TITLE PAGE

THE IMPACT OF PRUDENTIAL GUIDELINES AND DEREGULATION ON THE NIGERIAN BANKING INDUSTRY

A CASE STUDY OF UNION BANK NIGERIA PLC

BEING A RESEARCH PROJECT SUBMITTED TO THE DEPARTMENT OF BUSINESS ADMINISTRATION, AHMADU BELLO UNIVERSITY, ZARIA. IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF MASTER DEGREE IN BUSINESS ADMINISTRATION.

BY

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DECLARATION

I declare that apart from casual reference and consultation of books, journals and annual report of the bank's of my case study and other related literatures which have been acknowledged as references, all materials contained in this research are the findings of the researcher.

And that this project work has not been submitted in part or whole for any other academic programme of this or any other university.

October, 1999

13/3/2001

Date and signature.

APPROVAL PAGE

This research project entitled " The impact of prudential guidelines and deregulation on the Nigerian Banking Industry, A case study of Union Bank Nigeria Plc., has been read and approved by us as meeting the requirement for the award of master degree in Business Administration of Ahmadu Bello University, Zaria.

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The Dean School of Post Graduate,

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DEDICATION

This project is dedicated to my wife Zulaihat.

ACKNOWLEDGEMENT

My special thanks goes to my Project Supervisor, Mall. Sani Abdullahi whose intellectual guidiance and constructive criticisms made this research a success. And I must state that any shortcoming found in this work is essentially mine.

My appreciation also goes to Ahmed Arabi El-Nafaty, Ibro, Dr. Kabiru Ibrahim, Mohammed Zubairu (Alh. Baba), and others I cannot individually mention, who contributed one way or the other to the successful completion of this work.

ABSTRACT

The deregulation of the Nigerian financial system in 1987 until recently, magnified financial and other forms of risk in the banks' that were hitherto minimal.

The systemic risk which has now increased due to the deregulation brought the need to focus more attention on the operations of banks, their risk exposure and ways to eliminate or minimize such risks. It was in the light of such concerns that the Central Bank of Nigeria (CBN) came out with the prudential Guidelines in November, 1990, which is aimed at streamlining banking operation in the country by creating a sound capital base and the application process.

This project is written primarily to examine the impact of the implementation of the guidelines on bank's financial risk management. It will also seek to analyze the operation of prudential guidelines.

The instrument used by the researcher in collecting information include secondary data - published literature and primary data - questionnaires and interviews to complement the secondary data. The bulk of the data were culled from published materials which were mainly available from CBN Annual report, Annual report of Union Bank and materials from NDIC, write - up by associates of NDIC in journals and magazines and comments by scholars like Prof. Nwankwo.

The prudential guidelines were well implemented and as a result of proper implementation and monitoring the activities of commercial Banks by the CBN, some banks who had inadequate capital base found it difficult and even up to

date still finding it difficult to operate successfully under the current banking guidelines due to it stringent requirements and hence, such banks condemned the guidelines as an unimaginative invitation of American system and that the guidelines are too stringent for the banks in the country. -While the giant banks like the likes of the case study see it as timely and appropriate measure that returned the sector to the part of profitability and sanity. This is because most of the banks were declaring paper profit before the implementation of the guidelines and during and after the guidelines' implementation, many banks declared loss.

Although the problem of capital inadequacy and the attendant risk remained, the guideline has created an increased awareness of the risk by both operators and supervisors. The guidelines also made banks to classify their loans as performing and non-performing by reducing their risk of in coming bad debts.

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CHAPTER ONE

GENERAL INTRODUCTION

1.1 BACKGROUND OF THE STUDY.

In the recent past, one of the deficiencies in Nigerian banking system was the failure by many bankers to recognize problem assets through classification, provisioning and write – off. Some banks simply fail to recognize problem assets, establish realistic provisions for potential losses and suspend interest on the non-performing assets. Consequently, the balance sheet of such banks fail to reflect the true condition of the bank and the income statements overstated profit upon which dividends to owners were paid.

No doubt, in the course of on – site examination, the examiner at the Central Bank of Nigeria (CBN) and the Nigerian Deposit Insurance Corporation (NDIC) identified problem assets but had some difficulty convincing the banks to make adequate represent the position of the two regulatory authorities on this subject.

To compound this problem, the deregulation of the Nigerian financial system in 1987 until recently, magnified some risks in banks that hitherto minimal. As the number of players in the system increased significantly, competition became more intense and some bankers resorted to cutting corners to stay in business.

Such behaviour increased the risk exposure of banks, particularly the risk to depositors. Still, deregulation allows persons who had no business in the

financial industry to get licenses to establish financial institutions which they subsequently used as trading outfits to the detriment of depositors.

The perception that systematic risk in banks had increased due to the deregulation reforms drew attention to the need to focus more attention on the operation of banks, their risk exposures and way to eliminate or minimize such risks. It was in the light of this concerns that the Central Bank of Nigeria (CBN) came out with the Prudential Guidelines for licensed Banks in November, 1990.

The guidelines were to be strictly adhered to by all banks in reviewing and reporting their performance. The provision of the guidelines have been implemented for almost four years now. The intention of Prudential Guidelines is to limits and constraints on banks to insure the safety and soundness of the banking system.

Prudential regulations in Nigeria over the years have covered such areas as bank licensing, bank expansion, capital adequacy, liquidity requirements and lending policy and limits.

