

KEYNOTE ADDRESS BY MR. G. A. OGUNLEYE (OFR), MANAGING DIRECTOR/CHIEF EXECUTIVE OF NIGERIA DEPOSIT INSURANCE CORPORATION, AT THE OPENING CEREMONY OF THE NDIC/CIBN JOINT WORKSHOP ON RISK MANAGEMENT PRACTICES IN FINANCIAL INSTITUTIONS HELD ON NOVEMBER 17 - 19, 2004 AT GATEWAY HOTEL, IJEBU-ODE, OGUN STATE

The President and Chairman of CIBN Council
Registrar
Invited Guests
Distinguished Participants
Ladies and Gentlemen

- 1. I feel highly honoured to be invited, once again, as a Special Guest of Honour, to deliver a Keynote Address and to declare this year's workshop open. Let me start by thanking the Chartered Institute of Bankers of Nigeria (CIBN) for the honour and commend it for jointly organizing this workshop on the theme: "Risk Management Practices in Financial Institutions" with the Nigeria Deposit Insurance Corporation.**

- 2.0 As you are aware, great concern is being expressed by various stakeholders in financial institutions' ability to appropriately assess and manage their overall risk exposure. This concern is borne out of the fact that conventional tools and approaches of appraising and managing these risks are increasingly becoming ineffective. The reasons for this seeming ineffectiveness are not far fetched. This is primarily because the environment of banking business is continually changing and so is the financial products being sought by bank customers. The extant financial products are hybrids of the conventional ones and therefore have more complex and rapidly changing feature. It is therefore, imperative to continually develop appropriate assessment tools for the latent risks and also disseminate

such knowledge among banking practitioners and supervisors in order to ensure the safety and soundness of our financial system.

- 3.0 No doubt, Regulatory/Supervisory authorities throughout the world have increasingly emphasized the importance of sound risk management practices in ensuring a safe, sound and stable financial system. The emphasis reflects the view that sound risk management practices have been found to be imperative in financial institutions as new technologies, product innovation, and the size as well as the speed of financial transactions have changed the nature of financial markets. An institution's ability to establish a management culture that adequately identifies, measures, monitors and controls the risks involved in its various products and lines of business has long been associated with compliance with best practice.
- 4.0 Against the above background and coupled with the recent developments in our banking system such as impending adoption of the new Basel Capital Accord and the new capital requirement in the industry which has prompted the on-going consolidation exercise in the banking industry, the increased complexity of the assessment and management of financial institutions' risks readily comes to the fore. The next logical (rhetorical) question is: how well do we appreciate these new dimensions to financial institutions' risks exposure, their assessment and management in our financial system? This question underscores the continued relevance of this workshop. Basically, two broad stakeholders have shared responsibility for assessing and managing the financial institutions' risks. These are the shareholders (primarily) as represented by the financial institution's board of directors and management on the one hand and secondarily, by the supervisors of the financial institutions on the other hand. That constitutes the framework for appraising and managing financial institutions' risks. Other elements of that framework include legal stipulations and guidelines on assigned responsibilities in that regard.
- 5.0 Ladies and gentlemen, let me crave your indulgence at this juncture to shed some light on the new Basel Capital Accord and the on-going

consolidation of the banking industry in the country. The new capital accord, which has the ultimate objective of promoting safety and soundness in the operations of banking institutions through a framework that is risk sensitive, remains a formidable challenge to both operators and supervisors. For instance, the new capital accord emphasizes credit, market, operational and reputational risks among others. While it is imperative for the operators to sharpen their risk management arsenals, it is important for the supervisors to intensify their efforts to enhance the skills of their staff to enable them grapple with the development.

6.0 You will recall that in July this year, The Central Bank of Nigeria introduced a new minimum capital requirement of 25 billion as part of the 13-point reform agenda. Each bank is expected to meet this minimum requirement latest by end of December, 2004. As a means of meeting this requirement, the consolidation of banks through mergers and acquisition was introduced. The new reform is aimed at ensuring a sound, responsive, competitive and transparent banking system appropriately suited to the demands of the Nigerian economy and the challenges of globalization. As banks consolidate to become bigger and stronger, there is the need for enhancing risk management skills of operators just as regulators/supervisors need to become even more efficient, effective, focused and pro-active in order to achieve the objective of evolving a stable, safe and sound banking system.

7.0 Distinguished audience, with the unprecedented advancement in information and telecommunications technology, the imminent application of the new capital accord, cross-border financial flows as well as mergers and acquisition, among other developments, you will agree with me that risks facing the modern banking system are more complex than hitherto. These developments have made it imperative for both the regulators and operators to continuously adapt and upgrade their skills in the area of risk management in order to adequately face the emerging challenges.

8.0 My address today applies to the entire spectrum of risks facing a financial institution including, but not limited to, credit, market, liquidity, operational, legal and reputational risks. In practice, an institution's business activities present various combinations of these risks depending on the nature and scope of the particular activity.

