed by computer hackers.

Another problem is lack of government support for the improvement of e-banking, there should be an involvement of C.B.N in public awareness campaign and escalating infrastructural challenges to the relevant government agencies and also encourages Nigerians to trust and migrate to e-payments.

Lastly one of the major problem is low level of awareness computer appreciation and literacy among the public and also over dependence on cash for all types of transaction. Awareness should be created to the public through media such as, television, bill board, radio etc on the trust and benefits derived from the usage of e-payment and also continuous promotion of cashless society via payments system reform programmes.

3.4 NEGATIVE IMPACT OF ELECTRONIC BANKING IN NIGERIA

Power Failure and Communication Link

Constant electric failure leads to deficiencies in infrastructures such as ATMs computers etc which slows down the rate of electronic transactions and also failure links from Nitel lines which are often as a result of spikes and surges caused by NEPA's in consistent electronic power supply.

Lack of Computer Bank Up

As a result of lack of computer backup when the bank system is corrupt there will be a loss of information about a customer, and this may lead to misappropriation of customers account, therefore the bank should have a manual backup (ledger) containing all data about the customers.

Lack of Adequate Investment Capital

Funds that can be used to buy new information technologies and for modernizing existing systems is generally in short supply. While there are a number of modern banking applications in use, there is also integrated banking system, Nigeria has continued to experience innovations in terms of

product development specifically, there has been tremendous improvement in the speed in which funds are transferred within and outside the domestic economy (international money transfer).

Reduces Employment in the Country

Electronic banking in the country today has reduced the rate of employments in the country whereby most works that should be done by human are done by machines thereby lead to minimum rate of employment and high rate of unemployment in the country.

High Charges on Machines

The rate of commission or charges imposed by banks is too high thereby discouraging customers from using the electronic machine for exchange of transactions example of such charges are cheques on withdraw ATMs and online transfer from one bank branch to another.

Low Public Acceptance

Customers and public do not have trust in the machine in the sense that fraudulent personals uses the system in carryout fraudulent activities, even today banks uses the machine in looting customers money from their accounts. Some customer complains that sometimes when they go for withdraw with their ATM the machine will seize the card while their account will still be debited with un withdraw sum in course of ratification of this problem, the customer might be discouraged because it will take a longer time or end up unsolved.

Insecurities in Banks

Most electronic machines today are not secure thereby making it easier for fraudulent personnel to carry out their fraudulent activities without been caught. Due to insecurity, banks cannot prevent stop or dictate any fraudulent activity. Computer hackers also use the system in stealing data or information by breaking of codes.

Encourages Excessive Withdrawal

Un-operational days like Saturdays when banks are not in operation customers can go and withdraw with their ATM cards, especially when there is a function like weeding ceremonies, customers with little or no money can rush to a nearby ATM machine to withdraw money for excessive spending, customers complained about this in an interview conducted by banks.

3.5POSITIVE IMPACT OF ELECTRONIC BANKING IN NIGERIA

Speedup Settlement of Transaction: Electronic banking speedup settlement of transaction either national or international level where the bank stand as paying bank to the customers for settlement of transaction or debt and collection bank for the collection of payment on transaction made.

Reduces the Rate at Which Customers Visit Banks: The introduction of this system has bridge the gap between customer and his bank, where the customer can easily go any branch bank close to him and withdraw money from the ATM's machine through the help of the inter bank-switch and also safes time energy and reduces stress of the customer. Also customers can make or carryout transaction while at home with the use of telephone.

Move into a Cashless Society: The introduction of the electronic machine has reduced the use of raw cash thereby moving the country into a cashless economy. As **stipulated** by Anyanwaokoro M. (1997), that the settlement of financial obligations are now done by the use of electronic gadgets such as computer, facsimile and telex, instead of currency notes and coins. He went on to say that individuals can pay their bills by using credit cards or even pressing some buttons that transfer money from one account to another. The perfection of this system is what he described as a move into cashless society.

Reduction of Theft: The use of electronic payment system has reduced the rate of theft stealing in the society. The federal government reported to daily champion on Tuesday, April 21 (2009) that

due to endemic corruption in official transaction and incessant robbery attacks on bullion van and bank vaults which made the federal government to direct immediate automation of government fiscal operations through a system known as electronic payment (e-payment).

Clearance of Good: Payment system in the custom areas help in ensuring easy facilitation of clearance of goods by importers, also the money accrue to the government would be paid up electronically thereby making the gathering of revenue very easy and checking of any fraudulent moves as reported by Mumdu H. Daily sun, Friday May 21, 2010.

4.0 CONCLUSION

Electronic banking has long been recognized to play an important role in economic development on the basis of their ability to create liquidity in the economy through financial intermediation between savers and borrowers. It also offers financial services and products that accelerate settlement of transactions and in the process reduce cash intensity in the financial system, encourage banking culture, and catalyses economic growth.

5.0 SUMMARY

E-banking is about using the infrastructure of the digital age to create opportunities both local and global. E-banking enables the dramatic covering of transaction cost and the creation of new types of banking opportunities that address the barriers of time and distance.

6.0TUTOR MARKED ASSIGNMENT

Discuss the positive impact of electronic system in Nigeria.

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MODULE 2

UNIT 1 Overview of the Nigerian Financial System

UNIT 2 External Control of Banks

UNIT 3 Internal Control of Banks

UNIT 4 Cheque Clearing System

UNIT 1 OVERVIEW OF THE NIGERIAN FINANCIAL SYSTEM

CONTENTS

1.0 Introduction

2.0 Objectives

3.0 Main Content

- **3.1 Evolution of the Nigerian Financial System**
- **3.2 Nigerian Financial System**
- **3.3 Functions of the Financial System**

4.0 Conclusion

5.0 Summary

6.0 Tutor-Marked Assignment

7.0 Reference/Further Reading

1.0 INTRODUCTION

The Nigerian financial system comprises the regulatory/supervisory authorities, banks and "other" financial institutions. The regulatory/supervisory authorities are the Central Bank of Nigeria, the Nigeria Deposit Insurance Corporation (NDIC) the Securities and Exchange Commission (SEC).

The Federal Ministry of Finance (FMF) which along with the Central Bank constitutes the monetary authorities shares control over the Bureaux de Change. Also the FMF shares control over the insurance companies with the NISB which is the apex regulatory authority in the insurance sector. The FMBN regulates mortgage finance business in Nigeria.

The CBN adopted the auction-based system of trading in government securities during the last quarter of 1989. The auction system allowed dealers to indicate the volume and the rate at which they were ready to buy securities, instead of the previous practice of fixing the rates administratively. This was aimed at making the money market instruments more attractive and to enhance public participation in the marker. The key elements of the deregulation were the pricing

and allotment of securities by issuing houses, arrangement to establish Over the Counter (OTC) market for trading in non-quoted companies' securities, shortening the delivery/settlement period and efforts towards internationalization of the market.

2.0 OBJECTIVES

At the end of this unit, students should be able to:

- discuss the Nigerian financial system
- explain the functions of Nigerian financial system

3.0 MAIN CONTENT

3.1Evolution of the Nigerian Financial System

There is no doubt that the Nigerian financial system industry has been evolving slowly in the last decade; and like any sector undergoing significant regulatory-led transformation, the industry has had its fair share of variability and challenges. Despite this, the sector has attained momentous milestones along its development cycle, in spite of the global financial and economic setbacks encountered by most of Europe, Asia and the United States in the last five years.

Nigeria's Financial Markets, like any financial market is made up of the money and capital (debt & equity) markets. The money market is where short-term and liquid (or near-liquid) financial instruments are created, sourced and traded with the Central Bank of Nigeria (CBN) – the market regulator. The capital market, on the other hand, is involved in the mobilisation of long-term financial instruments; and is structured into the debt and equity markets. The debt aspect of the market is where bonds and other debt instruments are created by the Debt Management Office (DMO) with the CBN acting as the Issuing House and Registrars. While the stock market is involved in the creation of equity instruments, which are traded on the Nigerian Stock Exchange (NSE), a Self-Regulatory Organisation (SRO) with the Securities and Exchange Commission (SEC) acting as its apex regulatory body. This is complemented by the corporate debt market, which is yet to blossom despite the strides made in the public issued debt markets.

In line with two of the reform pillars of the CBN to develop the Nigerian financial markets and ensure financial system stability based on the regulator's Vision 2020 Strategy, there has been an incremental broadening of tradable and investible financial instruments backed by policy guidelines and regulations to mitigate the inherent risks involved across the money, foreign exchange, debt

and capital markets. Consequently, Nigeria's capital market is set to experience further transformation with the establishment of the National Association of Securities Dealers (NASD) Plc and the commencement of operations of the FMDQ OTC Plc. FMDQ is acronym for Financial Markets Dealers Quotation.

NASD Plc was set up to provide a trading platform and a means of mobilisation of long term capital funds for non-quoted securities in the West African region. NASD PLC will act as a confluence point for issuing houses, retail and institutional investors, accredited dealers, stockbrokers, banks, private equity, and venture capital firms with a view to enhancing liquidity in the non-quoted segment of the capital market. Like its OTC markets' counterparts in the United States, we expect NASD Plc to continue to evolve and positively impact on Nigeria's financial markets, as it provides a diversified resource mobilisation market distinct from the exchange-traded stock market.

3.2Nigerian Financial System

The Nigeria Financial System consists of bodies, institutions and persons engaged in financial intermediation and in the provision of financial services. They include the Central Bank of Nigeria, the apex institution with supervisory role, commercial banks, merchant and development banks, the Nigerian stock exchange, insurance companies and other non bank financial institutions. Collectively the financial institutions exert far-reaching influence on the economic health of the nation. They determine the rate of economic growth and development and impact greatly on the economic well being of Nigerian both at the macro and micro levels. The banking system creates the institutional environment and framework for mobilization and channeling of financial resources into productive areas of the economy.

It is on account of the domineering influence of the financial institutions on the overall development of the economy that government exerts control directly by legislation and indirectly through other policy instruments.

The need for control became apparent following massive failure of early financial institutions in the country. The expatriate banks we established to serve the commercial and administrative interest of the colonial masters and most of the early indigenous bank established before 1952 collapsed on account of capital and human resource inadequacies in an unregulated banking environment. The Federal Government of Nigeria provides the legal and structural framework for the overall control of the financial institutions.

SELF-ASSESSMENT EXERCISE 1

Explain the role of Nigerian financial system

3.3FUNCTIONS OF THE FINANCIAL SYSTEM

The primary function of any financial system is to facilitate the allocation and deployment of economic resources, both spatially and temporally, in an uncertain environment. Professor Merton and Professor Bodie further distinguish five core functions performed by the financial system:

Transferring resources across time and space.

A well developed financial system provides a way to transfer economic resources through time and across geographic regions and industries. Loans help move resources from the future to today, and savings products help do the opposite, but the underlying function for these two seemingly different products is the same. Student loans, borrowing to buy a house and saving for retirement are all actions that shift resources from one point in time to another. The financial system also provides mechanisms to shift resources from one place to another. So, when a person sends money to a family member in a different location, the basic function the movement of resources to him to the recipient.

Clearing and settling payments.

The financial system provides a payments system for the exchange of goods and services. Suppose you live in a country whose government sets a limit on the foreign currency that is accessible. In your country you will be able to pay for your goods and services with the local currency. But if you wish to travel, you will need to use other means of payment. One way of making payments is to barter, exchange goods without making payments, but this would be inconvenient. An important function of the financial system is to provide an efficient way for people and businesses to make payments for the goods and services they wish to buy. Depository financial intermediaries serve this function with wire transfers, checking accounts, and credit/cash cards.

Pooling resources and subdividing shares.

The financial system provides a mechanism for the pooling of funds to undertake large-scale indivisible enterprise or for the subdividing of shares in enterprises to facilitate diversification. Suppose you wish to invest in a business that costs $100,000, but you only have $10,000 to invest. Since you cannot possibly divide the business to buy a part of it, you will not be able to make this investment. A financial system corrects this problem by bringing together a bunch of investors and distributing shares to them, thereby dividing the $100,000 investment into smaller economic pieces. Any money the business earns from the race will then be distributed among the shareholders.

Providing information.

The financial system provides price information that helps coordinate decentralized decision-making in various sectors of the economy. The clear function of financial markets is to allow individuals and businesses to trade financial assets. An additional function of the capital market is to provide information that assists in decision-making. For example Interest rates and security prices are information that households use in making their consumption-saving decisions.

Dealing with incentive problems

The financial system provides a way to deal with the asymmetric-information and incentive problems when one party to a financial transaction has information that the other party does not. An efficient financial system reduces these incentive problems. Incentive problems take a variety of forms – moral hazard, adverse selection and principal-agent problems. The financial institutions develop mechanisms to help overcome these problems. For example, they develop ways to take and manage collaterals to address the moral hazard and adverse selection problems.

SELF-ASSESSMENT EXERCISE 2

Discuss the functions of the Nigerian financial system.

4.0 CONCLUSION

A financial system is a conglomerate of various markets, instruments, operators, and institutions that interact within an economy to provide financial services such as resource mobilization and allocation, financial intermediation and facilitation of foreign exchange transactions to exchange foreign trade.

5.0 SUMMARY

One of the characteristics of the Nigerian financial system is the dominant role the Federal and State Government play in the financial intermediation directly or indirectly. There are a number of government parastatals which the government often lend money to. The state and federal governments also borrow money from the financial system. The governments are also involved in the financial intermediation indirectly through ownership of banks or financial institutions.

6.0 TUTOR-MARKED ASSIGNMENT

Discuss the Evolution of the Nigerian Financial System.

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UNIT 2 EXTERNAL CONTROL OF BANKS

CONTENTS

1.0 Introduction
2.0 Objectives
3.0 Main Content
- **3.1 The Nigerian Deposit Insurance Corporation**
- **3.2 The Bankers Committee**
- **3.3 The Clearing House Committee**
- **3.4 The Chartered Institute of Bankers of Nigeria**

4.0 Conclusion
5.0 Summary
6.0 Tutor-Marked Assignment
7.0 References/Further Reading

1.0 INTRODUCTION

The NDIC is a parastatal under the Nigerian Ministry of Finance. The corporation is charged with protecting the banking system from instability occasioned by runs and loss of depositors' confidence. It operates under the Nigeria Deposit Insurance Corporation Act (1990). The NDIC is a member of the Financial Reporting Council of Nigeria. The NDIC complements the regulatory and supervisory role of the Central Bank of Nigeria (CBN), although it reports to the Federal Ministry of Finance. The NDIC advises the CBN in the liquidation of distressed banks and manages distressed banks' assets until they are fully liquidated.

The NDIC has a supervisory role over insured banks. In April 1996, the Chief Executive of NDIC said that the corporation had 514 case files of insider abuse and corruption for the police to prosecute. In December 2007, the NDIC announced that as of January 1, 2008 it would start providing deposit insurance services to microfinance institutions in Nigeria

2.0 OBJECTIVES

At the end of this unit, student should be able to:

- discuss the functions of the NDIC
- explain the roles of the bankers committee

- explain the functions of the chartered institute of bankers of Nigeria

3.0 MAIN CONTENT

3.1 THE NIGERIAN DEPOSIT INSURANCE CORPORATION

The NDIC is a regulatory body established by the Federal Government to complement the efforts of the Central Bank in the supervision and regulation of the banking sector. Its major responsibility is to ensure the security of funds deposited in bank accounts by the investing public. It carries out periodic examination of commercial and other licensed banks that accept deposits from the public to ensure that banks comply with statutory requirement with regards to capital adequacy, liquidity, and reserve ratios. It provides insurance cover for customers' deposit in bank accounts.