The intention of the researcher is to examine the impacts of the implementation of the guidelines on bank's financial risk management.

1.2 STATEMENT OF THE RESEARCH PROBLEM

The rapid growth of the financial services industry and the resulting intense competition brought about by the deregulation of the financial institutions, necessitates the need for Prudential Guidelines, which was subsequently aided

by the failure of the market mechanism not only to reflect a bank's financial risk exposure but more importantly to control such exposure.

Even in the efficient financial markets, the market mechanism has been known to fail to perform these functions timely and properly, hence the need for the guidelines to protect the interest of depositors and the Nations financial systems.

Thus, the researcher hopes to provide an answer to the following question, which from the statement of the research problem.

1. Does the Prudential Guidelines limits and constraints on banks to ensure the safety and soundness of the banking system?
2. Does the deregulation of the Nigerian financial system magnify some risk in banks that were hitherto minimal?
3. How and to what extent? Has the Prudential Guidelines put in place by government in 1990 reduced the multitude of risk, which are faced by banks.

1.3 OBJECTIVE OF THE STUDY

Generally, the objective of this study is to assess the effectiveness of the Prudential Guidelines in reducing the systematic risks in banks which had increased due to deregulatory reforms of the Nigerian banking system.

However, specific objectives of the study includes:-

1. To fulfil an academic requirement, which is a pre-requisite for the award of Master degree in Business Administration.
2. To highlight areas where the implementation of the guidelines has affected (whether positively or negatively), bank's financial risks or bank's management of risks.
3. Finally, to summarize the rational and major provision of the guidelines and assesses its impacts or lack thereof of the provision of the guidelines on the selected bank's financial risks.

1.4 SCOPE OF STUDY

The study dwells generally on an assessment of the performance of financial service industry in Nigeria in the era of pre and deregulation era and the subsequent banking reforms through the Prudential Guidelines initiated for the purpose of uniformity of approach by banks in the affected areas so that published accounting information by banks can be comparable and reliable.

It is not the intention of the research to cover the entire financial system, hence, analyses will be directly related to Union Bank Nigeria PLC., which serve as the case study for the research work.

The work is divided into five chapters, chapter one introduces in a broad perspective general discussion on banking reforms and controls, it proceeds to state the research problem, objective of the study, significance and scope of the study are also discuss in chapter one.

Chapter two reviews the literature on subject matter and summarizes the rationale and major provisions of the guideline. Chapter three focuses on the methodology of the research work.

In chapter four, some financial risks faced by banks are described and analyzed. Summary, conclusion and recommendations are the trust of chapter five.

1.5 SIGNIFICANCE OF THE STUDY

The research findings and recommendation offered will help banks to detect much earlier any act of fraud and financial malpractice relating to loans and advances in the banking sector.

The study will also provide a basis for appraising the performance of the banking industry in Nigeria in the area of asset classification, provisions for potential losses and suspension of interest on the non-performing assets.

Finally, the study will inject a close intellectual stamina to other researchers related to this area of study and may even provide a solid basis for carrying out a further research work.

1.6 LIMITATION OF THE STUDY

Though, to ensure a more comprehensive and detailed research work, the study focus its analyses on Union Bank Nigeria PLC. But still, there are some other problem which limit the scope of the study.

1. A major limitation of this work lie in the fact that very few detailed studies have been conducted in this area. There is therefore, a comparative shortage of literature on the subject.
2. The secrecy of revealing information the bank's consider to be strategic is also a major problem confronted by the researcher.
3. The problem of time with regard to the period at which the research work must be completed, coupled with funds also constitute a serious limitation to the study.

1.7 DEFINITION OF OPERATIONAL TERMS

Financial institution - This is an institution that accepts deposit and pays cash on demand.

Service - A service is any act that one party performs to another that is essentially intangible and which does not result into the ownership of anything.

Risk - Is the chance or probability that some unfavourable event will occur such that the financial position of bank is adversely affected.

Balance Sheet - An accounting statement which sets out all the assets, liabilities and capital or equity of a firm as at a given date.

Trend - The growth or decline of activities over a period of time.

Portfolio - A portfolio is a combination of security.

Interest Rate Risk - This refers to the potential variability in a bank's not interest income and market value of equity.

Liquidity Risk - This is the risk that bank may be unable to fund contractual obligations.

Credit Risk - This refers to the probability that a bank's borrower will default on a loan granted.

Capital Risk - This is the probability that a bank may become insolvent because of insufficient capital to operate its business.

Off Balance Sheet Risk - This is the risk associated with off balance sheet transaction of a bank.

Operational Risk - This is the possibility that the operative expenses of a firm might vary significantly from what is expected, thereby affecting the firm net income.

Bank Failure - A situation where a bank becomes insolvent or whose total assets are insufficient to pay all its debts.

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CHAPTER TWO

LITERATURE REVIEW

2.1.0 HISTORY OF BANKING IN NIGERIA

The business of modern banking business in Nigeria started in 1892 by the Bank of British West African to which the Standard bank of Nigeria limited, now First Bank of Nigeria is a successor bank. There was no banking legislation of any kind then, and neither a central bank nor a ministry of finance existed until 1958 when the Central Bank of Nigeria (CBN) was established. Prior to 1952, there were all kinds of speculative investors who started mushroom banks in Nigeria.

However, this period also witness the emergence of reputable banks like the banks of British West African which then secured and monopolized banking business as was prevalent until much later when Barclays bank acquired the colonial bank an opened a branch in Lagos in 1925.