8.0 At this juncture, let me remind you that risk management processes involve the identification, measurement, monitoring and control of the institution's risks. It entails a proper understanding of the institution and its various activities. Also, as you are all aware, the basic elements of a sound risk management system are:

- 1. active board and senior management oversight;**
- 2. adequate policies, procedures and limits;**
- 3. adequate risk measurement, monitoring and management information systems; and**
- 4. comprehensive internal controls.**

9.0 While my address last year highlighted how the risk management practice on each of the above listed elements in our banking system represented a departure from the best practice, my focus this year would be on what the supervisors expect from the operators in the area of risk management and what we, as regulators/supervisors, are expected to put in place to ensure a safe and sound banking system. This has become imperative in the light of current developments in the industry as indicated earlier.

10.0 In view of the global and local developments which have implications for risk management in our banking system, the supervisors would expect, at the minimum, the development of a robust risk management model from each of our banks. Such a model would facilitate the assessment of the risk that banks may pose to the overall supervisory objectives of the industry and to decide the

responses to these risks. Developing a bank's own risk management model is necessary because:

- 2. it would facilitate the supervisor's assessment of the risk that a bank poses which will determine the amount of resources to be committed by the supervisor in monitoring that bank. The risk assessment by the supervisor would be the key input to deciding the bank's financial strength and viability; and**
- 3. it would assist in determining the degree of reliance to be placed on senior management's commitment to consider and address changes in the environment that may create new risks or change existing risks significantly. This is because the processes put in place for the effective management of risks in any financial institution underscores the ability of Board and management of each bank to identify, measure, monitor and control all risks inherent in its activities;**
- 4. supervisory actions that would be taken would depend or be driven largely by the risk appetite of the institution;**

11.0 In addition to the above and as one of the requirements imposed by the new capital accord, bank managements are being encouraged to develop their own Internal Ratings Based (IRB) approach to risk management of all facets of their operations which will be subject to supervisory review. As a first step, banks are expected to identify the various risks to which they are exposed, evolve objective criteria for assessing such risks and design appropriate mechanisms for managing them.

11.0 Also, there is the need for responsive corporate governance in order to ensure the transparency and accountability of management of banking institutions and the curtailment of their risk appetite.

Responsive corporate governance involves the enthronelement of mechanisms, processes and systems for ensuring that:

- 5. there is appropriate direction and oversight by directors and senior managers;**
- 6. there is transparency and accountability to the various stakeholders;**
- 7. the organisation complies with the applicable legal and regulatory requirements;**
- 8. there is disclosure of all material information to stakeholders such as investors, depositors, regulatory authorities, etc; and**
- 9. the organisation's viability and solvency is sustainable through adequate internal controls and audits as well as appropriate risk management framework.**

12.0 On the part of regulators/supervisors, there is the need for strong prudential regulation/supervision. In order to foster a sound risk management practice in our banking system, there is the need for effective frameworks for strong prudential regulation, supervision and laws covering the stipulation of minimum capital requirements, the qualifications of directors and managers, sound-business activities, standards for risk management, strong internal controls, and external audits. Supervisory discipline can be exercised by ensuring that banks are monitored for safety and soundness as well as compliance issues and that corrective actions are taken promptly when risks are managed poorly, including the closure of banks when necessary.

- 13.0 There is the need to adopt a robust, proactive and sophisticated supervisory process, which should essentially, be based on risk profiling of banks. In other words, the adoption of an appropriate risk-based supervisory approach is imperative. The approach entails the design of a customized supervisory programme for each bank and it should focus more attention on banks that are considered to have potentially high systemic impact. The approach should enable the supervisory authorities to optimize the utilization of supervisory resources. That necessarily requires that supervisors should have a clear understanding of risks flowing from banks and that the risk management processes adopted by the banks are adequate. That calls for enhanced capacity building in that area.
- 14.0 With the adoption of universal banking concept in addition to other developments in the industry, consolidated supervision that requires consultation and cooperation amongst the various regulatory/supervisory institutions in the system has become critical. It is equally imperative that the present reporting format of banks be reviewed so as to incorporate all possible activities that banks undertake under the present dispensation. This will make it possible for supervisors to obtain a global view of the bank's operations. The current efforts of the CBN/NDIC in the development of an electronic Financial Analysis Surveillance System (e-FASS) and the activities of the Financial Services Regulation Coordinating Committee (FSRCC) would go a long way to assist in that regard.

15.0 It is important that the accounting as well as disclosure requirements of emerging banks be reviewed. There is also the need for the regulatory agencies to review information disclosure requirements so as to minimize information asymmetry between banks and investing public. Adequate information disclosure requirement will force banks to pay greater attention to reputational risk that could result in loss of confidence as well as patronage. As a necessary step to promote market discipline, it is important that the full weight of the provisions of relevant laws be brought to bear on erring operators in order to help promote safe and sound banking practices.