FUNCTIONS OF THE CORPORATION

(a) Insuring all deposit liabilities of licensed banks and such other deposit -taking financial institutions (hereinafter referred to as " insured institutions") operating in Nigeria within the meaning of sections 16 and 20 of this Act so as to engender confidence in the Nigerian banking system.

(b) Giving assistance to insured institutions in the interest of depositors, in case of imminent or actual financial difficulties particularly where suspension of payments is threatened to avoid damage to public confidence in the banking system.

(c) Guaranteeing payments to depositors, in case of imminent or actual suspension of payments by insured institutions up to the maximum amount as provided for in section 20 of this Act.

(d) Assisting monetary authorities in the formulation and implementation of banking policy so as to ensure sound banking practice and fair competition among insured institutions in the country.

e) Pursuing any other measure necessary to achieve the functions of the Corporation provided such measures and actions are not repugnant to the objects of the corporation.

SELF-ASSESSMENT EXERCISE 1

Discuss the functions of the Nigerian Deposit Insurance Corporation.

3.2THE BANKERS COMMITTEE

The Bankers Committee is the apex organization of the banking profession from operational point of view. It is the supreme body in matters affecting banking operations. It has the responsibility of formulating policies and finding solutions to common banking problems arising in Nigeria. The committee is composed of:

i. The Governor of the Central Bank, who acts as the chairman of the Committee and presides over all its meeting.

ii. The Chief Executives of all other banks operating in Nigeria. Policies formulated by the Bankers Committee are binding on the commercial and other banks covered by umbrella organization. It also provides guidelines for the operations of the Clearing House Committee.

3.3THE CLEARING HOUSE COMMITTEE

The Clearing House Committee is composed of:

i. A representative of the Central Bank of Nigeria as chairman.
ii. Five other members drawn from among member banks. The body is charged with the responsibility of controlling the clearing houses, making amendments to the clearing house rules, subject to subsequent ratification by the bankers committee. The committee may also introduce changes in the regulations affecting the day-to-day running of the clearing houses and approves applications for membership in the scheme.
iii. The Nigerian Bankers Clearing House is established in all towns (state capitals and others) where there is Central Bank branch or cash office. The clearing house committee sees to the implementation of all Nigeria bankers clearing house rules. The rules have to do with eligible instruments for clearing purpose, demarcation of clearing areas, duration of clearing periods and procedure for giving value. The clearing rules are changed from time to time to reflect changes in the financial and business environment.

3.4 THE CHARTERED INSTITUTE OF BANKERS OF NIGERIA

The Chartered Institute of Bankers of Nigeria (CIBN) is the umbrella professional body for bankers in Nigeria. The CIBN was incorporated in 1976 as the Nigerian Institute of Bankers. It was chartered in 1990, and is now covered by the CIBN Act 5 of 2007. The Institute is authorized to control entry into the banking profession, to set standards for bankers and to maintain professional ethics through sanctions of erring members. Corporate members include the Central Bank of Nigeria, the Nigeria Deposit Insurance Corporation and all Deposit Money Banks, Development Banks, Mortgage Banks, Micro Finance Banks and Discount Houses in Nigeria.

The Chartered Institute of Bankers is another super structure, a professional body established by the bankers committee in November 1963 as a local branch of the London institute of Bankers. It has since acquired independent state from the chartered institute of bankers London.

The main objectives of the institute are as follows:

i. To maintain discipline in the banking profession through a disciplinary committee.

ii. To promote banking education with a view to helping staff employed in the banking industry to acquire modern banking techniques and prepare them for higher responsibilities in their various institutions.

iii. To give advice to the government whenever such is requested and collaborated with it in formulating policies for the banking sector.

iv. To facilitate the consideration and discussion of matters of interest to bankers and public.

The Chartered Institute of Bankers of Nigeria serves a useful role of providing common forum for professional interaction of Nigerian bankers. Through its disciplinary committee the institute is expected to sustain in members high standards of professional ethics and compliance with the requisite code of conduct.

4.0 CONCLUSION

The NDIC's key role is to provide financial guarantee to depositors in the event of the failure of a member institution and to administer the deposit insurance system in Nigeria. As one of the nation's financial safety-net participants, the NDIC has major roles to play in contributing to the stability of the financial system, and protecting deposits in insured deposit-taking financial institutions.

5.0 SUMMARY

The Nigeria Deposit Insurance Corporation (NDIC) is an independent body and acts as an additional regulatory authority in the banking Industry. NDIC insures deposit liabilities of both Commercial and Merchant banks. By protecting depositors, NDIC inculcates banking habit amongst the people; it also promotes safe and sound banking system in Nigeria.

6.0 TUTOR-MARKED ASSESSMENT

Discuss the history and functions of the Nigeria Deposit Insurance Corporation (NDIC).

7.0 REFERENCES

Ajayi, S.I. and Ojo, O.O. (1981): Money and Banking: An Analysis and Policy in the Nigerian Context London:George Allen & Unwin Ltd.

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UNIT 3 INTERNAL CONTROL MECHANISM

CONTENTS

1.0 Introduction
2.0 Objective
3.0 Main Content
- **3.1 Head Office Control System**
- **3.2 Control by Means of Returns**
- **3.3 Control at Branch Level**

4.0 Conclusion
5.0 Summary
6.0 Tutor-Marked Assignment
7.0 References/Further Reading

1.0 INTRODUCTION

As part of its on-going efforts to address bank supervisory issues and enhance supervision through guidance that encourages sound risk management practices, the Committee on Banking Supervision is issuing this framework for the evaluation of internal control systems. A system of effective internal controls is a critical component of bank management and a foundation for the safe and sound operation of banking organisations. A system of strong internal controls can help to ensure that the goals and objectives of a banking organisation will be met, that the bank will achieve long-term profitability targets, and maintain reliable financial and managerial reporting. Such a system can also help to ensure that the bank will comply with laws and regulations as well as policies, plans, internal rules and procedures, and decrease the risk of unexpected losses or damage to the bank's reputation.

2.0 OBJECTIVE

At the end of this unit, student should be able to:

- explain the head office control mechanism.
- discuss the control by means of return.

3.0 MAIN CONTENT

3.1 HEAD OFFICE CONTROL SYSTEM

Control is maintained through inspection division and by means of periodic returns. The chief security officer of any commercial bank is the chief inspector who heads the inspection division. The division takes responsibility for installation and supervision of all security and operational controls. The major functions of inspection division include:

i. Establishment and management of coding and security system covering payment instruments, inter branch transfers and other sensitive operations.
ii. Unusual events and abnormal matters are promptly reported to inspection division for information and necessary action.
iii. Compilation or updating of bank instruction manual. This is the code of rules and instructions guiding various operations of the bank.
iv. Monitoring of banking operations through annual inspection and periodic spot checks to ensure that operational rules are observed. Annual inspection reports provide vital information system to the board and top management as well as external regulatory bodies such as the Central Bank of Nigeria.
v. Supervision and control of major installations and changes in operational system and methods. The installation and change of strong room keys for example cannot be effected without involvement of inspection division. Similarly inspection division must supervise a change from manual or mechanical to computerized system at every point and in every branch.

SELF ASSESSMENT EXERCISE 1

Enumerate the functions of inspection division

3.2 CONTROL BY MEANS OF RETURNS

The Board of Director and management of commercial banks obtain direct information and are able to control operations in branches and head office departments by means of periodic returns. Returns which could be weekly, monthly, bi-monthly, quarterly, semi-annually and annually cover all essential operational areas from treasury figures, operating results like statements of assets and liabilities (balance sheet), income and general expenses (profit and loss account) to loan and advances to customers. The returns not only help the board and management of banks to keep close watch over banking operations, they also enable banks render both statutory and other returns (reports) to the Central bank.

3.3 CONTROL AT BRANCH LEVEL

The branch manager takes responsibility for the management and control of his branch. He ensures adequate security through controlled movements within the premise and to sensitive areas such as the machine or computer room. Besides physical control of working environment, the manager exerts operational control using the branch diary system. Diary cards are opened for major aspects of branch operations and the manager or his delegate confirms work done by periodic checks and entry on the diary cards. To ensure that individual staff discharges their functions within approved limits and in accordance with bank operational rules the following control measures are usually installed:

1. **Call over of vouchers: -** vouchers that are posted to accounts, whether personal or impersonal are called over at the end of operational to ensure accuracy of positing. Call over is particularly indispensable in manual or mechanical operations where operational errors can easily be made.
2. **Balancing of Account: -** All books of account must be periodically balanced. This is a very important control measure. The general ledgers (in manual and mechanical operations) must be prepared and balanced on daily basis. Weekly, monthly and quarterly balancing of accounts must equally be concluded before returns are made to head office. Even in computerized branches where ledger cards are no longer in use the audit trail must show a balanced position. The manager for purpose of effective monitoring and control must personally see abnormality and other sensitive computer reports.
3. **Use of Passwords: -** In computerized branches every computer operator is given a password by the branch manager who makes changes as may be necessary for purpose of effective control and security.
4. **Spot Checks: -** The manager conducts periodic spot checks on cashiers till, foreign exchange float and clerical staff drawers. Such surprise checks keep staff on alert and reduce to minimum unprofessional and unethical practices.
5. **Control of General Expenses and Overdrafts: -** The branch manager personally approves general expenses whatever the amount. He equally has close surveillance on overdrawn accounts to ensure that approved limits are respected.

4.0 CONCLUSION

The Basle Committee, along with banking supervisors throughout the world, has focused increasingly on the importance of sound internal controls. This heightened interest in internal controls is, in part, a result of significant losses incurred by several banking organisations.

5.0 SUMMARY

The internal control process, which historically has been a mechanism for reducing instances of fraud, misappropriation and errors, has become more extensive, addressing all the various risks faced by banking organisations. It is now recognised that a sound internal control process is critical to a bank's ability to meet its established goals, and to maintain its financial viability.

6.0 TUTOR-MARKED ASSESSMENT

Explain the components of internal control mechanism.

7.0REFERENCES

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UNIT 4 CHEQUE CLEARING SYSTEM

CONTENTS

1.0 Introduction

2.0 Objectives

3.0 Main Content

  3.1 Management of Clearing House

  3.2 Demarcation of Clearing Areas

  3.3 Operational Procedure

4.0 Conclusion

5.0 Summary

6.0 Tutor-Marked Assignment

7.0 References/Further Reading

1.0 INTRODUCTION

The cheque clearing system is a system for the presentment of cheques by collecting banks to paying banks in order that they may be paid or dishonoured. It is true that cheques do not have to be presented through the clearing system, and do not have to be presented through banks at all if they are not crossed. Even if crossed, the cheque may be specially presented at the request of the payee directly to the branch of the paying bank on which it is drawn and avoid the clearing system. In practice, almost all cheques pass through the clearing system.

The rights and obligations of the collecting bank and paying bank between themselves, the payer and the payee depend in large part on a proper understanding of the clearing system.

2.0 OBJECTIVES

At the end of this unit, student should be able to:

- discuss the management of clearing house
- explain the demarcation of clearing house
- discuss the operational procedures

3.0 MAIN CONTENT

3.1 MANAGEMENT OF CLEARING HOUSE

The Nigerian Bankers Clearing House is managed by a committee which consists of the representatives of commercial banks and the CBN. The CBN assigns the chairman of the committee, the clearing house superintendent and the assistant clearing house superintendent. Each member bank appoints a representative to the committee whose position would not fall under the rank of an assistant general manager. Clearing sessions are presided over by the clearing superintendent and the assistants whose decisions are binding on all clearing representatives at any session. Clearing sessions are controlled over by the clearing superintendent and the assistants whose decisions are bound on all clearing representatives at any session. Such decisions are however subject to appeal to the senior manager of banking office in the states or the assistant director, clearing office at the CBN head office at the end of the day's session.

A member-bank can be suspended from participation in any clearing session for any of the following reasons:

i. If it fails to maintain adequate collateral on daily basis.
ii. If despite a written notice, it fails to provide a qualified or competent representative at the clearing sessions.
iii. If after a written warning the member still contravenes the NBCH rules.
iv. If it is so suspended by the management of CBN for any other reason in the interest of the system.

SELF-ASSESSMENT EXERCISE 1

Discuss the management of clearing house.

3.2 DEMARCATION OF CLEARING AREAS

The All-Nigerian Bankers' Clearing House rules introduced with effect from 2nd January 1995 treated the whole of Nigeria as a clearing area comprising:

i. Local Clearing Area: - This covers transactions between banks located in a place where a clearing house has been established by the CBN. The area covered is defined by the committee in each state.

ii. Intra-state Clearing Area: - This covers all clearing transactions between banks located within a state where such banks are not in close proximity with the NBCH in the state as to be covered under local clearing area.
iii. Inter-state Clearing Area: - This covers all clearing transactions between banks located in different states anywhere in Nigeria.

By the All Nigeria Bankers Clearing House Rules that came into effect on 2nd January 1995, clearing instruments presented at the counter of any member bank shall be deemed paid after the date of presentation as follows:

i. Local clearing: - Four clearing sessions that is five working days.
ii. Intra-state clearing area: - Eight clearing sessions that is nine working days.
iii. Interstate clearing: - Fourteen clearing sessions that is fifteen working days.

The Central Bank of Nigeria in consultation with the bankers' committee from time to time make changes in the clearing house rules as may be considered necessary to ensure speedy clearing of instruments. Currently, local clearing period remains four clearing sessions the intrastate and interstate clearing areas have been merged and all up country instruments are now cleared within eight clearing sessions.

3.3 OPERATIONAL PROCEDURE

We need to differentiate inward and outward clearing and the procedure for inter branch and interbank clearing.

Clearing generally involves the receipt of house cheques from other branches of the same banks and from other banks for payment, as well as the forwarding or presentation to other branches of the same banks or other banks, their cheques for collection and payment. The fate of all inward clearing instruments, that is, house cheques received from other banks and branches must be determined promptly and must be either paid or returned unpaid within a period. In the event of non-payment of an instrument, it should be clearly stated on the face of such instrument and must not be at variance with actual fact. With respect to outward clearing instruments, the procedure is as follows. At the end of the day's banking operations the clearing officer, supervisor or clerk, sorts the cheques and other instruments paid in by customers. Other banks' cheques are separated from cheques drawn on other branches of the same bank. Cheques drawn on other branches, listed separately in cheque sent for collection schedule and forwarded by internal mailing system directly

to respective branches. Each bank has its own documentation requirements and design but the principle is the same.

Other banks instruments are similarly sorted according to drawee banks and these are the instruments that are cleared through the CBN supervised Nigerian Bankers Clearing Houses (NCBH). Clearing sessions at NCBH usually begin around 9.30am. Before reporting to the clearing centre, the bank-clearing representative enters the sorted cheques on presentation forms, banks by bank, and prepares debit notes in respect of cheques returned unpaid. Settlement forms are also prepared and net position for each bank is established as cheques are exchanged during the clearing session.