Other banks established there after are, the National Bank established in 1933, while African Continental Bank came into being in 1947. The United Bank of African limited in 1961, while the Bank of the North limited was established in 1961. All other commercial and cooperative banks were established in the late sixties and early seventies, most of them being wholly owned by Nigerian and individuals. Basically, their activities centered on commercial banking relating to the financing of exports and imports.

2.1.1 BANKS: DEFINITION, TYPES AND FUNCTIONS.

Definition: There has been controversy regarding the definition of the term 'Bank' or 'banker'. Various scholars have put forward their definition of what they understand by the term by looking at the services that banks render: According to Macleod, he see the essential business of a "banker as that of buying money and debt by creating their debts". A better definition is that given by Dr. H. L. Hart; according to him "a banker or bank is a person or company carrying on the business of receiving moneys, and collecting draft, for customer subject to the obligation of honouring cheques drawn upon them form time to time by the customers to the extent of the amount available on their current accounts".

The legal definition of banks is given by Bills of Exchange Act 1882, Section 2 which states that the term banker includes persons, or a corporation, or a company acting as bankers while Section 5, Subsection 1 of the Banking Companies Act 1949 defined a banking company as "any company which transacts the business of banking – the accepting, for the purpose of lending or investment, of deposits of money from public, repayable on demand or otherwise, and withdrawable by cheque, draft, orders or otherwise.

Banks are basically institution whose debts, usually referred to as "bank deposits" are commonly accepted in final settlement of other peoples' debts.

2.1.2 TYPES OF BANKS

The banking systems of different countries vary substantially form one another, but there has been during the present century a universal tendency for

each nation to develop a wide network of banks centred upon the chief trading centre of the country, with the largest banks themselves established in that centre and grouped round a quite different institution referred to as the "central bank". The English system had already assumed this shape more than a century ago, though the banks were more smaller and more numerous than they are today. The system of many other countries, including undeveloped countries, have shown some tendency to gravitate towards the English pattern, but all have their peculiarities, especially the banking system of the United State of America which has characteristics of its own.

The American banking system is one described as "Unit banks", not branch banks which is what is obtained in England and most other countries. The banks in the U.S.A. may probably be said to form a banking system in the important sense that all are linked directly or indirectly with New York money-market and all look to one Central bank, although that Central Bank is Federal in organisation and has its Chief seat of government in Washington.

The development of nation-wide branch banks has been provided by law in the U.S.A. and still more by the traditional feeling in which the legal restriction are deeply entrenched. So in general sense there are two forms of banking systems and those are Unit banks and Branch banks.

When classifying banks according to its function, there are basically four types and these are Commercial Banks, Specialized Banks, Merchant Banks, and Central Banks. All these banks do basically banking services of receiving deposit withdrawable on demand, but they differ in their function to the society.

Commercial banks are financial institution where in money is managed, created, serviced and an avenue by which deposits are accepted from the public which is payable on demand. The specific functions of commercial banks include:-

i. Accepting and safe keeping in deposits.

ii. Circulating of loans or overdrafts to customers.

iii. Transferring of funds on demand (instruction) by their customers.

iv. Management of customers investment.

v. Providing foreign exchange facilities to travellers.

vi. Acting as referees (Agents) for and on behalf of customers.

vii. Providing services to the exporter and importer.

viii. Purchasing, selling and underwriting of shares.

ix. Giving financial and commercial advice to the customers.

x. Giving status opinion about their customers

The function of Merchants are similar to that of commercial banks but differs in the magnitude of such services.

Specialized banks on the other hand are established to cater for different needs and sectors of the economic. The function of Central Bank as the apex of the all banks is more of a regulatory type. It ensures that smooth running of the entire financial system of the country. It has the following specific functions which include:-

i. Liquidity management.

ii. Domestic debt management

iii. Financial sector surveillance.

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iv. Agricultural credit operators

v. Foreign exchange management.

2.2 AN OVERVIEW OF THE PRUDENT GUIDELINES.

Prudential regulation generally establishes the outside limits and constraints on banks to ensure the safety and soundness of the banking system. Prudential regulations in Nigeria over the years have covered such areas as bank licensing, bank expansion, capital adequacy, liquidity requirements, and lending limit.

The 1990 prudential guidelines covered assets classification, provisions for non-performing assets, credit portfolio disclosure, interest accrual and off balance sheet engagement. The guidelines were to ensure uniformity of approach by banks in the affected areas so that published accounting information by banks can be comparable and reliable.

It can also be argued that the issue of the prudential guidelines was added by the failure of the market mechanism not only to reflect a bank's financial risk exposure but mere importantly to control such exposure.

Even in efficient financial market, the market mechanism has been known to fail to perform these functions timely and properly, hence the need for the guidelines to protect the interest of depositors and the nation's financial system.

The acceptance of the recommendation of the Basle committee on the need for common and effective accounting standard for banking globally, made the prudential guidelines imperative for banking system.

The international nature of banking reinforces the need to strive to attain international acceptable prudential standard. The prudential guidelines introduced are therefore based on practices endorsed by many other nations.

The prudential guidelines were also issued to reduce the risk of the systematic failure and avoid the distributions caused by financial crisis in banks. The guidelines required banks to classify their assets and make stipulated provision for such classification, including bank's off balance sheet engagement. Also, banks were required to suspend interest on non-performing assets and to revise previously accrued but un-collected interest.

The implementation of the guidelines first had the effects of exposing banks that were inadequately capitalized, and were not classifying their assets properly. The provisions required to be made on such banks non-performing assets were such that would have driven the bank into insolvency. The supervisory authorities cooperated with the banks to find a temporary solution to the initial difficulty.

However, the problem of capital inadequacy and attendant risks remained and are getting worse, inspite of the almost four years of the guidelines implementation.

From available secondary data, there is no indication that the financial risks in banks have significantly been minimized as a result of the guidelines. What has been achieved has been increased awareness of the risks by both operators and supervisors. Also, the guidelines have minimized

misunderstanding between the operators and supervisors concerning assets classification and the required provision to be made.

The guidelines can only succeed to the extent that bankers are willing to be guided by them. Where bankers look for, and can find creative ways to avoiding the provision of the guidelines, then little can be expected in terms of the impacts of the guidelines on bank's financial risks.

2.2.1 MAJOR PROVISIONS OF THE PRUDENTIAL GUIDELINES.

The prudential guidelines introduced two types of provision for perceived losses. Specifically, banks were required to classify their credit portfolio into:-

a. Performing credit facilities

b. Non performing credit facilities.

PERFORMING CREDIT FACILITIES

This is those credits on which payment on both principal and interest rate are made to date.

NON PERFORMING CREDIT FACILITIES

This is facilities which either:-

1. Interest or principal is due and unpaid for 90 days or more, or
2. Interest rates up to 90 days or more has been capitalized, rescheduled or rolled over into a new loan.

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The non-performing credit facilities are to be further categorized into three. The categories and the provision to be made on the perceived losses in principal repayment not yet due of such credits were stipulated as follows:-

a. Sub standard

b. Doubtful credits

c. Lost credit facilities

SUB STANDARD

This is where the principal and/or interest remained unpaid for more than 90 days but less than 180 days. The provision for this category of credit is 10% (percent).

DOUBTFUL CREDIT

This is where the principal and/or interest had remained unpaid for at least 180 days but less than 360 days and not secured by legal title to leased assets or perfected realizable collateral in the process of collection or realization. The provision of 50% is to be made for this category.

LOST CREDIT FACILITY

This is a situation where principal and/or interest had remained unpaid for 360 days or more and not secured as in (II) above. A 100% (percent) provision is recommended for this type of credit.

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Also principal repayment that are due on non-performing credit facilities should be fully provided for and recognized on cash basis only, while interest due on them should be suspended and recognized on cash basis also.

A general provision of at least one percent (1%), should be made against risk assets not specifically provided for. That is, risk assets considered as performing.

As stated in the guidelines, floating equitable and unperfected charges are completely, discountenanced. For credit exposure where the principal is in arrears by more than six months but not more than one year, the outstanding principal unprovided for should not exceed 50 percent of the estimated net realizable value of the collateral security.

Finally, the guidelines require bank to undertake "proper appraisal" of off balance sheet (OBS) engagements with a view to determining the extent of loss the banks are likely to sustain in their OBS engagements.

The guidelines require that certain factors such as: the date a liability was incurred, expiry date, security pledged, performance of other facilities being engaged by the customer (e.g. loans and advances) as well as perceived risk must be taken into consideration in recognizing losses on banks' off balance sheet engagement (OBS). The prudential guidelines require banks to fully provide for any loss that may arise from off balance sheet (OBS) transactions.

2.3 AN OVERVIEW OF BANKS FINANCIAL RISKS.

Risk is the chance or probability that some unfavourable event will occur such that the financial position or cash flow stream of the bank is adversely affected.

Risk arises from the uncertainty associated with future event and since rational bank managers are able to anticipate some future events, even the bad ones, risk arises therefore from anticipated changes.

Risk taking is central to the business of banking. It is a necessary companion of bank profitability. In other words, the banking business's coin has profitability on one face and risk on the other. Unfortunately, so very little is heard about banking risks but profitability commands newspaper headlines.

Perhaps the only time Nigerians are conscious of banking risk is when the Nigeria Deposit Insurance Corporation (NDIC) publish a report on the financial condition of insured banks and/or when the Central Bank of Nigeria (CBN) takes over distressed banks for restructuring or liquidation by the NDIC. Thus, even in our environment where a banker can post profits from government subsidiaries in the official foreign exchange market, banking risk remains.

Perhaps one reason so very little is known or written about risk is because of the difficulty of measuring it exact. Even when measurement proxies have been evolved, few practitioners care to use them. Instead, such practitioners depend on quest estimates and the quest for better risk measurement is not simply an amusing exercise that accomplishes only the satisfaction of permitting

academics to play with their computers. It has important implications for protecting investors.

Though the efforts of academics, such risk measures as the variance and beta have been developed for the finance industry.

2.3.1 MAJOR RISK AREAS IN BANKING.

Banks face a multitude of risk which are usually identified with sources of such risk. Some example of the sources includes: credit, interest rate, purchasing power, exchange rate, leverage, investment, liquidity, assets concentration, off balance sheet engagements, ownership and management.

The list can be long since unanticipated out comes can arise from virtually all areas of banking. We shall however, briefly explain some of these risks on which the implementation of the prudential guidelines can have some impact.

1. Credit risk
2. Portfolio risk
3. Liquidity risk
4. Interest rate risk
5. Capital risk
6. Off balance sheet risk
7. Operational risk

CAPITAL RISK

This refers to the probability that a bank's borrower will default on a loan granted or that the issuers of securities held by the bank will default in interest and/or principal payment. Thus, credit risk is the potential variation in a bank's net income and market value of equity outstanding resulting in non payment by borrowers of interest or principal.