4.0 CONCLUSION

In banking and finance, clearing denotes all activities from the time a commitment is made for a transaction until it is settled. Clearing of payments is necessary to turn the promise of payment (for example, in the form of a cheque or electronic payment request) into actual movement of money from one bank to another.

5.0 SUMMARY

In trading, clearing is necessary because the speed of trades is much faster than the cycle time for completing the underlying transaction. It involves the management of post-trading, pre-settlement credit exposures to ensure that trades are settled in accordance with market rules, even if a buyer or seller should become insolvent prior to settlement.

6.0 TUTOR-MARKED ASSESSMENT

Discuss the demarcation of clearing areas.

7.0 REFERENCES

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MODULE 3

Unit 1 Theories of Banking

Unit 2 Principles of Money and Banking

Unit 3 Principles of Bank Lending and Portfolio Management

Unit 4 System of Banking and Essentials of a Sound Banking System

Unit 5 Resources Management and Regulations in the Nigerian Banking Sector

UNIT 1: THEORIES OF BANKING

Contents

1.0. Introduction

2.0. Objectives

3.0. Main Content

3.1. The Real Bill Theory

3.2. The Shiftability Theory

3.3. The Anticipated Income Theory

3.4. The Liability Management Theory

4.0. Conclusion

5.0. Summary

6.0. Tutor-Marked Assignment

7.0. References/ Further Readings

1.0. INTRODUCTION

In this unit you are going to learn about the various theories of banking. These theories which are propounded by scholars who, bearing in mind the banks unique type of business, sought to provide solutions on how can the unique business survive. These theories include the Real Bills Doctrine, the shiftability theory, the anticipated income theory, and the liability management theory.

2.0. OBJECTIVES

At the end of this unit, you should be able to;

• State and explain all the theories of banking

• Differentiate between all the theories of banking

• Identify and explain the weaknesses of the banking theories.

3.0. MAIN CONTENT

3.1. The Real Bills Doctrine

The Real Bills Doctrine or the commercial loan theory states that a commercial bank should advance only short-term self-liquidating loans to business firms. In other words, this theory holds that banks should lend only on "short-term, self-liquidating commercial papers. This is for the simple reason that a bank has liabilities payable on demand, and it cannot meet these obligations if its assets are tied up for long periods of time. Rather, a bank needs a continual and substantial flow of cash moving through it in order to maintain its own liquidity, and this cash flow can be achieved only if the bank limits its lending activities to short-term maturities. Self-liquidating loans are those which are meant to finance the production, and movement of goods through the successive stages of production, storage, transportation and distribution. When such goods are ultimately sold, the loans are considered to liquidate themselves automatically. The theory states that when commercial banks make only short-term self-liquidating productive loans, the central bank, in turn should only lend to the banks on the security of such short-term loans. This principle would ensure the proper degree of liquidity of each bank and the proper money supply for the whole economy. This in essence aim at the stabilization of the banking system. The weakness of this theory stems from the failure to realize that the loans are made, given the value of the goods and not the good itself; and also the value of goods itself is subject to variations, given the state of the economy.

3.2. The Shiftability Theory

The Central thesis of this theory holds that the liquidity of a bank depends on its ability to shift its assets to someone else without any material or capital loss when the need for liquidity arises. This theory asserted that if the commercial banks maintain a substantial amount of assets that can be shifted on to the other banks for cash without material loss in case of necessity, then there is no need to rely on maturities. According to this view, an asset to be perfectly shiftable must be

immediately transferable without capital loss when the need for liquidity arises. This is particularly applicable to short-term markets investments, such as treasury bills and bills of exchange which can be immediately sold whenever it is necessary to raise funds by banks. For example, it is quite acceptable for a bank to hold short-term open market investments in its portfolio of assets, and if a large number of depositors decide to withdraw their money, the bank need only sell these investments, take the money thus required and pay off its depositors. Therefore, the theory tried to broaden the list of assets demand legitimate for bank ownership, and hence redirected the attention of banks and the banking authorities from loans to investments as a source of bank liquidity that is; the fundamental source of liquidity is the banks secondary resources.

The flaw of this theory does not lie on the theory itself, but on the bank management practices to which the theory led. One bank could obtain the needed liquidity by shifting its assets but not so possible when all members of the bank behave the same way (Fallacy of composition). Hence, the problem of liquidity of the whole banking system is simply not solvable by commercial banks alone. This is where a central bank that is prepared to act quickly and decisively is an absolute necessity.

Self-Assessment Exercise1

What do you understand by the Real Bill Doctrine?

3.3. The Anticipated Income Theory

According to this theory, regardless of the nature and character of a borrower's business, the bank plans the liquidation of the loan from the anticipated income of the borrower. This theory opines that a bank should make long-term and non-business loans since even a "real bill" is repaid out of the future earnings of the borrower; i.e out of anticipated income. At the time of granting a loan, the banks take into consideration not only the security, but the anticipated earnings of the borrower. Thus a loan by the bank gets repaid out of the future income of the borrower in installments, instead of in lump sum at the maturity of the loan.

Self-Assessment Exercise 2

Differentiate between the Real Bill Doctrine and the Anticipated Income Theory.

3.4. The Liability Management Theory

According to this theory, there is no need for banks to grant self-liquidating loans and keep liquid assets because they can borrow reserve money in the money market in case of need. A bank can acquire reserves by creating additional liabilities against itself from different sources. These sources include the issuing of time certificates of deposits, borrowing from other commercial banks, borrowing from the central bank, raising of capital funds by issuing shares, and by ploughing back of profits. Arguing that a bank can use its liabilities for liquidity purposes, the theory opines that it can manage its liabilities so that they actually become a source of liquidity by going out to by money when it needs it (for paying its demand deposits and meeting loan requests). That is, liability management suggests that the bank borrow the funds it needs by means of various bank-related money market instruments.

4.0. CONCLUSION

The unit discusses four theories of banking which explains how the banks try to survive in an economy as a business entity.

5.0. SUMMARY

In this unit, we have studied about;

- the real bill doctrine
- the shiftability theory
- the anticipated income theory
- the liability management theory

6.0. TUTOR-MARKED ASSIGNMENT

What do you understand by Shiftability Theory? What are its flaws?

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Unit 2 PRINCIPLES OF MONEY AND BANKING

Content

1.0. Introduction

2.0. Objectives

3.0. Main Content

- **3.1. The Principle of time (time has value)**
- **3.2. The principle of Risk Compensation**
- **3.3. The principle of decision making on the basis of adequate information**
- **3.4. The principle of efficient Resources allocation by markets**
- **3.5. The principle of Stability**

4.0. Conclusion

5.0. Summary

6.0. Tutor-Marked Assignment

7.0. References/ Further Readings

1.0. INTRODUCTION

Understanding these principles of money and banking does not only helps you understand how the financial system works today in Nigeria, but also gives you an insight into why things go wrong, and what the consequences might be for future events in the economy. The simple Principles of money and banking you shall learn in this unit include the principle of time (time has value), the principle of risk compensation, the principle of decision making on the basis of adequate information, the principle of efficient resource allocation by markets, and the principle of stability.

2.0. OBJECTIVES

At the end of this unit, you should be able to;

- describe the importance of timing of payments in banking transactions
- explain why risks in banking transaction needs compensation
- describe the implication of a decision taken on the basis of adequate information
- describe how markets are an efficient way of resources allocation

• explain the Principle of Stability in banking transaction.

3.0. MAIN CONTENT

3.1. The principle of Time; (time has value)

The timing of payments is an important part of any transaction. Lenders will demand compensation for parting with their money and getting it back slowly overtime. Borrowers are willing to give this compensation in return for getting the funds today. This is the basis for an interest rate. Furthermore, how long payments are stretched out, and how frequently they occur will be important in determining the value of any financial investment. Value is based on both the SIZE and the TIMING of promised payments.

3.2. The Principle of Risk Compensation

Risk is pretty much unavoidable, and no one like it. Putting these two realities together means that people are willing to pay to avoid risk and those who assume certain risks will demand compensation. This is the whole basis of the insurance industry. Therefore, the value of a financial instrument is based on the SIZE, TIMING, and CERTAINTY of payments associated with instruments.

SELF-ASSESSMENT EXERCISE 1

Explain the assertion that the principle of Risk is the basis of the Insurance Industry.

3.3. The Principle of Decision-Making on the Basis of Adequate Information

At the core of microeconomics is the assumption of rational decision - making. Rational decisions are partly based on using all available information to make a decision. Some decisions are more important than others, e.g. buying a car vs buying your lunch. Some information are harder to gather than other types. Problems can arise especially when one party to a transaction has more / better information than the other party. This asymmetric information problem is a big motivation for financial intermediation by banks, insurance companies and other institutions. One role of financial institutions is to gather and disseminate information so that financial markets run smoothly.

SELF-ASSESSMENT EXERCISE 2

Discuss the principle of time (Time has value) in banking Business.

3.4. The Principle of Efficient Resources Allocation by Markets.

In economics, we learn about the fundamental problem of scarcity and that most of the time markets are an efficient way to allocate scarce resources. A market sets a price that rations scare resources to those willing and able to pay. In the financial sector markets will determine what investment projects get funded and what capital stock is built.

3.5. The Principle of Stability

This principle is closely related to the core principle of risks compensation. People prefer the known to the unknown, all things being equal. Therefore when financial institutions offer instruments with stable payments or insurance against variability, and central banks work to create a stable financial system, individuals tend to be better off. That is, stability improves welfare.

4.0. CONCLUSION

This unit throws light on the time value of money, principles of risk compensation and the principle of decision making. It also sheds light on the principles of efficient resources allocation and stability.

5.0. SUMMARY

In this unit, we have learned about;

- the principle of time in banking business,
- the principle of risk management,
- the principle of decision-taking on the basis of adequate information,
- the principle of efficient resources allocation by markets,
- the principle of stability banking business.

6.0. TUTOR-MARKED ASSIGNMENT

Identify and discuss the principles of money and banking you know.

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UNIT 3 PRINCIPLES OF BANK LENDING AND PORTFOLIO MANAGEMENT

CONTENT

1.0 Introduction

2.0 Objectives

3.0 Main Content

3.1 Principle of Bank lending

3.2. The concept of Portfolio Management

3.2.1 Objectives of Portfolio Management

4.0 Conclusion

5.0 Summary

6.0 Tutor-Marked Assignment

7.0 References/ Further Readings

1.0 INTRODUCTION

In this unit, you shall learn broadly speaking, about two major issues. These are the principles of bank lending; and portfolio management. In the principles of bank lending, you shall get to know that these are the guiding principles for banks in terms of advancing loans to customers. The portfolio management on the other hand has to do with the day-to-day management of the total resources (wealth) of the bank.

2.0. OBJECTIVES

At the end of this unit, you should be able to;

- describe the principles which banks follow in terms of lending in the economy.
- list and explain each of the principles of bank lending in an economy.
- define and explain the concept of Portfolio management
- state and explain the objectives of portfolio management

3.0. MAIN CONTENT

3.1. Principles of Bank Lending

Banks follows some principles in terms of lending in the economy. These principles include the below:

a. Liquidity principle

Liquidity is an important principle of bank lending. Banks lend for short periods only because they lend public money which can be withdrawn at any time by depositors. They, therefore, advance loans on the scarcity of such assets which are easily marketable and convertible into cash at a short notice. A bank chooses such securities in its investment portfolio which possess sufficient liquidity. It is essential because if the bank needs cash to meet the urgent requirements of its customers, it should be in a position to sell some of the securities at a very short notice without disturbing their market prices so much. There are certain securities such as government bonds which are easily saleable without affecting their market prices. The shares and debentures of large industrial concerns also fall in this category. Therefore, banks invest in government securities, shares and debentures of reputable companies.

b. Principle of profitability

This is the cardinal principle for making investment by banks. It must earn sufficient profits. Banks therefore, invest in such securities which assure a fair and stable return on the funds invested. The earning capacity of securities and shares depends upon interest rate and the dividend rate and the tax benefits they carry. Banks normally invest in securities that yields more returns than those that yield less returns, all things being equal.

c. Principle of safety of bank funds

The safety of funds lent is another principle of bank lending. Safety means that the borrower should be able to repay the loan and invest in time at regular intervals without default. The repayment of the loan depends upon the nature of security, the character of the borrower, his capacity to repay and his financial standing. Like other investments, bank investments involve risks. But the degree of risk varies with the type of security. Securities of Federal Government are said to be safer than those of the state and local governments. This is because the resources of the Federal Governments are higher than that of the state and local government resources. The banks always take into consideration the debt repaying ability of the governments while investing in their securities.

Political stability, peace and security are prerequisites for this. It is safer to invest in the securities of a government having larger tax revenue and high borrowing capacity than in government securities with less tax revenue. Above all, the safety of bank funds depends upon the technical feasibility and economic viability of the project for which loan is advanced.

d. Principle of diversity

Commercial banks always follow the principle of diversity in choosing its investment portfolio. Banks invest their surplus funds in a particular type of security but different industries. They choose the shares and debentures of different types of industries situated in different regions of the country. Diversification aims at minimizing risks of the investment portfolio of banks. The principle of diversity also applies to the advancing of +-loans to varied types of firms, industries, businesses and trades. These principles seek to emphasize the fact that “keeping all eggs in one basket is disastrous”. Banks need to spread their risks by giving loans to various traders and industries in different sectors of the economy and different parts of the country.

e. Principle of stability

Another important principle of banks’ investment policy is investment in those stocks and securities which possess a high degree of stability in their prices. The bank cannot afford any loss on its securities. It should, therefore, invest its funds in the share of reputable companies where the possibility of decline in their prices is remote. That is why banks normally invest more in debentures and bonds which are more stable than the shares of companies.

SELF-ASSESSMENT EXERCISE 1

Identify and explain the Principles of bank lending

3.2. Bank Portfolio Management

The main aim of commercial banks is to seek profit like any other institution. Their capacity to earn profit depends upon their investments policy. Their investment policy, in turn, depends on the manner in which they manage their investment portfolio. Thus commercial banks investment policy emerges from a straight forward application of the theory of portfolio management to the particular circumstances of commercial banks.

3.2. The Concept of Portfolio Management

Portfolio refers to the securities held by an investor or the commercial paper held by a bank or other financial institutions. It could be a group of investments, asset of individual equities, bonds and other marketable assets the investor owns. Portfolio management involves the principles and procedures by which to manage such assets. Bank portfolio management therefore, refers to the prudent, management of a bank's assets and liabilities in order to seek some optimum combination of income or profit, liability and safety. In banking, the parts of a bank's asset portfolio include investments, liquidity, reserves, and loans, and their management involves the total balance sheet.

3.2.1. Objectives of Portfolio Management

There are three major objectives of portfolio management which banks follow. These include liquidity, safety and income or profit. These three objectives are opposed to each other. For examples, if the banks seek high profit, they may have to sacrifice some safety and liquidity. If they seek more safety and liquidity on the other hand, they may have to give up some income or profit. The main objectives of bank portfolio management are discussed below.

a. Liquidity

A commercial bank needs a high degree of liquidity in its assets which form one of the cardinal objectives of its portfolio management. The liquidity of an asset refers to the ease and certainty with which it can be turned into cash. The liabilities of a bank are payable on demand at a short notice. Therefore, it must hold a sufficiently large proportion of its assets in the form of cash and liquid assets for the purpose of profitability. If the bank keeps liquidity the upper most, its profit will be low. On the other hand, if it ignores liquidity and aims at earning more, it will be disastrous for it. Thus, in managing its investments portfolio a bank must strike a balance between the objectives of liquidity and profitability. The balance must be achieved with a relatively high degree of safety. This is because banks are subject to a number of restrictions that limit the size of earning assets they can acquire.

b. Safety

Another objective of portfolio management by commercial banks is to achieve safety in their funds / assets. A commercial bank always operates under conditions of uncertainty and risks. It is uncertain about the amount and cost of funds it can acquire and about its income in the future. Moreover, it faces two types of risks. The first is the market risk which results from the decline in

the prices of debt obligations when the market rate of interest rises. The second is the risk by default where the bank fears that the debtors are not likely to repay the principal and pay the interest in time. The risk is largely concentrated in customer loans, where banks have a special function to perform, and bank loans to business and bank mortgage loans are among the high-grade loans of these types. In the light of these risks, commercial banks have to maintain the safety of its assets.

c. Profitability

One of the principal objectives of portfolio management by a bank is to earn more profit. It is essential for the purpose of paying interest to depositors, wages to the staff, dividend to shareholders and meeting other expenses. It cannot afford to hold a large amount of funds in cash for that will mean foregoing income. But the conflict between profitability and liquidity is not very sharp. Liquidity and safety are primary considerations while profitability is subsidiary, for the very existence of a bank depends on the first two.

SELF-ASSESSMENT EXERCISE 2

Define and explain the concept of Portfolio Management

4.0. CONCLUSION

The unit discusses the principle of bank lending and the management of the portfolio of the bank which are very cardinal to the successful management of a bank and its profitability in the economy. In specific terms the unit recognizes liquidity, profitability, safety, diversity and stability among the banking lending principles while liquidity, safety and profitability are considered crucial objectives of portfolio management.

5.0. SUMMARY

In this unit, we have learned about the principles of bank lending and the portfolio management of a bank. While the principles of bank lending guide the lending activities of the bank, the portfolio management helps the bank in managing the resources (portfolios) of the bank.

6.0. TUTOR-MARKED ASSIGNMENT

Enumerate and discuss the objectives of portfolio management

7.0. REFERENCES/FURTHER READINGS

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UNIT 4 SYSTEMS OF BANKING AND ESSENTIALS OF A SOUND BANKING SYSTEM

CONTENTS

1.0. Introduction

2.0. Objectives

3.0. Main Content

- **3.1. System of banking**
  - **3.1.1. Unit banking**
  - **3.1.2. Branch Banking**
  - **3.1.3. Group banking**
  - **3.1.4. Chain banking**
  - **3.1.5. Correspondent banking**
  - **3.1.6. Universal banking**
  - **3.1.7. Electronic banking**
- **3.2. Essentials of a Sound Banking System**
  - **3.2.1. High degree of Liquidity**
  - **3.2.2. Safety of Bank's money**
  - **3.2.3. Profitability**
  - **3.2.4. Stability of the system**
  - **3.2.5. Efficient Reserve management**
  - **3.2.6. Expansion**
  - **3.2.7. Sufficient Elasticity**

4.0. Conclusion

5.0. Summary

6.0. Tutor-marked Assignment

7.0. References/ Further Readings.

1.0. INTRODUCTION

The countries of the world practice different banking systems. The type of banking system practice by any country depends on the banking rules and regulations, the size of the economy and the level of development of the banking and the financial system of the economy among other factors. The most common banking systems in most developed and developing countries of the world includes the Unit banking, Branch banking and Corresponding banking. Others include Universal banking, Group banking, and Chain banking among others. You shall also learn about the essentials of a sound baking system in this Unit.

2.0. OBJECTIVES

At the end of this unit, you should be able to;

- identify and explain each banking system
- mention and explain the advantages and disadvantages unit banking
- enumerate and explain the advantages and disadvantages of branch banking
- list and discuss the essentials of a sound banking system

3.0. MAIN CONTENT

3.1. Systems of Banking

In this unit, we are going to look at the following systems of banking, unit banking, branch, group, chain banking and correspondent banking.

3.1.1. Unit Banking

Unit banks are independent, one-office- banks. Their operations are confined to a single office. The unit banks operate in small towns, cities and rural areas in Nigeria. Examples of Unit banks in Nigeria are the community banks and other banks that exists only in particular communities that established them without any branch anywhere. The existence of unit banking in the USA is due to legal restrictions which prevent the growth of monopoly in banking. Some unit banks have grown to large sizes but they operate under severe restrictions which limit or prohibit the establishment of branches particularly in the U.S.A.

Advantages of Unit Banking

Unit banks, being independent and one-office-banks, posses certain advantages which include:-

i) The provision of prompt and efficient services to customers

ii) ii) Personal relations with the people (Since its organizers and staff are local people) which help in mobilizing large resources for the bank.

iii) Meeting the financial needs of the people promptly and efficiently because of the usual on-the-sport decision making by the banking management.

iv) Enjoying the advantages of branch banking as they are connected with a big bank through correspondent banking system.

Disadvantages of Unit Banking

Some of the disadvantages of unit banking include;

i) Failure to spread risks as the unit banking operations are localized in a particular area, the failure of customers to repay loan in time may bring disaster to the bank.

ii) Limited resources at its deposal which always leads to bank failure during financial and economic crisis.

iii) Non-diversified banking services to its customers because of its inability to establish branches and higher cost.

iv) Absence of economies of large scale operations. The unit banking system cannot have advantages of large scale banking in that it cannot recruit more efficient and highly paid staff, and cannot enjoy the economies of large scale and intensive specialization and division of labour.

3.1.2. Branch Banking

Under this banking system, a big bank has a number of branches in different parts of the country and even outside the country. The branch banking is the most prevalent banking system in most of the countries of the world. In Nigeria, all the commercial banks quoted in the stock exchange market have at least a branch in almost all the 36 states of the federation including the Federal Capital Territory Abuja.

Advantages of Branch Banking

The branch banking system has many advantages which make this system supervisor to the unit banking system. Some of the advantages of this system include;

i) Advantage of spreading risks geographically and industrially. If branches in particular area suffers losses due to recession in industries located there, the losses can be offset by profits from prosperous areas.

ii) Enjoys the advantage of large scale organization because a large bank is able to recruit efficient and trained staff and pay better than unit banks. It also enjoys the advantage of specialization and division of labour.

iii) Under this system, the bank enjoys the advantage of diversification of banking operations. Big banks can provide banking facilities to trade, industry, businessmen and the common man at cheaper rates and more efficiently than unit banks because they posses larger financial resources.

iv) The central bank of the country can control the banks more effectively under the branch banking system than under the branch banking Unit banking system. It is easier to control the credit policies of a few banks than those numerous unit banks.

Disadvantages of Branch Banking

The branch banking system has also some disadvantages which include the following;

i) Delayance in decision taking under the branch banking system: there are bureaucratic procedures in decision making and the management of all the branches is under the control of the head office. This leads to delay in taking prompt decision by the branch managers. They have to refer all cases above certain limit for advance to the head office.

ii) Inability to meet the need of local business communities: The branch managers are not able to meet the borrowing needs of the local business community as efficiently and sympathetically as the unit banks. This is because the branch bank managers stays in one locality and have to operate under rules set by the head office. He may not know the needs of the customers at different branches and also may be concentrating more on bigger industries at the detriment of small scale businesses in the rural areas.

iii) Fear of loss: When branch banking spreads on a large scale, some of the branches may run under losses due to bad debts and low mobilization of deposits. Such situation may leads to huge loss to the bank thereby leading to its failure.

iv) In adequate supervision: As the big bank has a number of branches spread throughout the country, it is difficult to manage and supervise them effectively and efficiently. The control become relax, the banking services suffer and the clients are hit hard.

v) Unhealthy competition: Branch banking leads to competition among different banks in establishing branches at various places. This tendency leads to unnecessary increase in expenses.

SELF- ASSESSMENT EXERCISE1

Define Unit Banking and discuss its advantages and disadvantages.

3.1.3. Group Banking

Group banking is part of the banking system in Nigeria. It is a type of multiple office banking consisting of two or more banks under the control of a holding company, which itself may or may not be a bank. The parent company controls and manages the operating banks under the group but each bank continues to keep its separate entity or name. The parent company pools the resources of the group and helps the group banks to make large loans and advances. An example of group banking in Nigeria is the Union Group which is made up of Union Bank of Nigeria Plc (Banking), UBN Merchant Bank (Merchant Banking), Union Assurance Co. Ltd (Insurance), Union Trustees (Trusteeship), and Union Homes Savings and Loans (Mortgage).

3.1.4 Chain Banking

Chain banking is a system where some individuals or group of individuals control one or more banks, as against control by a holding company under group banking. Chain banking results when an individual, family or some other close association of persons controls the operations of two or more banks. That is, it occurs when a syndicate or other small group of individuals with common interest own more than two banks. Chain banks are controlled through directors, and a recognized organization hierarchy beyond that of individual banks. A principal "key" bank frequently coordinates the management of the entire group and also serves as the depository for required reserves of state chartered holding company banks.

3.1.5. Correspondent Banking

It is a bank which acts as agent for another bank in a place where the latter has no office, or for some reasons, is unable to conduct certain operations for itself. All banks with overseas business require correspondent banks abroad, and the arrangements are usually reciprocal with each party

maintaining balances with the other. Correspondent banking is a familiar banking feature in the U.S.A and Nigerian financial systems. The U.S.A is geographically a big country where there are thousands of banks which operates in restricted areas. The various types of banks are able to operate efficiently through a correspondent relationship with one another. The country banks have deposits with city banks and city banks have deposit in the state banks in the same and other cities. The centre of correspondent banking is the New York city, followed by Chicago and other regional centres in big America cities. Many banks have deposits in more than one centre and correspondent banks in one centre have correspondent relations with banks in other centres.

When a small bank maintains its deposits with a big correspondent bank having a network of branches, the later provides such services to the former as extending large credit facilities, facilitating foreign exchange transactions, cheque clearing and collection, purchase and sale of securities etc. It also provides a wide range of other services to small banks which include reports on the state of the economy, advice on portfolio management, etc. In Nigeria, this kind of relationship between banks may exist between big commercial banks and Peoples Banks on one hand and between commercial banks and Community Banks on the other hand. The peoples Banks and the Community banks are not commonly found everywhere, so they resort to the use of some commercial banks as their corresponding banks.

SELF-ASSESSMENT EXERCISE2

Describe Branch Banking and explain its advantages and disadvantages.

3.1.6. Universal Banking

Globally, Universal Banking (UB) is increasingly becoming the major route to doing banking as there appears to be a shift in the mindset from providing customers with only isolated banking services to that of providing them with a supermarket where all financial services are available. Universal banking refers to the combination of deposit-taking, the making of advances and the conducting of stock exchange business all under the same roof. Banks involved accept deposits of all sizes for the most varied terms, grant short, medium and long-term credit to the business sector and private customers, and at the same time carry on securities business on a more or less wide scale; handle payment transactions; finance imports and exports, and deal in foreign exchange, notes and coins.

The central bank of Nigeria in its draft guideline for the adoption of universal banking practice in August 2, 2000, defines universal banking as “the business of receiving deposits on current, savings

or other accounts paying or collecting cheque drawn or paid in by customers, provision of finance, consultancy and advisory services relative to corporate and investment matters, making or managing investments on behalf of any person and the provision of insurance marketing services and capital market business or such other services as the Governor of the CBN may by regulation designate as banking business". Banks under the universal banking programme can choose to undertake one or a combination of the following; clearing house activities, underwriting/issuing house business and insurance services.

Universal banking simply connotes collapsing the various regulatory divides that separate commercial and merchant banking activities. In other word, it is all about creating a level playing field for both commercial and merchant banks.

Historically, commercial banking, in line with its retail orientation, involves general commerce and by implication, a credit policy that favours short-term finance. On the other hand, merchant banking or investment banking is about wholesale banking involving provision of long-term finance to fund users. On this basis of specialization, banks concentrate on one of wholesale banking, retail banking, private banking, savings and loan mortgage among others. However, under universal banking, authority is given to banks to decide on their portfolios of business, select appropriate delivery channels and infrastructure within an applicable regulatory framework. The distinction between money, capital market and insurance business is removed. The most important issue in this system is the fact that the statutory / regulatory dichotomy between commercial and merchant banking activities is dismantled and the difference between banks in terms of functions and activities will only exist as a matter of choice rather than by reason of regulatory barriers.

The concept of universal banking came into operation in Nigeria in November, 2000. The universal banking system introduced in Nigeria was meant to result into huge finance conglomerates where any or all of the following services may be offered. Retail (Commercial banking) Cheque clearing Funds management, investment (Merchant) banking services. Financial advisory services including; Financial consulting; Unit trusts; Mutual funds; Mortgage finance, Securities trading including derivation, under writing business, Insurance (life and general), Trusteeship accounts, Pension funds, and Credit cards.

3.1.7. Electronic Banking

Electronic banking more commonly called the electronic funds transfer system (EFTS) refers to the application of computer technology to banking especially the payments (Deposit transfer) aspects

of banking. The major distinct pieces of hardware that comprises it are the Automated letter Machine (ATM), the point of scale (POS) system, and the automated clearing house (ACH).

An ATM can perform most of the routine banking functions that are now done by bank tellers-deposits can be made, funds withdrawn, funds transferred between savings and current account etc. The customer operates the ATM by using a plastic card plus a personal identification number (PIN) know only to himself.

The POS involves a computer terminal in retail stores that will transfer funds instantly from the bank deposit of the customer to the bank deposit of the store in which he is making purchase. In the process, the computer will verify that the customer has sufficient funds to cover the purchase, and will inform the customer of the new bank balance. The customer can also arrange for overdrafts at the bank, so that "instant loan" (Up to a preset limit) can be made.

On the other hand, the ACH is largely designed to transfer funds among banks electronically, although customers may also become involved. For example, a company may, with the authorization of its employees record its monthly pay roll on electronic tape. The company then takes this type to its bank and that bank then uses the tape to deposit (In other banks) salaries directly to the credit of the employees. The ACH can also be used for preauthorized payments of a recurring nature, e.g. instance premiums. The major merit of electronic banking lies in its ability to reduce costs given the number of cheques written in the economy each year.

3.2. Essentials of a sound Banking System

The essentials of a sound banking system are regarded, as its liquidity and profitability. The secret behind any successful banking business is to distribute resources between the various forms of assets in such as way as to get a sound balance between liquidity and profitability, so that there is cash (at hand or quickly realizable) to meet every claim, and at the same time enough income for the bank to pay its wages and earn profits for its shareholders. In addition, some of the essential issues modern banks also consider for a sound banking system include the following:

3.2.1. High degree of Liquidity

One of the essentials of a sound banking system is to have a high degree of liquidity. The bank holds a small proportion of its assets in cash. Therefore, its other assets must possess the criterion of liquidity so that they may be turned in to cash easily. This is only possible if the bank possess

such securities which can be easily liquidated. The CBN has made it mandatory for commercial banks to keep a certain proportion of their assets in cash to ensure liquidity.