Different types of assets have different default probabilities. Loans exhibit the greatest risk while bank investment securities tends to exhibit less credit risk. High credit quality no doubt, minimizes credit risk.

Short term open market obligations tends to be of high credit quality because only low risk borrowers are generally able to borrow in the short term end of a financial market. Credit risk can be minimized through stringent evaluation, adequate collaterization, diversification and by limiting the proportion of funds committed to low quality assets.

PORTFOLIO RISK

A bank's asset portfolio is subjected to several rates including: capital risk that is, the risk of selling the financial assets at a loss, reinvestment risk, that is, the risk of reinvesting the proceed of short term securities at low interest rate, and income rates, that is, the probability of loosing income as a result of a rise in interest rate after the funds have been invested.

While these risks can not be eliminated, they can be reduced. This requires a clear understanding of the nature of the bank's portfolio and its

functions. Portfolio risk can be managed by a careful selection of quality assets. It can also be managed by proper diversification.

Portfolio risk management has benefited tremendously from modern portfolio theory pioneered by Markaritz (1952) and refined by Sharpe (1963, 1964) and extended by (Roll and Ross, 1980).

This application of the modern portfolio have been in linear and quadratic programming models MPT see portfolio as a weighted average of the return on the individual assets which make up a portfolio where the weights are the proportion of funds invested in each asset thus:

$$E(R_p) = \sum w_i r_i \text{ ---------- (1)}$$

Where, w_i are weights and r_i are the returns on the assets. However, portfolio risk is defined as a weighted average of the security risks scaled or reduced by the product of the co-variation of the security returns as follows for a two assets portfolio.

$$Var(R_P) = \sum w_i^2 \delta_i^2 + w_j^2 \delta_j^2 + 2\, w_i\, w_2\, Cov_{ij} + 2$$

Where δ^2 is the variance of return on the assets and Cov_{ij} is the covariance of return between asset i and j. It is evident from this formulation that if the returns covary negatively, the last term will be negative and the portfolio risk will be smaller than the weighted average of the individual security.

A linear programming model can be formulated to minimize portfolio risk subject to a number of constraints such as a target level of portfolio return and a liquidity constraint. Such models with simulation are widely used in sophisticated banking circles.

LIQUIDITY RISK

This is the risk that the bank may be unable to find all contractual obligations, especially lending and investment commitment, as well as meeting customers' deposit withdrawals and maturing liabilities at a cost the bank can bear.

Thus, liquidity risk is the variation in net income and market value of equity caused by a bank's difficulty in obtaining cash at reasonable cost from either the sales of assets or new borrowings to meet obligation.

The greater the marketability of open market assets, the less the likelihood that the sale of such an instrument will require a price concession, hence banks endeavouring to invest in marketable instruments.

However, each investment constrains profitability as the yields on the investment are usually minimal. The demand for liquidity should be greatest if a bank can not anticipate deposit withdrawals or new loan demands hence banks management should continuously monitor potential cash out flows, funds needs, and the ability to meet these payment obligations.

INTEREST RATES RISK

Interest rates risk refers to the potential variability in a banks net interest income and market values of equity due to changes in the level of market interest rates.

The risk encompasses the total portfolio composition, focusing on mismatched asset and liabilities maturities and durations. Since banks have the tendency to fund long term assets with short term liabilities, as interest rates rises, the banks with the mismatched face the risk of reprising the liabilities at higher rates or of not being able to roll over the liabilities that funded the assets.

Banks must learn to forecast interest rates which the asset liability committee should use to price assets and accept liabilities. In addition to interest rates forecasting, banks in mature economies use such tools as hedging, gag management, simulation and duration models to manage interest rate risk.

CAPITAL RISK

This is the probability that a bank may become insolvent because the capital available to it may not be sufficient for the volume and character of the bank's level of business and to cushion potential losses. Capital risk is closely associated with financial leverage which refers to the use of debt and preferred stock paying fixed rates as part of a firm's capital structure.

It was the concern for declining levels of capital in banks that made the Bank of International Settlements (BIS) to come up with the risk weighted capital guidelines for international banks. The required minimum of 8 percent is hardly enough to cushion losses in some banks.

OFF – BALANCE SHEET RISK.

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This is the risk associated with off balance sheet transactions of a bank. The prudential guidelines set some factors that must be considered in determining the extent of loss a bank's off balance sheet engagements may entail.

The guidelines require full provisions to be made in respect of such losses from off balance sheet transactions. Bank's disclosure was to be note form as it should not form part of the balance sheet totals, and it should distinguish between direct credit substitutes, transaction related contingencies and short term, self liquidating trade related contingencies.

The risks here are multiple. There are elements of credit, liquidity interest rate and capital risks in off balance sheet engagements. It all depends on the nature of the engagements. Bankers are generally advised to thread cautiously in this potential land mine of off balance sheet engagements.

OPERATING RISK

Operating risks refers to the possibility that the operating expenses of a bank might vary significantly from what is expected thereby leading to a decline in net income and bank value. On the other hand, the risks of embezzlement and theft which is considered to be part of operational risks relates to the risk that bank asset will be diminished through dishonest acts.

A possible way out of these risks is through an improvement and effectiveness of internal control systems.