3.2.2. Safety of Bank's

Money Safety of banks' money is another essential of a sound banking system. Since the banks keep the deposit of the people, it must ensure the safety of their money. Therefore, the banks are expected to make safe loans and investments and avoid unnecessary risks. If the debtors of the banks do not repay the loans on time and the banks loss their investments, the banks in the system will become insolvent. As a result, depositors in the system lose money and suffer hardship. Thus, the banks must ensure the safety of deposits in the system

3.2.3. Profitability

A sound banking system should be able to earn sufficient profits for the shareholders. Profits are essential for individuals and the entire system to be viable. Individual banks should be able to pay corporation tax like any other company, pay interest to its depositors, dividend to shareholders, salaries to the staff and meet other expenses. Therefore, unless the banks earn, they may not operate soundly in the system. For this purpose, it must adopt judicious loan and investment policies.

3.2.4. Stability of the System

A sound banking system must be stable. It should operate rationally. There should neither be undue contraction nor expansion of credit. If the banks restrict the creation of credit when trade and industry need it most, it will affect the interests of the business community negatively. On the other hand, if it expands credit when the economic conditions do not permit such, it will lead to boom and inflation. The CBN help in achieving stability in the banking operations of the commercial banks by a judicious credit control policy.

3.2.5. Efficient Reserve Management

A sound banking system should be able to possess efficient reserve management ability. A bank keeps some amount of money in reserve for meeting the demand of its customers in case of emergency. Though the money kept in reserve is idle money, yet the bank cannot afford the risk of keeping a small amount in reserve. There are however, some statutory limits laid down by the Central Bank in maintaining minimum reserves with itself and with the central bank. However, how much reserve money should a bank maintain is governed by its own wisdom, experience and the

size of the bank. The bank should manage its reserve policy effectively and efficiently without keeping too much or too little cash. It has to balance between profitability and safety.

3.2.6. Expansion

A sound banking system must be spread throughout the country. It should not be concentrated only in big towns and cities but also in rural and backward localities. It is only by widespread expansion of the banking system that the deposits can be mobilized and credit facilities can be made available to trade, industry, agriculture, etc. This is especially in developing countries where the banking system must provide these facilities through its expansion in all areas.

3.2.7. Sufficient Elasticity

The elasticity of banking operations should have sufficient elasticity, in its lending operations. It should be in a position to expand and contract the supply of loanable funds with ease in accordance with the directives of the Central Bank of Nigeria.

4.0. CONCLUSION

The countries of the world practice different banking systems and the soundness of the banking sector of the countries varies from country to country. This unit highlights systems of banking varying from unit banking, Branch banking etc to electronic banking. It also discusses essentials of a sound banking system.

5.0. SUMMARY

In this unit, you have learned about,

- systems of banking
- advantages and disadvantages of unit banking
- advantages and disadvantages of branch banking
- essentials of a sound banking system

6.0. TUTOR-MARKED ASSIGNMENT

Discuss the essentials of sound banking system.

7.0. REFERENCES/ FURTHER READINGS.

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UNIT 5 BANK RESOURCES MANAGEMENT AND BANK REGULATIONS IN NIGERIA. CONTENTS

1.0. Introduction

2.0. Objectives

3.0. Main Content

3.1. Bank Resources Management

3.1.1. Human Resources Management

3.1.2. Working Capital Management

3.1.3. Cash management

3.1.4. Credit Management

3.1.5. Inventory Management

3.2. Bank Regulations in Nigeria

3.2.1. The concept of Bank Regulation

3.2.2. Objectives of Regulation of the Nigerian banking system

3.2.3. Some banking Laws and Regulations in Nigeria

3.2.4. Benefits of Regulation in Nigeria

3.2.5. Problems of Regulation in Nigeria

3.3. Bank Fraud

3.3.1. The concept of bank Fraud

3.3.2. Types of bank fraud

4.0. Conclusion

5.0. Summary

6.0. Tutor – Marked Assignment

7.0. Reference / Further readings

1.0. INTRODUCTION

In a sense, the dual purpose of banking is to provide needed banking services, and to earn an appropriate return on the capital investment. These needed banking services reflect recognition of a

bank's obligations to its customers and depositors, its shareholders, its staff, and the community and hence must play its part in making needed aid and justifiable credit available.

In addition, its obligation must look beyond local considerations, and conscientiously shape its institutional policies and practices to conform to the national pattern of monetary policy. The mission of a bank is the task of accomplishing such objectives with due regard for the conditions and constraints that must be observed, and in accordance with accepted criteria of successful accomplishment.

In fulfilling these tasks, the bank consciously manages its human resources, cash, credit, working capital and inventories judiciously and efficiently on daily basis. It is the primary occupation of this unit to educate you on how banks manages these available resources and also expose you to the concept of bank regulation and bank fraud in Nigeria.

2.0. OBJECTIVES

At the end of this unit, you should be able to;

- discuss how a bank manages human, Working Capital, Cash, Credit and inventory resources.
- define and explain the concept of Bank Regulation
- state and explain the objectives of bank regulations in Nigeria
- identify some banking Laws and Regulations in Nigeria
- discuss the benefits and problems of bank Regulations in Nigeria.
- define and explain the concept of bank Fraud
- identify and explain the types of bank Fraud

3.0. MAIN CONTENT

3.1. Bank Resources Management

Here, we are going to be looking at what type of inputs are pooled together to achieve pre-determined results within the banking sector. We will be looking at human resource management, working capital management, cash, credit and inventory management.

3.1.1. Human Resource Management

Personnel management is an important element of the broader subject of human resources management (HRM), although in practice the two are frequently interchanged emphasizing the fact

that the people employed in a bank or company are resources which at least as important as financial material resources and must be given careful expert attention. Personal Management is the responsibility of all those who manage people, as well as being a description of the work of those who are employed as specialist (Nmadu, 1991:1). It is the part of management which is concerned with people at work and with their relationships within a bank or an enterprise. Through human resources management, banks seeks to bring together and develop into effective organization the men and women who make up an enterprise, enabling each to make his own best contribution to its success both as an individual and as a member of a working group. It seeks to provide fair terms and conditions of employment, and satisfying work for those employed. In managing human resources in the bank, it requires that employees be treated as important resources to be invested in prudently, to be used productivity, and from a return can be expected, a return that should be monitored wisely. Human resources management plans, develops and administers policies and programmes to make expeditious use of the banks human resources. The major role that human resource management plays in the management of banks includes planning, staffing, development and maintenance. In the aspect of planning, human resource management in banks involves the planning of organizational goals and objectives, job analysis and human resources. In the area of staffing, it recruits and select staff. Besides, development in this respect, involves activities like orientation, training and development, performance appraisal, carrier planning etc. Finally, the activities that are involved in maintenance include compensation, benefits, safety and Health, labour relations etc.

3.1.2. Working Capital Management

Working capital can be defined as the excess of current assets over current liabilities. It is the same as net current assets. It represents the investments of a company's medium and long-term funds in assets which are expected to be realized within the years trading. It is not permanent investment, but as the name implies is continually in use, being turn over many times in a year. It is used to finance production, to invest in stock and to provide credit for customers. The more of a business finance invested in working capital, the less is available for investing in long-term assets such as buildings, plant and machinery.

In the management of working capital, at least three questions need to be considered. First, what size of investment should be allocated to the different forms of current assets? Second, what proportions of these current assets should be financed respectively by short-term and long- term funds? Third, what proportion of the total assets should be in the form of current assets, and what

proportion in fixed asset? The successful control of working capital or cash depends on detailed budgets, which must be as accurate as possible. These are needed for planning balance sheets and profits and loss accounts, and consequently it is common practice for the conventional budgetary system to include estimates of the component parts of working capital. All that is needed for the management of working capital as a whole is that the parts should be put together. The size of the cash balance that a company might need depends on the nearness or availability of other sources of funds at short notice, on the control of debtors and creditors – a crucial factor for short-term financial planning.

3.1.3. Cash Management

There are no simple rules to govern decisions concerning the amount of cash a firm should have on hand or short call at a bank. Part of the difficulty is that such decisions involve management's subjective attitude to the risks ahead. The more cash that is on hand, the more easily the company can meet its bills when they are due for payment. By carrying a quantity of cash or processing securities at short call, the company is buying peace of mind. On the other hand, the more cash the company can invest or put to work within the business, the greater will be the profits it earns. However, if it does not retain a sufficient amount of liquidity, the company can lose the opportunities to take advantage of discounts and perhaps, because of late payments, lose suppliers. Management must therefore balance liquidity with profitability. There are three basic reasons why a company would wish to hold some of its assets in the form of cash or cash equivalent. These reasons according to economic theory are; the transaction motive, precaution motive, and the speculative motive. One explanation often given for holding cash is that any profitable opportunities that arise can be met immediately. This motive may be strong in the case of a company that exists primarily for speculative purposes. To hold cash or near cash has a cost, which is the earnings that could have been obtained through using the funds elsewhere. The company has to ensure that the gains from the possible speculative opportunities are greater than the earnings from normal investment opportunities. Determining the amount of cash a firm needs at a point in time is not an easy matter. As already explained, if a bank has too little cash, it can run into liquidity difficulties, if it has too much cash, it will be missing opportunities to earn profits. The problem is to determine how much cash is too much cash. The key statements by which management can be kept informed about the cash position of the company are the cash budget and the cash -flow statement. It is necessary to have these informative statements as quick as possible and as up to date as possible, so that action can be taken on the figures. The cash budget involves

estimating what the inflow and outflow of cash will be at fixed intervals over the next planning period.

3.1.4 Credit Management

Credit management is an important part of financial management. The credit issuing policy of a company should answer several questions. For instance, whom should credit be extended to? How much credit should be allowed (at individual level and in total), how long should the credit be for? And what is to be done about defaulting debtors? The objective of the company is assumed to be to choose the credit policy that, taken into conjunction with its other policy decisions, maximizes the expected profits of the company. It may well be that the credit policy cannot be formulated without reference to constraints. The liquidity position of the company presents an obvious constraint, and production capacity, management capacity, and risk may define others. The problem is thus a programming problem in form, but it is, even in principle, so involved that a complete vigorous and general formalization would not be useful from the operational point of view. Some of the data that would be required for such model illustrates this difficulty. The company need to know the probability of sale to each potential customer as a function of the credit terms offered to him and the expected timing of the payments received from the customers. The choice of which customers to advance credit to, is really a question of the level of risk of non-payment that is considered acceptable. With every credit or sale, there is some risks that the customers will not be able to pay, but with most large banks or companies, the risk may be small. But with small illiquid banks or companies, the risks of non-payment might be so high.

3.1.5. Inventory Management

An inventory policy is a set of decision rules which determine the size and timing of replenishment orders and what to do in a stock out situation. The policy issue here is that an order for replenishment is placed when inventory fell to or below the re-order level and the size of replenishment is fixed. The re-order level policy calls for continuous monitoring of inventory level. The periodic review policy retains the concept of a re-order level but stock on hand is not constantly known, there are periodic stock takings. If at the time of stocktaking inventory is at or below the re-order level a replenishment order, of fixed size, is placed. Otherwise there is no re-ordering. An efficient inventory policy is always an important requirement for the successful management of banking, manufacturing and distributing enterprise. Usually a fraction of the total assets of these companies are in the form of stock, so that improvement in stock control policy can bring major benefits for companies. Any idle resource may be thought of as an inventory. Rather

more vividly, stocks have been described as “money in disguise”. Indeed the stock may be of money itself, as in the case of holdings of cash. In terms of physical goods, it is conventional to distinguish three types of inventory. i. Pre-production inventory ii. In- process inventory iii. Finished goods inventory Pre- production inventory is a raw material or other inputs secured from outside the firm. In-process inventory is work-in-progress (Possibly at several stages in the production process) and finished goods are the products of the enterprise awaiting sale. The purpose of inventory is to allow each stage of the production and distribution system to operate economically by insulating it from different or varying rates of activity at other stages. The most obvious illustration of this is the role that finished goods inventory plays as a cushion between production and sales. Even if the rate of sales is predictable and steady, it may be uneconomical to produce continually at just that rate while if demand is erratic it would be nonsense to keep changing the rate of production. The entire production process usually needs insulating from irregularities in the arrival of suppliers. This is the main function of pre- production or raw material inventory. In times of inflation, there may be a speculative role too.

SELF-ASSESSMENT EXCERCISE1

Discuss how human Resources, Working Capital, Cash and Credit are managed by banks

3.2. Bank Regulations in Nigeria

Bank Regulation refers to the supervision and control of the banking sector by government in the interest of economic efficiency, fairness, healthy and safety of the banking system in the country. Regulation may be imposed simply by enacting laws and leaving their supervision to the normal process of the law, by setting up special regulatory agencies or by encouraging self-regulation by recognizing, and in some cases delegating powers to bodies or agencies. Regulation in the banking sector is ultimately aimed at the “safety and soundness” of the banking institutions, the protection of depositors’ money, the shareholders’ investments and the effective implementation of government monetary and other policies in the economy.

In Nigeria, there is evidence that over the years, the banking laws and regulations tended to make operations of commercial and merchant banks uniform. For example, while in 1979, the amendment to the repealed 1969 Decree made wholesale banking and medium-term lending as the main functions of merchant banks, the Banks and other Financial Institutions Decree of 1991 was silent on the role of merchant banks in wholesale banking and medium to long-term lending. Furthermore, the prescribed proportion of loans to medium and long-term enterprises was reduced

from 50% in 1979 to 20% in 1991 and was abolished in 1996. Similarly, the prescribed minimum deposit accepted by merchant banks was reduced from N50,000 in 1992 to N10,000 since 1994. These legal and regulatory changes continued in the banking sector until the adoption of universal banking in 1999 and subsequently bank consolidation in 2004. The changes in the laws and regulations were responses to the pressures mounted by the banking institutions to be allowed to expand the scope of their activities. Since the establishment of the CBN in 1958, the other major regulatory measure that had been taken was the establishment of the NDIC in 1988.

3.2.1. Objectives of Regulation of the Nigerian Banking System

The objectives of bank regulation and the emphases, varies from one country to another. In Nigeria, some of the objectives of regulating the banking sector include the following:

i. To achieve public policy objectives of financial stability, high economic growth, price stability, full employment levels of output, and a balance of payments equilibrium position.
ii. To ensure that adequate services are provided at reasonable costs to the public and that the services reach the people at reasonable low costs.
iii. To provide safety for depositors.
iv. To protect investors from fraud and deceit.
v. To limit the risk taken by banking financial institutions.
vi. To preserve the liquidity and ensure the solvency of the banks.
vii. To built up confidence in the public and hence promote savings mobilization and investment.
viii. To promote a highly competitive financial market.
ix. To prevent unhealthy proliferation of banking institutions.
x. To prevent bank failure and help built up confidence in the public.
xi. To ensure that resources are allocated into their most efficient and profitable uses.
xii. To improve the flexibility of financial institutions to respond to the challenging needs of individuals and businesses.
xiii. To preserve a sound and resilient financial system.
xiv. To maintain a base for effective monetary policy.
xv. To promote a stable and growing standard of living.

3.2.3. Some Laws and Regulations in Nigeria

Some of the regulations/ legislations affecting the Nigerian banking system are enumerated below. You should note that by this enumeration, these bank laws and legislations in Nigeria are not exhaustive.

1. The banking ordinance of 1952; which provided for the licensing of banks and prescribed a mandatory minimum capital requirement of N25, 000 for the banks to operate in the country.

2. The Central Bank of Nigeria, Act 1958; this provided for the establishment of the CBN as an apex financial institution to regulate and control the commercial banks and other banks or financial institutions.

3. Banking Decree of (Acts), 1969; this provided for the regulation and control of the monetary and financial system. It made provision for the grant of licenses to banks before they can carry on banking business in the country and also imposed restriction on certain activities of licensed banks. It also empowered the CBN, among other things, to prescribe the licensed banks' minimum holding of cash reserves, specified liquid assets, specified deposits and stabilization securities.

4. Banking (Amendment) Act, 1970; this provided sundry amendments to the CBN Act of 1958, including approval required before the award of certain banking activities and the determination of the salaries and allowances of the employees of the CBN.

5. Banking (Amendment) Act, 1972; This further amended the CBN Act of enable the CBN to grant advances to commercial banks which incur deficits in their clearing operations. Some of the Nigerian banking laws and regulations are listed below to include:

i. Money Laundering Act (PROHIBITION) Act No.7, 2003.

ii. Banks and other financial institutions Decree 25, 1991 Act CAP. B3 L. F. N.

iii.Nigerian Bank for commerce and industry Act CAP. 296 L.F. N 1990 Act CAP. N92, L. F. N 2004.

iv. Peoples Bank of Nigeria Decree No. 22 1990 Act CAP. P7 L.F.N 2004.

v. Revocation of Banking license S. I 1 2003.

vi. Nigerian Education Bank Decree No. 50 1993 Act CAP. N104 L.F.N 2004.

vii.Urban Development Bank of Nigeria Act. U16 L. F. N 2004.

viii.Community Banks Decree No.46 1992 Act CAP. C18 L. F. N 2004. ix. Nigerian Export Import Bank Decree No. 38 1991 Act CAP. No.106 L. F. N 2004. x. Federal Savings Bank Act CAP. 142, L. N. F 1990 Act CAP F20 L. F. N 2004.

3.2.3. Benefits of Bank Regulations in Nigeria

Banking regulation is expected to yield some benefits not only to the banking industry, but to the entire economy. Some of the benefits of bank regulation in Nigeria include the following:

i) It prevents bank runs and avoidance of the resulting losses to depositors and to bank institutions.

ii) Reduction of fraud, gross mismanagement, and excessive risk-taking by some managers of banks.

iii) Reduction of some possible aspects of centralized power and self-dealing should this occur were banks unconstrained as to location and products offered to the public.

iv) Greater and efficient allocation of resources than in the absence of laws and regulations.

v) Enhances bestow confidence in the banking system.

3.2.5. Problems of Bank Regulation in Nigeria

i) Consumers tend to be major losers since they bear the cost of reduced competition in the form of higher prices and or worse services.

ii) The regulated institutions bear costs also from two sources; first, the cost of complying with the regulations such as supervision and examination, and second, the cost of being prevented from organizing their activities efficiently and offering products that customers want.

iii) It entails movement away from free competition and toward greater costs or suboptimal portfolio.

iv) It limits innovations in the banking system and banks also attempt measures to evade the supervisory/ regulatory structures.

SELF-ASSESSMENT EXERCISE2

Define and explain the concept of bank regulation.

3.3. The Concept of Bank Fraud

Fraud, generally, refers to an act or course of deception deliberately practiced to gain unlawful or unfair advantage; such deception directed to the detriment of another. It therefore suggests unfair dealing and could be against the customer by the bank officers, or against the bank by its officers, or by the customers against the bank, etc. What constitutes fraud in banking practice has to do with some elements of deception, misrepresentation and the intent to obtain some unjustifiable advantage. Such act is generally perceived professionally unethical, legally unjust, and morally wrong.

3.3.2. Types of Bank Frauds

a). Forged cheques: This is perpetrated in a number of ways depending on the type of cheque. Any type of cheque, be it personal cheque, government cheque or travellers cheque, has its unique and peculiar characteristics and vulnerability. Compared to corporate cheques, individual cheques are more vulnerable to theft and fraud since they do not necessarily require confirmation as in the case of corporate cheques.

b).Cash fraud: This includes suppressing and converting customers' cash lodgements by fraudulent bank cashiers. Bank depositors who are illiterate are always victims of this kind of bank fraud.

c). Cross firing of cheques or kiting: This involves using bank funds without proper authority, whereby the customer usually has two or more accounts at two or more different banks or branches. He draws a cheque on his account in bank A, (knowing fully well that there are no funds in that account) and deposits the cheque into his account with Bank B. He then draws on the uncollected funds at bank B and immediately deposits in bank A another cheque drawn on non -existing funds in his account at Bank B.

d). Foreign exchange malpractices: These involve unlawful trafficking in foreign exchange and non-adherence to official guidelines on foreign exchange transactions.

e). Printing of Bank Stationary and Carving of bank Rubber Stamps: These forged papers and stamps are usually used by unscrupulous people to prepare forged letters of and other international trade instruments which are circulated all over the world with a view to obtaining goods worth millions of naira under pretence.

f). Spurious letters of Credit: This kind of letters of credit is usually accompanied with spurious “bank drafts” on the reserve of which are fake endorsements which guarantee payment.

4.0. CONCLUSION

While managing the resources of a bank prudentially and in the most efficient way enhances the attainment of the bank’s basic objectives with less time and efforts and at minimal cost, bank regulations keep the banking system under check and guides the back staff, its shareholders, customers and all who are involves in the system from any form of irregularity for the smooth operation of the system. On the other hand, bank fraud is a very serious cankerworm that has caused failure in many banks in Nigeria and it requires all hands on deck to fight the menace to a halt and total elimination for economic development.

5.0. SUMMARY

In this unit, we have learned about;

- managing the available resources in a bank
- bank regulation in Nigeria
- bank fraud in Nigeria.

6.0. TUTOR-MARKED ASSIGNMENT

Discuss the objectives of bank regulation in Nigeria

7.0. REFERENCES/ FURTHER READINGS.

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MODULE 4

UNIT 1: MEASURING THE EFFECT OF REGULATION ON PERFORMANCE OF BANKING

CONTENT

1.0. Introduction

2.0. Objectives

3.0. Main Content

3.1 Measuring the Effect of Regulation on Performance of Banking

3.2 Problems and Challenges of Bank Regulation

4.0. Conclusion

5.0. Summary

6.0. Tutor-Marked Assignment

7.0. References/Further Readings

1.0INTRODUCTION

The effect of banking sector reforms on corporate governance and concluded that to check abuses in the emerging consolidated banking system institutionalization of good corporate governance practice is both necessary and desirable. Some school of thought conducted a study that quantifies regulatory efforts to use capital requirements to control risk-shifting by U.S. banks during 1985 to 1994 and investigates how much risk-based capital requirements and other deposit insurance reforms improved this control. The result revealed that capital discipline did not prevent large banks from shifting risk onto the safety net. Banks with low capital and debt-to- deposits ratios overcame outside discipline better than other banks. Mandates introduced by 1991 legislation have improved but did not establish full regulatory control over bank risk-shifting incentives. That is why Scott (2010) regards Capital requirements as key element in containing systemic risk. Adams (2004) evaluated effect on bank regulation and supervision on the risk asset and income performance of banks in Nigeria and observed increase in banks distress as major reason for the various reforms. He argued that bank mismanagement and adverse ownership influence and other form of insiders' abuse couples with political consideration process especially as regard debt recovery created difficulties to reducing distress in the financial system as submitted by Sanusi (2002).

2.0. OBJECTIVES

At the end of this unit, you should be able to:

Measure the effect of Regulation on performance of banking; and

Evaluate the problems and challenges of bank regulation

3.0 MAIN CONTENT

3.1 Measuring the Effect of Regulation on Performance of Banking

The major purpose of the various financial sector reforms is to strengthen the banking industry and position it to meet the world standard. Bank supervision entails not only enforcement of rule and regulation, but also judgment concerning the soundness of bank asset, its capital adequate and management.

Therefore effective supervision is expected to lead to a healthy banking industry that possesses the power to propel the economic growth (Ogunleye 2001, Adam 2005, Soludo 2007, Scott 2010).

The reform programme is expected to engender a diversified, strong and reliable banking sector in the country. In a view of the above, Balogun, 2007 opined that in order to give objective assessment of the outcome of the banking sector reforms there is the need to specify the evaluating criteria. He used descriptive statistics and economic methods to test the hypothesis that each phase of reform as identified in the literature culminated into improve incentives for the provision of better services to the economy as a whole. The assumption was that the post reform values of measure of institution and policy response performance represent significant improvement over the pre-reform value among these measures according to Balogun (2007) are branch network, increase supply and improved access to credit improvement in selected financial sectors and distress ratio, and above all increased profit earnings as well as increased ability to complete within the global economy.

The empirical result confirms that eras of pursuit of market reform were characterized by improved incentive. However these did not translate to increased credit purvey to the real sector. Also while growth was suffered in eras of control the reform era was associated with rise in inflationary pressures. Among the pitfalls of the reforms identified by the study are faulty premise and wrong sequencing of reforms, frequent reversal and /or non sustainability of reforms.

3.2 Problems and Challenges of Bank Regulation

The various reforms have been acquired to be necessary but it is debatable if they yielded the anticipated result (Balogun 2007). The new policy initiative will no doubt pose some challenges to both the economy as well as the banking system as observed by Ogunleye (2005)that given the fury of activities that have attended effort of bank to comply with the new consolidation policy and the antecedent of some operators in the system, there are concerns on the need to strengthen corporate governance in banks in order to boost public confidence and ensure efficient and effective functioning of the banking system on the effect of small business. Emeria and Okafor (2008) identified merger and acquisition as one of the instrument of recent banking reforms in Nigeria, using cross sectional survey research and ordinary least square regression analysis the result

observed two effect of merger and acquisition as static effect and dynamic effect. The static effect resulted in positive relationship between small businesses lending and bank size because or each N1 deposit received about N0.33k was given out to small business. However, dynamic effect of merger and acquisition in the Nigerian banking sectors which was reported as restructuring, direct and external effect gave on opposite result.

The restructuring and direct effect shows that bank size is negatively related to small business lending and also there is a negatively relationship between external loan by institution like microfinance institution and small business lending. Aminu (2004), identified human resources realignment, technology integration, stakeholders concern, monitoring and supervision problems as culminating from the consolidation of banks in Nigeria. Abati (2006) submitted that the Biggest losers in the banking consolidation was the human element especially depositors in the liquidated banks and workers of the merged banks, observing conflicting conditions of service for workers within the same grade level in some emergent banks.

The policies also have implication for the supervisory authorities in the country like the central bank of Nigeria (CBN) and Nigeria deposit insurance corporation (NDCI) most essentially. Though the number of bank has reduced drastically the need to cope with the complex system of the new mega banks require greater surveillance and monitoring by the CBN. The announcement of the new recapitalization policy as well as its implementation have induced a shake-out in the banking industry which pose a new set of challenges to the Nigeria deposit insurance corporation. According to Ogunleye (2005), following the announcement, the interbank market was adversely affected as interbank placements by the big players in the market were withdrawn from the smaller banks as precautionary measure. There was also a wave of flight to safety by depositors who were apprehensive of the survival of their bank, thus creating capital flight problem. The development complied with the planned phased withdrawal of public sectors funds from the universal banks made by the

MODULE 4 BANKING LAWS & REGULATIONS & THEIR EFFECTS ON BANK PERFORMANCE AND ETHICS OF BANKING

Unit 1 **Measuring the effect of Regulations on performance of Banking**

Unit 2 **Ethics and Code of Banking Practices in Nigeria**

Unit 3 **Corporate Governance Code for Microfinance Bank in Nigeria**

Unit 4 **Code of Ethics and Professionalism in the Banking Sectors**

UNIT 1: MEASURING THE EFFECT OF REGULATION ON PERFORMANCE OF BANKING

CONTENT

1.0. Introduction

2.0. Objectives

3.0. Main Content

3.1 Measuring the Effect of Regulation on Performance of Banking

3.2 Problems and Challenges of Bank Regulation

4.0. Conclusion

5.0. Summary

6.0. Tutor-Marked Assignment

7.0. References/Further Readings

1.0 INTRODUCTION

The effect of banking sector reforms on corporate governance and concluded that to check abuses in the emerging consolidated banking system institutionalization of good corporate governance practice is both necessary and desirable. Some school of thought conducted a study that quantifies regulatory efforts to use capital requirements to control risk-shifting by U.S. banks during 1985 to 1994 and investigates how much risk-based capital requirements and

other deposit insurance reforms improved this control. The result revealed that capital discipline did not prevent large banks from shifting risk onto the safety net. Banks with low capital and debt-to-deposits ratios overcame outside discipline better than other banks. Mandates introduced by 1991 legislation have improved but did not establish full regulatory control over bank risk-shifting incentives. That is why Scott (2010) regards Capital requirements as key element in containing systemic risk. Adams (2004) evaluated effect on bank regulation and supervision on the risk asset and income performance of banks in Nigeria and observed increase in banks distress as major reason for the various reforms. He argued that bank mismanagement and adverse ownership influence and other form of insiders' abuse couples with political consideration process especially as regard debt recovery created difficulties to reducing distress in the financial system as submitted by Sanusi (2002).

2.0. OBJECTIVES

At the end of this unit, you should be able to:

- measure the effect of Regulation on performance of banking; and
- evaluate the problems and challenges of bank regulation

3.0 MAIN CONTENT

3.1 Measuring the Effect of Regulation on Performance of Banking

The major purpose of the various financial sector reforms is to strengthen the banking industry and position it to meet the world standard. Bank supervision entails not only enforcement of rule and regulation, but also judgment concerning the soundness of bank asset, its capital adequate and management. Therefore effective supervision is expected to lead to a healthy banking industry that possesses the power to propel the economic growth (Ogunleye 2001, Adam 2005, Soludo 2007, Scott 2010).

The reform programme is expected to engender a diversified, strong and reliable banking sector in the country. In a view of the above, Balogun, 2007 opined that in order to give objective assessment of the outcome of the banking sector reforms there is the need to specify the evaluating criteria. He used descriptive statistics and economic methods to test the hypothesis that each phase of reform as identified in the literature culminated into improve

incentives for the provision of better services to the economy as a whole. The assumption was that the post reform values of measure of institution and policy response performance represent significant improvement over the pre-reform value among these measures according to Balogun (2007) are branch network, increase supply and improved access to credit improvement in selected financial sectors and distress ratio, and above all increased profit earnings as well as increased ability to complete within the global economy. The empirical result confirms that eras of pursuit of market reform were characterized by improved incentive. However these did not translate to increased credit purvey to the real sector. Also while growth was suffered in eras of control the reform era was associated with rise in inflationary pressures. Among the pitfalls of the reforms identified by the study are faulty premise and wrong sequencing of reforms, frequent reversal and /or non sustainability of reforms.