2.3.2 IMPACTS OF THE PRUDENTIAL GUIDELINES ON BANKS' RISKS.

Upon full implementation of the guidelines, it became clear that some banks were not prudent in the management of their assets and affairs.

Banks supervisors had known all along that licensed banks were not adequately capitalized. But it took the implementation of the guidelines to know what cushions the banks had against operating losses. In other words, the available capital could not support the losses in the income statement occasioned by the provisions.

Consequently, the supervisory authorities had to grant some measure of forebearance to the banks to enable them spread the provisions' shortfall to four years.

Bankers were also to be very circumspect in lending activities and were expected to take debt recovery seriously. For the first time, bankers realized that they had to classify credit facilities to government and its agencies and to make adequate provisions against the risks inherent in the credits just like other credit facilities.

The implementation of the guidelines has been marked by an inclination to classify credit facilities out of line with the growth of loan assets.

Moreover, the ability of the banks to detect much earlier any act of fraud and financial malpractices relating to loans and advances is a significant consequence of the prudential guidelines implementation. Because non performing facilities must be classified after 90 days, it follows then that any

fraudulent act in loans and advances would likely be detected within such period, as the facility would become a subject of investigation as soon as it is found to be non performing.

Finally, the prudential guidelines require full provisions to be made in respect of losses from off balance sheet (OBS) transactions.

Off balance sheet activities expose banks to such risks as interest rate risk and credit risk in ways that are not very obvious. While banks usually receive up front fees for OBS engagements, such transactions commit the bank to unlimited downside risk.

The prudential guidelines were issued to reduce the risk of systematic bank failure And avoid the disruptions caused by financial crises in banks.

2.4 THEORETICAL BACKGROUND ON DEREGULATION

Financial liberalization is the establishment of interest rates that equated the demand for and the supply of savings. It is a pre requisite economic reform for social economic reform for economic development.

The regulation of interest rates, is a major evidence of financial repression. Public policies that abolish interest rate control would normally set in motion forces that encourage financial innovations.

The deregulation of interest rates often make external liberalization possible. This includes the adoption of floating exchange rates, liberalization of trade and capital accounts, the abolition of import and capital controls.

It is generally believed that interest deregulation enhance the growth of financial institutions which provide more investors with access to borrowing.

Another expected effect of interest rate deregulation is the reduction in capital flight from the domestic^economy. It will also reduce self investment curb market loans and advances and investment in unproductive asserts.

Consequently, efficiency and economic growth will be encouraged which will result into economic growth of the financial institutions.

The increase in the number of financial institutions especially banks would increase the degree of competition in the financial services industry and promote its efficiency.

All these are expected to have effect on the profitability of the financial services industry. In the long run profits are reduced as monopoly rents are - eliminated, it is therefore^esirable to investigate the extent to which all the above mentioned theoretical expectation are met in any economy that embarks on financial liberalized programmes. Such as investigation would assist in the monitoring of the reform programmes.

2.5 NATURE OF THE NIGERIAN FINANCIAL LIBERALIZATION PROGRAMME.

In Nigeria, domestic financial liberalization commenced when the government abolished interest rate ceilings in August, 1987. The rate were then left to be determined by the market.

On the external front, financial liberalization came with the introduction of the Second Tier Foreign Exchange Market Scheme (SFEM) which later became the Inter Bank Foreign Exchange Market.

The SFEM (IFEM) an auctioning system replace the former fixed exchange regime when the rate was fixed by administrative fiat. Since the SFEM was introduced the environment in which banks make foreign exchange related earnings had been changed in a fundamental manner.

Besides the SFEM and IFEM, the Nigerian Naira ha substantially depreciated.

The Bureaux de change the name given to the licensed dealers in the parallel market were expected to transact their business at market determined rates. In a similar vein, domiciliary accounts that were expected to accept foreign deposits, were legalized.

Also, banks were not expected to ask questions, from depositors on the source of their funds. This was expected to encourage capital inflow and encourage the repatriation of the Nigeria capital that had earlier fled.

While there was no compelling evidence to suggest that the monetary authorities were more liberal on the conditions for granting banking license. The government's programme of financial liberalization witnessed an upsurge in the number of licensed banks.

It is possible that this upsurge in the number if licensed banks is the direct result of the new market opportunities created by the changes in the regulatory

environment to liase than being a deliberate effort on the part of monetary authorities to license more banks.

2.6 LIBERALIZATION AND THEIR EFFECTS ON NIGERIAN BANKS.

Interest rate deregulation, as we noted encourages the growth of financial institutions which provide more investors with access to borrowing and consequently, interest deregulation in Nigeria is expected to lead in an increase in the number banks, as well as in the number of non banking financial institutions.

Another expected effect of interest rate deregulation is the reduction in capital outflow from Nigeria. It will also reduce self investment, curb market loans and advances and finally it will bring about advances and investment in unproductive assets.

The increase in the number of financial institutions, especially banks would increase the degree of competition in the banking industry.and promote its efficiency.

The deregulation of the Nigerian financial system magnified some risks in banks that were hitherto minimal. Because the deregulation exercise increase the number of players in the system, competition thus become more intense and some bankers resorted to cutting corners as a strategy to survive and stay in business.

The exercise also increased risk exposure of banks, particularly the risk to depositors. Still, the deregulation of the Nigerian banking Industry allowed

individual(s) who had no business and prior banking knowledge and experience to get licenses to establish financial institutions which they subsequently used as trading outfits to the detriment of the depositors and the Nigerian banking industry.