3.2 Problems and Challenges of Bank Regulation

The various reforms have been acquired to be necessary but it is debatable if they yielded the anticipated result (Balogun 2007). The new policy initiative will no doubt pose some challenges to both the economy as well as the banking system as observed by Ogunleye (2005)that given the fury of activities that have attended effort of bank to comply with the new consolidation policy and the antecedent of some operators in the system, there are concerns on the need to strengthen corporate governance in banks in order to boost public confidence and ensure efficient and effective functioning of the banking system on the effect of small business. Emeria and Okafor (2008) identified merger and acquisition as one of the instrument of recent banking reforms in Nigeria, using cross sectional survey research and ordinary least square regression analysis the result observed two effect of merger and acquisition as static effect and dynamic effect. The static effect resulted in positive relationship between small businesses lending and bank size because for each N1 deposit received about N0.33k was given out to small business. However, dynamic effect of merger and acquisition in the Nigerian banking sectors which was reported as restructuring, direct and external effect gave on opposite result. The restructuring and direct effect shows that bank size is negatively related to small business lending and also there is a negatively relationship between external loan by institution like microfinance institution and small business lending.

Aminu (2004), identified human resources realignment, technology integration, stakeholders concern, monitoring and supervision problems as culminating from the consolidation of banks in Nigeria. Abati (2006) submitted that the biggest losers in the banking consolidation was the

human element especially depositors in the liquidated banks and workers of the merged banks, observing conflicting conditions of service for workers within the same grade level in some emergent banks. The policies also have implication for the supervisory authorities in the country like the central bank of Nigeria (CBN) and Nigeria deposit insurance corporation (NDCI) most essentially. Though the number of bank has reduced drastically the need to cope with the complex system of the new mega banks require greater surveillance and monitoring by the CBN. The announcement of the new recapitalization policy as well as its implementation have induced a shake-out in the banking industry which pose a new set of challenges to the Nigeria deposit insurance corporation. According to Ogunleye (2005), following the announcement, the interbank market was adversely affected as interbank placements by the big players in the market were withdrawn from the smaller banks as precautionary measure. There was also a wave of flight to safety by depositors who were apprehensive of the survival of their bank, thus creating capital flight problem. The development complied with the planned phased withdrawal of public sectors funds from the universal banks made by the liquidity position of some banks precarious, this among other emerging challenges would put pressure on NDCI; both pre-consolidation and post consolidation challenges.

Ogunleye (2005), further identified the post consolidation challenges as possibility of bank failure where Merger and Acquisition (M&S) failed thus run the risk of liquidation. Other challenges are the inadequate executive capacity as to the need for NDIC to ensure the effective merging of information technology system, business lines, products, culture and people by the new mega banks, weak corporate governance that will put pressure NDIC and other regulators to ensure probity, transparency and accountability. There is also the supervisory approach that would need to be broadened, closing information gap between banks and investing public and the need to establish asset Management Company. Pressure would be on NDIC to put in place some specific insurance design feature that will ensure adequate deposit protection.

Aminu (2004), argued that the policy of recapitalization was a subtle way of compelling banks to merge with a submission that Merger and Acquisition are business imperatives that should not be forced or hurriedly conclude as was the case in Nigeria. In the bankers position paper presented to the Senate Committee on banking, insurance and other financial institutions, bankers argued that the Nigerian socio-political and macroeconomic environment is fraught

with a lot of imperfections and inadequacies that make the comparison with other countries a mere theoretical postulations that while Malaysia with a population of 23 millions has a GDP of 104.6 billion and per capital GDP of $4,528.14, the Nigerian economy with a population of 125.8 million has GDP of 3.04 billion and per capita GDP of $24.2. It was also observed that in spite of the superior strength of the South African economy over that of Nigeria the minimum capital requirement of banks in South Africa is $39.06 million (N5 billion), while credit is 5.4% as against the Nigerian $192.3 million (N25 billion) and 32.25% credit extension to the Federal Government. It was also argued that the capital base of N25 billion will do more of harm than benefit to the banking industry and thus highlighted the major pitfalls to be crowding out other sectors, unethical practices like tactical money laundering, mass unemployment and neglect of micro lending to small businesses needed for growth of the economy.

4.0 CONCLUSION

In conclusion, the reform programme is expected to engender a diversified, strong and reliable banking sector in the country. In a view of the above, it was argued that in order to give objective assessment of the outcome of the banking sector reforms there is the need to specify the evaluating criteria. He used descriptive statistics and economic methods to test the hypothesis that each phase of reform as identified in the literature culminated into improve incentives for the provision of better services to the economy as a whole.

5.0. SUMMARY

In this unit, we have learned about:

- measure the effect of Regulation on performance of banking; and
- evaluate the problems and challenges of bank regulation.

6.0. TUTOR-MARKED ASSIGNMENT

Explain the problems and challenged of Bank regulations

7.0. REFERENCES

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UNIT 2: ETHICS AND CODE OF BANKING PRACTICE IN NIGERIA

CONTENT

1.0. Introduction

2.0. Objectives

3.0. Main Content

3.1 General Standards expected of Bankers and Banking Institutions

3.2 Code of Conduct of the Banking Practices

4.0. Conclusion

5.0. Summary

6.0. Tutor-Marked Assignment

7.0. References/Further Readings

1.0 INTRODUCTION

An Ethics Committee of the General Assembly of Bank Chief Executives will consider and deliberate on matters of ethics referred to it. It will pronounce opinions and/or make recommendations to the General Assembly of Bank Chief Executives where appropriate. Matters may be referred to the Committee by a Bank or by an individual banker (through the Institute) or by the General Assembly of Bank Chief Executives. In the event that further action is indicated, the General Assembly may refer the matter to the Council of The Chartered Institute of Bankers of Nigeria to be considered by its Investigating Panel and, if necessary, a Tribunal in accordance with the provisions of The Chartered Institute of Bankers of Nigeria Decree 12 of 1990 or any amendment or re-enactment of same. The Ethics Committee has no legal status. It has no formal powers to compel appearance nor to impose any sanction. Its whole purpose is to provide rulings on the facts as presented to it in each instance. Its force is moral.

2.0. OBJECTIVES

The overall objectives of code of banking practice are to ensure the highest level of adherence to good banking practice and a strong commitment to high ethical standards in the banker-customer relationship.

3.0 MAIN CONTENT

3.1 General Standards Expected of Bankers & Banking Institutions

The following were the Standards expected of Bankers & banking Institutions:

a) Banks and bankers will operate within the legal framework

b) Banks and bankers will follow the best professional practice in the global industry.

c) Banks will always place their depositors' interest before all others.

d) Banks will always meet their commitments. Such commitments will not be lightly given, and should never be broken.

e) Banks will repay depositors at maturity on the agreed terms

f) Banks will meet their trade engagements

g) Banks will meet delivery on their trading contracts at maturity at agreed rates.
h) Banks will always lend on agreed terms.

i) The CBN or any arbitration body duly constituted should be invited to arbitrate, to resolve disputes among banks if such disputes cannot be resolved through the Institute.

j) Banks will deal only with respectable parties. They will take all reasonable steps to

establish that all parties they deal with are bona-fide. Individual bankers should not ask for, nor even accept, any form of gratification, either in cash or in kind, *for* performing their normal services.

k) Banks should not pay brokerage to members of their staff

l) Banks and employers will follow only the best professional practice in their recruiting and employment policies.

m) Bankers (of either sex) should not harass (either sexually or otherwise) their staff or colleagues.

n) Banks should not undermine other banks' stability in the process of marketing so that competition is healthy..

3.2 Code of Conduct of the Banking Practices

1. GOVERNING PRINCIPLES

The governing principles of the Code are:

1. To set out the standards of good banking practice which banks will follow in their dealings with their customers;

2. To provide guidelines for banks to make them act fairly and reasonably in all their dealings with customers and other banks;

3. To cause banks to help customers to understand the operations of their accounts and to give them a good understanding of their banking services including known risks relating to the operations; and

4. To maintain confidence in the security and integrity of banking system. Banks must recognize that their systems and technology need to be reliable to protect their customers and themselves.

Self – Assessment Exercise 1

Discuss the Governing principles of the banking code

CUSTOMERS AND THEIR BANKS

2. OPENING AN ACCOUNT

1. Banks are required by law to satisfy themselves about the identity and address of a person seeking to open an account to assist in protecting their customers, members of the public and themselves against fraud and other misuse of the banking system. References on character and suitability for an account holder are imperative.

2. Banks will provide to prospective customers details of the identification needed.

3. Banks should educate customers on the proper handling of cheque books and other security items.

3 TERMS AND CONDITIONS

i. Banks will provide written terms and conditions expressed in simple language, to customers, of the various types of financial services offered by them.

ii. Banks will ensure that adequate notice is given to customers about any change in such terms and conditions. For changes resulting from administrable or statutory action by authorities, notices as contained in the Monetary Policy circulars (or any other circulars from the Regulatory Authorities) should be considered adequate.

iii. Banks will give reasonable notice before closing a customer's account.

iv. Banks will send comprehensive statements of accounts to customers, at regular (agreed) intervals in order to enable customers to manage their accounts effectively and to check entries. Customers should in addition be at liberty to ask for their balances at any time.

v. All terms and conditions should be in line with the prevailing laws.

Self – Assessment Exercise 2

What are the Terms and Condition of the banking code?

4. CHARGES AND INTEREST PAYABLE BY CUSTOMERS

1. Banks will disclose to their customers in sufficient detail the basis of the charges incidental to the operation of their accounts. Such charges will be determined by the Bankers Tariff published by the Central Bank of Nigeria from time to time. based on the recommendations of the Bankers Committee. Such disclosures will be made to customers when new accounts are opened or upon request.

   Adequate information about changes in the tariffs will be made available or sent to customers.

2. Information on charges for services not covered by the tariff will be provided by the bank on request or at the point of rendering the service.

3. Banks will inform their customers about the interest that is applied to debit balances on their accounts, the basis on which it is calculated and the timing of the debit. Banks will also inform their customers of the basis on which the interest rates may be varied.

5. INTEREST PAYABLE TO CUSTOMER

1. Banks will make information about the rates on all interest bearing accounts which they offer freely available and accessible to customers by one or more effective means, for example:

   i notices and/or leaflets at Head Office and all Branches;

ii press advertisements, 5.1.3 personal notices; and

iii a branch/central telephone service.

2.Banks will inform customers about the interest rates applicable to their accounts, the basis on which tile interest is calculated and when it will be paid to their accounts. Banks will also inform their customers of the basis on which they may vary interest rates.

3.When banks change interest rates wittt immediate effect they will effectively publicise those changes, for example by notices in their

branches, if any, or in the press, or on statements of account or a

combination of any or all of the methods.

6. HANDLING CUSTOMERS COMPLAINTS

1. Each bank will have its own internal procedures for handling customers' complaints fairly and expeditiously.

2. Banks will inform their customers that they have a complaints procedure. Details of that procedure will be made available at each office showing how complaints can be made and what further steps are available if they believe that the complaint has not been dealt with satisfactorily either at the branch or more senior level within the bank.

3. Banks will ensure that all their staff who deal directly with customers are made aware of their institution's internal complaints procedures and are able to help customers by giving correct information about it.

4. All banks should have public complaints/suggestion boxes displayed in their operational locations.

7. CONFIDENTIALITY OF CUSTOMER INFORMATION

1. Banks will observe a strict duty of confidentiality about their customers (and former customers') affairs and will not disclose details of customers' accounts or their names and addresses to any third party, including other companies in the same group, other than in the four exceptional cases permitted by the law, namely:

i. Where a bank is legally compelled to do so;
ii. Where there is a duty to the public to disclose;
iii. Where the interests of the bank require disclosure; and
iv. Where disclosure is made at the request. or with the consent, (expressed or implied) of the customer.

2.Banks will not use exception iii above to justify the disclosure for marketing purposes of details of customers' accounts or their names and addresses to any third party, including other companies within the same group.

3. All banks should insist on their staff signing a "Declaration of Secrecy" to guarantee the confidentially of customer information.

Self – Assessment Exercise 3

Explain the Confidentiality of customer information

8. STATUS ENQUIRIES (BANKERS' REFERENCES)

Banks will on request:

1. advise other parties whether they provide bankers' references or bankers' opinions in reply to status enquiries made about their customers; and
2. explain how the system of Status Enquiries (Bankers' References) works.

9. MARKETING OF SERVICES

‹cept in response to a customer's specific written request or where a customer has given his express written consent, banks will not pass customers' names and addresses to other companies in the same group for marketing purposes. Banks will not make the provision of basic banking services conditional on customers giving such written consent. For this purpose, basic banking services' include the opening and the maintenance of accounts for money transmission by means of cheques and other debit instruments.

2. Banks will act responsibly and prudently in marketing. In particular, banks will ensure that all advertising and promotional literature is fair and reasonable, does not contain misleading information and complies with all relevant legislation, whether relating to their own Bank or their competitors banks.

10 FOREIGN EXCHANGE SERVICES AND CROSS-BORDER PAYMENTS

1. Banks will provide customers with details of the exchange rate and the charges which will apply to foreign exchange transactions.

2. Banks will provide customers wishing to effect cross- border payments with details of the services they offer. In doing so, they will provide, as a minimum:

    i. basic description of the appropriate services available and the manner in which they can be used;

    ii. information as to when money sent abroad on customers' instructions will usually reach its destination or, when an exact date cannot be given, the latest date by which the money might be expected to arrive; and

    iii. the details *of* any commission or charges payable by customers to their bank including a warning where agents' charges may also be incurred

Self – Assessment Exercise 4

Elaborate on the foreign exchange services and cross-border payment of the banking code.

11. GUARANTEES AND OTHER TYPES OF THIRD PARTY SECURITY

1. Banks will advise private individuals proposing to give them a guarantee or other security for another person's liabilities:

    i. that by giving the guarantee or their party security he or she might become liable instead of, as well as, that other person;

    ii. that he or she should seek independent legal advise before entering

    iii. into the guarantee or third part security.

2. Guarantees and other third party security documentation will be clear and prominent notice to the above effect.

12. INTER-BANK TRANSACTIONS

1. A bank should at all times and as expediently as possible seek adequate information about the credit-worthiness of any other bank before engaging in inter-bank transaction with it.

2. Banks should accord priority to inter-bank obligations.

4.0 CONCLUSION

In conclusion, banks are to provide basic information to customers on these codes conducts of the banking sectors. This will usually be at the time when an account is opened. Information, if any, will also be made available to customers from bank branches. Banks will provide additional information and guidelines about specific services at any time.

5.0. SUMMARY

In this unit, we have learned about:

- general standard expected of Bankers and Banking Institutions;
- code of conduct of banking practices

6.0 TUTOR – MARKED ASSISGNMENT

Explain the General standard expected of Bankers and Banking Institutions

7.0 REFERENCES/FURTHER READINGS

Central Bank of Nigeria (CBN). (2008). Ethics of Professionalisms in the Banking Sectors. Abuja.