2.7 PRE-DEREGULATION AND DEREGULATION ERA

The monocultured nature of the economy is such that the performance of one or two primary products always dictates the fortunes of the economy. The economy had relied mainly on agriculture engaging over 70% of the labour force and being the major source of foreign exchange earnings and government revenue.

The situation became more pronounced with the collapse of the world commodity prices especially crude oil prices in the late 1970s and early 1980s. hence, foreign exchange earnings and government revenue reduced drastically,.

Consequently, upon this unhealthy development, the government had to introduce some drastic measure to control the economy. Mostly the use of monetary and fiscal policies.

A major change in the Nigerian economic policies came into effect on 27th June, 1986 during Babangida's administration. The Structural Adjustment Programme was introduced to put in place a market oriented economy. The major features of the programme were:-

a. The introduction of variant of a flexible exchange rate.

b. Financial liberalization

c. A plan to restructure government expenditure and revenue programme

d. Privatization and commercialization of public enterprises.

The phenomenal growth of the banking industry in Nigeria following the deregulation of the financial services industry had generated interest and enthusiasm amongst top bankers.

It is becoming increasingly difficult for banking institutions to provide financial services while continuing to achieve real growth in assets and profits. Economic vulnerability has become particularly acute in the late 80's and within this period, competition amongst banks is severe and is growing dramatically.

The increased competition results in downward profit for the banking industry to be able to take full advantage of the unlimited opportunities provided by a deregulated market place, and over come the challenges posed by the uncertainty in the banking environment there is need for corporate repositioning and proper market focus.

2.8 PROFILE OF UNION BANK OF NIGERIA PLC.

Union Bank of Nigeria PLC is the successor of the Colonial Bank which was established in 1917. The bank's first office in Nigeria was located at the old 55 Marina, now No. 40 Marina, Lagos state.

The Bank was renamed Barchlay's Bank Dominion, Colonial and over seas (DCO) in 1954. The local head office was established in Lagos with Mr.

J.C. Cox as the first Director and Head of West African Board Comprising Ghana, Sierra Leone and Cameroon.

Today, the Union Bank of Nigeria PLC has over 240 branches spread throughout the country. In 1971 8.3% of the shares were offered to Nigerian citizens and Associations, and the bank was listed on the Nigerian Stock Exchange. As a result of the Nigerian Enterprises Promotion Decree of 1972, and 1977, which put the force of law behind government indigenization policy, the federal government of Nigeria acquired 51.67% of the bank's share while • Barcley's bank PLC was left with 40% and the remaining 8.33% with the Nigerian public.

One of the land marks of the Bank's history took place in 1979 when Barcleys Bank decided to sell 50% of its share holding in the bank to Nigerians, thus, reducing their equity holding to 20%. Following the reduction in Barcleys bank shareholding, the name of the bank was changed in 1979 from Barcleys bank of Nigeria limited to Union Bank of Nigeria limited, to reflect the new image and the new ownership structured the bank.

Since 1979 to date, the ownership structure of the bank has remained'the same. Viz.; ministry of finance incorporated 51.67%, private Nigerian investors, 28.33% and Barcleys Bank PLC, 20%. This equity structure makes Union Bank Nigeria Limited the only former expatriate bank currently with the largest proportion of its shares (80%) owned by Nigerians.

The banks outstanding performance over the decades attributable to bank's willingness to innovative banking services.

Union Bank Nigeria PLC is active in all aspect of commercial banking and provides international banking trustship, share registration, corporate finance and investment banking e.t.c.

The bank is also involved in the traditional banking. Services such as taking deposits, giving loans and advances, selling and buying of foreign and letter of credit arrangement e.t.c.

CHAPTER THREE

RESEARCH METHODOLOGY

This chapter focuses on the methodology of the research work. It deal exclusively with the method, procedure and schemes of the necessary data and information for the research work.

3.1 RESEARCH DESIGN

The researcher employed a mixture of exploratory, descriptive and survey method and every stage of the research process forces some kind of sampling. This is so because, it becomes apparently impossible to include all the variables which might be relevant to the study or to use all the data gathered in the final analysis.

On the whole twenty staff of the bank were selected to complete the prepared questionnaire and the selected staff cut across the management, senior and junior staff of the bank.

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3.2 POPULATION OF THE STUDY

The study considered and encompasses all the banking institutions (defunct or existing) which operated or are in Nigeria. This is because a broad assessment of the banking industry in the pre and deregulated period is intended to be carried out.

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3.3 SAMPLING TECHNIQUE

The fact that the entire banking industry can not be objectively surveyed and questioned makes it invariably important to select and choose Union Bank of Nigeria PLC and twenty staff of the bank as the representative sample.

For this purpose, the researcher found it convenient to use a random sampling technique. This is because, of the similarity and correlation in the characteristics of the population of the study.

3.4 SAMPLING SIZE

This represent a portion of the population of the study, that was choosing as the representative sample size for the study.

For the purpose of simplicity and objectivity twenty (20) staff of Union Bank of Nigeria PLC were selected as the sample size for the study.

3.5 RESEARCH INSTRUMENT USED.

1. OBSERVATION METHOD

The observation method provide a strong and effective means of achieving the research objective. It makes it possible for the researcher to give all the observable situation and trends in the banking industry a critical and objective evaluation and thus, provide a strong basis for analyzing all the data and information gathered from the secondary sources and the surveyed respondents.