Chartered Institute of Bankers of Nigeria (CIBN) (2011). Banks Code of Conduct. Lagos

UNIT 3: CORPORATE GOVERNANCE CODE FOR MICROFINANCE BANKS IN NIGERIAN

CONTENT

1.0. Introduction

2.0. Objectives

3.0. Main Content

3.1 Issues in Microfinance Corporate Governance

3.2 Objective of Corporate Governance Code

3.3 Control of Insider – Related Activities

3.3.1 Sanctions for the Violations of the Code

4.0. Conclusion

5.0. Summary

6.0. Tutor-Marked Assignment

7.0. References/Further Readings

1.0 INTRODUCTION

Recent disclosures by the Central Bank of Nigeria[CBN] of the large scale mismanagement and gross insider abuses in some of the universal banks taken over by the regulatory authority further strengthened the need for institutionalizing sound corporate governance in every financial institution. Given the large number of over 900 licensed microfinance banks, and the scanty but disturbing public information available on the governance practices in some of those banks, the need for the regulatory authority to establish and enforce implementation of effective guidelines for corporate governance code for this category of banks cannot be over-emphasised.

This paper examines the salient provisions in the operating guidelines on corporate governance

issued by the CBN; suggest other issues that need to be addressed in the proposed guidelines; identify the major facilitators and expected deliverables for ensuring that the objectives of the guidelines are achieved; and also suggest appropriate sanctions for violations.

2.0. OBJECTIVES

At the end of this unit, you should be able to:

Issues in Microfinance Corporate Governance;

Objective of Corporate Governance Code;

Control of Insider – Related Activities; and

Sanctions for the Violations of the Code

3.0 MAIN CONTENT

3.1Issues In Microfinance Corporate Governance

The operational framework for microfinance banks issued by the Central Bank set a minimum of two and a maximum of seven directors for a microfinance bank. Two directors other than the executive management are required to have banking experience; and no person is to serve as a director in more than two institutions under the regulatory purview of the Central Bank of Nigeria. Directors must be "fit and proper'' persons; while the board is expected to add value, provide strategic direction and effective oversight through board committees for their respective bank.

The CBN requires each bank to have 'strong' organisation structure, set authorization limits, and possess appropriate management information system[MIS]. Management must be suitably qualified, experienced, competent, committed and certified microfinance practitioners and must also demonstrate high level of integrity and rofessionalism. Microfinance banks are expected to operate in line with commercial principles and best practices, and maintain high accounting and auditing standards. They are also expected to comply with the Code of good corporate governance. Among other prudential requirements, microfinance banks Portfolio at risk [PAR] shall not exceed 2.5%, while monetary penalties are specified for late, false and inaccurate

returns.

The foregoing requirements are helpful in providing some guidance for microfinance banks in understanding some of the salient requirements in corporate governance code for the safety and soundness of the operation of the institutions. However the regulatory objectives will be better achieved if each bank is mandatorily required to articulate and faithfully implement corporate governance code based on a model to be provided by the CBN. We give below a specimen example of a code adopted by a microfinance bank, which could be modified to suit individual bank circumstances.

3.2 Objectives Of Corporate Governance Code

The cardinal objective for articulating and faithfully implementing a corporate governance code is to ensure that the bank's affairs are conducted in an orderly and responsible manner in order to ensure that the various stakeholders' expectations are met and indeed surpassed by the board and management who are entrusted with piloting the affairs of the bank.

The Code among other things defines the roles and responsibilities of the board, and also that of the management. In view of the need to ensure that insiders related activities are effectively monitored and controlled to guide against abuses, the code sets acceptable procedures and guidelines for the conduct of insiders related activities. In order to underscore the board members political will to enforce strictly the code provisions, appropriate sanctions are provided for its violations.

Board of Directors

Members of the board of directors are appointed by the shareholders and approved by the Central Bank of Nigeria. Except the Managing Director/Chief Executive who is also a member of the board, every other member is appointed in a non-executive capacity. Every board member is enjoined to recognise that in addition to the direct shareholding represented, he is also responsible for the collective interests of all the other stakeholders of the bank; including

the depositors, the employees, the regulators etc. Accordingly the need to ensure that the operation of the bank is at all times conducted in a sound and professional manner is a joint and several responsibilities of all members. Accordingly the board shall have responsibilities, for the following:

A. Enunciate and ensure implementation of sound policies on all matters affecting the bank.

B. Appoint, remunerate, establish a competitive performance incentive schemes, and discipline all management and other staff of the bank.

C. Consider, approve and monitor the implementation of the bank budget, and set budget expenditure limits for management and board committees.

D. Consider and approve all credit facilities proposed by the management;

E. Establish and monitor agreed performance targets for the management;

F. Ensure strict compliance with laws, policies and guidelines issued by the supervisory and regulatory authorities, namely CBN and NDIC.

G. Carry out other functions and responsibilities as spelt out by the relevant statutes, namely BOFIA, NDIC ACT CAMA.

Management

The Managing Director/ Chief Executive [MD/CE] is the head of the management team and he is responsible for the day to day operation of the bank. The appointment of the MD/CE shall be by the board for an initial period of two years commencing from the date of first appointment; and renewable for another two years subject to satisfactory measurable performance.

The MD/CE shall have primary responsibilities for recommending all credits presented to the board or its Credit Committee for consideration. Accordingly the disbursement and performance of all credits recommended and approved by the board or its Credit Committee is also the primary responsibility of the MD/CE.

The MD/CE shall propose for consideration to the Board Annual Budget for the bank, not later

than two months before the commencement of the accounting year to which the budget applies. After approval by the board, the MD/CE shall have responsibility for its implementation. In furtherance to this responsibility, the MD/CE shall be responsible for the efficient management of the bank's resources with a view to ensure very competitive returns to all stakeholders. The MD/CE shall present at every board meeting the financial position of the bank, on monthly and cumulative basis, together with the comparative variance analyses which will show a true and reliable performance evaluation of the bank.

The MD/CE shall have responsibility to ensure that all information on the bank provided to the board or any of its committees are accurate and reliable for the purposes intended in order to provide reliable basis for decision making.

The performance of the MD/CE shall be periodically evaluated by the board based on among other things on the bank's competitive superior performance; impressive return on investment; effectiveness of cost-reduction measures; quantum of non-performing loans; level of frauds and forgeries; provision for losses incurred; level of infractions of statutory regulations; and other evaluation factors to be determined from time to time by the board.

3.3 Control of Insider-Related Activities

The IMFB is not averse to insiders, especially the directors obtaining or guaranteeing credit facilities or having interest in providing any remunerative services for the bank. However, the interests of the directors concerned must be fully disclosed as required by the CBN guidelines. Furthermore, such facilities must be granted without compromising the bank's established rules and procedures. It is however paramount that any such facility granted must fully comply with the CBN lending limits. Furthermore all insider-related facilities must be consistently performing.

Regarding award of remunerative services contracts to interested directors, the bank must ensure that the price is competitive. In this regard the board shall establish a uniform mark-up on the profit to be added to the realistic estimated cost of executing the project to guide the contract cost.

3.3.1Sanctions for Violations of the Code

In order to underscore the importance of effective compliance with the contents of the corporate governance code, the following sanctions shall apply for their violations:

A. Where the MD/CE performance for consecutive two years fell below 50% of the budgeted target, his performance shall be adjudged not satisfactory, and appointment may not be renewed.

B. Where a loan granted to or guaranteed by a director remains non-performing for a period exceeding six months and is classified doubtful or loss, the director concerned will be called upon to repay the loan, failing which his membership of the Board may be suspended. If the failure to repay persist for an additional period of six months, his removal from the board may be recommended to the shareholders at the annual general meeting.

C. No director's related loan or any credit facilities nor the interest accrued thereon shall be written off without CBN written approval.

D. Where a contract awarded to an interested director is unsatisfactorily executed, such a director will be compelled to refund the bank's fund disbursed for the contract, in addition to being blacklisted from enjoying the privilege of introducing or recommending anyone for future contracts

The Board of Directors may review the contents of this code from time to time as the need and developments warrant.

4.0 CONCLUSION

The importance of ensuring that every licensed microfinance bank in Nigeria articulates and implement sound corporate governance code cannot be over-emphasised. However given the realistic level of the technical and operational knowledge and competence of the members of the board that are in charge of most of the institutions, the CBN and NDIC will have to provide further necessary guidance and capacity building to assist them to put in place model code. More importantly, the authorities must ensure that violations of approved codes are sanctioned to

minimise failure rates in those institutions.

5.0. SUMMARY

In this unit, we have learned about:

Issues in Microfinance Corporate Governance;

Objective of Corporate Governance Code;

Control of Insider – Related Activities; and

Sanctions for the Violations of the Code

6.0 TUTOR – MARKED ASSISGNMENT

Explain the sanctions, for the violations of the banking code

7.0 REFERENCES/FURTHER READINGS

Central Bank of Nigeria (CBN). (2008). Ethics of Professionalisms in the Banking Sectors. Abuja.

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UNIT 4: CODE OF ETHICS & PROFESSIONALISM IN THE BANKING SECTORS

CONTENT

1.0. Introduction

2.0. Objectives

3.0. Main Content

3.1 Chartered Institute of Bankers of Nigeria (CIBN) Review Code for Bankers

3.2 Central Bank of Nigeria mandates Banks to establish Code of Conduct

3.3 Code of Ethics and Professionalism in the Banking Sectors

4.0. Conclusion

5.0. Summary

6.0. Tutor- Marked Assignment

7.0. References/Further Readings

1.0. INTRODUCTION

This unit would examines

2.0. OBJECTIVES

At the end of this unit, you should be able to:

3.0. MAIN CONTENT

3.1. Chartered Institute of Bankers of Nigeria (CIBN) Review Code of Conduct for Bankers

The Chartered Institute of Bankers of Nigeria (CIBN) has reviewed professional code of conduct for bankers practicing in the country. The draft Code of Conduct has been sent to the Central

Bank of Nigeria (CBN), Nigeria Deposit Insurance Corporation (NDIC) and the 24 deposit money banks for their input before final copy is endorsed by all the relevant bodies. The disciplinary organs of the Institute, the Investigating Panel and Tribunal have also been activated to ensure enforcement of the subsisting Code. The CIBN President, said action is part of the blueprint set by the body to restore bankers professional reputation in the country. The CIBN boss promised to increase and spread sound banking knowledge and practice to bankers, which he said can be achieved through improved corporate governance structures. The review of the Code of Conduct for bankers became exigent after series of corporate governance breaches and outright mismanagement of public funds that led to near collapse of some 10 banks rescued by the CBN with N620 billion tax payers funds.

3.2 Code of Ethics and Professionalism in the Banking Sectors

This is produced by the Sub-committee on Ethics and Professionalism of the Bankers Committee. The code contains a list of acts, conducts and omissions classified as unethical as well as the frame work for addressing these in the business of banking and finance in Nigeria. The code thus provides the procedure for dealing with complaints of unethical practices and the sanctions for infractions of the provisions.

Unethical practices/unprofessional conduct in banks include but are not limited to the following:

1. Conflict of interests.
2. Abuse of Trust / Office.
3. Misuse of information.
4. Insider Abuse.
5. Offer and Acceptance of Gratification.
6. Non-conformity with standards and Guidelines.
7. Associating with people of doubtful character.
8. Aiding and Abetting.

Sanctions

The Sub-Committee shall apply the following sanctions:

1. The fundamental principles of restoration, retribution, deterrent and equity will be given priority in the application of sanctions on all cases decided.
2. Where offences are clear and contradict existing regulatory guidelines e.g. CBN guidelines - CBN sanctions would apply.
3. For offences with no precedent, the Sub-committee would use its best judgement based on the principles enunciated above. In such cases, the Sub-committee will recommend specific sanctions to the appropriate regulatory body.
4. Individuals may be warned or advised by the Sub-committee where necessary.
5. In all cases of sanctions, specific time-frame shall be stated for compliance.

3.2 Central Bank of Nigeria Mandates Banks to establish Code of Conduct

The Central Bank of Nigeria, CBN, has directed banks in the country to set up codes of conduct that would guide their practices and detail their compliance to highest ethical and professional standards, even as it announced plans to review its code of corporate governance and issued new guidelines for whistle-blowing in banks.

The CBN, in a document posted on its website, titled, 'Exposure Drafts of the Revised Code of Corporate Governance for Bank in Nigeria and the Guidelines for Whistle-Blowing in the Nigerian Banking Industry,' signed by Chris Chukwu, Director, Financial Policy and Regulation Department, said the code shall commit the bank, its Board and management (and employees) to the highest standards of professional behaviour, business conduct and sustainable business practices.

In the proposed code, the CBN is also seeking to ensure that banks put in place a proper succession plan for its Chief Executive Officer, executive directors and top management staff. The CBN is also planning, through the revised code which is scheduled to come into effect soon, to ensure that no two members of the same extended family occupy sensitive position in any bank in the country. According to the document, no two members of the same extended family shall occupy the positions of Chairman and Managing Director/Chief Executive Officer or Executive Director of the bank and Chairman or MD/CEO of a bank's subsidiary at the same time. CBN further barred Board Chairmen from being members of Board committees of the various banks

and their subsidiaries, except for the Governance and Nominations Committee, the various Board committees shall be headed by non-executive directors.

The apex bank further made it mandatory for all directors of banks to attend all meetings of the Board, saying that in order to qualify for re-election, a director must have attended at least two-thirds of all board meetings. As a means to regulate this, the revised code requires that, "The Board shall disclose, in the Corporate Governance section of the annual report, the total number of board meetings held in the financial year and attendance by each director. The CBN further reiterated its position on government's ownership of banks, pegging government's maximum direct and indirect equity holding in any bank at 10 per cent.

On banks establishing code of conduct, the CBN said, "Banks shall establish a code of conduct and disclose the code or a summary of the code as to: the practices necessary to maintain confidence in the bank's integrity; the practices necessary to take into account their legal obligations and the reasonable expectations of their stakeholders; the responsibility and accountability of individuals for reporting and investigating reports of unethical practices.

"The code shall commit the bank, its Board and management (and employees) to the highest standards of professional behaviour, business conduct and sustainable business practices.

"Be developed in association with management and employees; receive commitment for its implementation from the Board and the managing director/chief executive officer and individual directors of the company. Be sufficiently detailed as to give clear guidance to users including advisers, consultants and contractors."

5.0. SUMMARY

In this unit, we have learned about;

6.0 TUTOR – MARKED ASSISGNMENT

Central Bank of Nigeria Mandates Banks to establish Code of Conduct

7.0 REFERENCES/FURTHER READINGS

Adam, J.S (2005). Banking sector Reforms: The Policy challenges of banks consolidation in Nigeria, A paper presented at the 46th Nigerian Economic Society (NES0 annual conference,

Lagos, 23-25 August.

Central Bank of Nigeria (CBN). (2008). Ethics of Professionalisms in the Banking Sectors. Abuja.

Chartered Institute of Bankers of Nigeria (CIBN) (2011). Banks Code of Conduct. Lagos

Chartered Institute of Bankers of Nigeria (CIBN) (2011). Reviews Code Of Conduct For Bankers, May 11.