2. CLASSIFIED DOCUMENTS

The classified documents enabled the researcher to gain an insight into what earlier experts and researchers have said, done and come up with on the subject matter and thus, provide a basis for establishing a relationship with this research findings and what has earlier been said investigated.

3. QUESTIONNAIRE

A close ended questionnaire was designed and used for the purpose of obtaining necessary information relevant to the research work and it was designed in such a way that is unambiguous, clear and easy to answer.

The questionnaire gave the researcher some advantages because, it is uneconomical for reason of time and fund to observe or interview everyone that might provide relevant information for the research work.

3.6 METHODS OF DATA COLLECTION

The production of this research work was based on two main sources of data. Primary and secondary data sources.

The primary data sources for this study is the questionnaire that was designed to gather relevant information and data relating to the research work from the respondents surveyed.

The study also made extensive use of secondary data resources. These include Havard Business Review Magazine, Business and Financial Journals, Various textbooks, Bulletin and Annual Report of the Bank of my case study e.t.c.

The books and other secondary sources of data provided a reserviour of knowledge and different view points on the subject matter. All these were critically examined and logical conclusions derived from them.

3.7 METHOD USED IN RECORDING AND TABULATION OF DATA

In analyzing data and information gathered a simple statistical computation was made.

Thus, in the process of presenting, analyzing and interpreting the information and responses gathered, tables were used in presenting the major findings and summarization of the responses was done in such a way the enabled a simple description of the responses obtained.

3.8 METHOD OF DATA ANALYSIS.

The analysis was done by a general frequency on the responses obtained from the staff of Union Bank Nigeria PLC to the questions raised in the questionnaire.

Thus, in analyzing the data and responses obtained, statistical method of the research work is also substantially descriptive, statistical computations were

made where necessary to succinctly illustrate important points. In other words, the presentation of the research work is devoid of complex statistical computation.

CHAPTER FOUR

DATA PRESENTATION AND ANALYSIS

This chapter deals with the presentation and analysis of the data and information collected. These are the data and information collected and gathered from NDIC and the questionnaire administered on the staff of Union Bank Nigeria PLC.

4.0 IMPACTS OF PRUDENTIAL GUIDELINES ON BANK'S RISKS.

Upon full implementation of the guidelines, it became clear that some banks were not very prudent in the management of their assets and affairs.

Major impact and banks risks areas that will be examined here includes, capital risk, credit and portfolio risk, operational risk and off balance sheet risk.

The assessment of the prudential guidelines on the above listed bank risk will cover the period of 1996 that the guidelines was introduced to 1998.

4.1 CAPITAL RATES AND PRUDENTIAL GUIDELINES

Bank supervisors had known all along that licensed banks were not adequately capitalized. But it took the implementation of the guidelines to know what cushions the banks had against operating losses.

When required to make 10%, 15% and 100% provisions for performing; substandard, doubtful and lost credit respectively, the total provisions required wiped out some banks income and capital.

Consequently, the supervisory authorities had to grant some measure of forebearance to the banks to enable them spread the provisions' shortfall up to four (4) years.

Almost four years since the implementation of the guidelines, licensed banks remain grossly under capitalized for the volume of business done. Table 4.1 shows the shortfall in capital requirement as well as overall deterioration in bank's capital positions.

TABLE 4.1 CAPITAL REQUIREMENT OF BANKS (1990-1993)

YEAR	SHORTFALL ON CAPITAL REQUIREMENT (₦'m)
1995	1,483.6
1996	1,917.0
1997	5,553.0
1998	9,097.0

Source: [NDIC Annual Reports (Various Issues)]

The table shows that as at the end of 1993, licensed banks required additional capital to the tune of about ₦9.1 billion to meet the minimum capital fund necessary to support their operations.

4.2 CREDIT AND PORTFOLIO RISKS AND THE PRUDENTIAL GUIDELINES

The prudential guidelines made bankers to realize that they had to classify credit facilities to government and its agencies and to make adequate provisions against the risks inherent in the credits just like other credit facilities.

However, on reading examination reports, it does not seems that bankers have learned much on credit facility issue. Facilities are still being extended rather recklessly to bank directors and their affiliate companies.

Table 4.2 below have attempted to examine whether the post guidelines era has been marked by a significant growth in classified asset portfolio not accounted for by the growth in loan assets.

TABLE 4.2 GROWTH IN LOAN ASSETS AND IN CLASSIFIED LOAN ASSETS. (1990 – 1993)

YEAR	LOAN ASSET GROWTH(%)	CLASSIFIED LOAN ASSET GROWTH (%)
1995	16	26
1996	21	5
1997	26	50
1998	94	74

Source: [NDIC Annual Reports (1990 -1993)]

Table 4.2 reveals that in two years, 1991 and 1993, the growth in classified loan assets lagged behind the growth in loan assets.

While in two years also (1990 and 1993), the growth in classified loan assets exceeded the growth in loan assets.

4.3 OPERATIONAL RISK AND PRUDENTIAL GUIDELINES.

The ability of banks to detect much earlier any act of fraud and financial malpractice relating to loans and advances is a significant consequence of the prudential guidelines implementation.

There is thus an empirical issue where bank managers would have to be asked to assess the contribution of the guidelines in assessing fraud detection. In the absence of such a study, we can only rely on secondary data with it shortcomings. One of such data is presented in table 4.3 below.

TABLE 4.3 AMOUNT INVOLVED IN FRAUDS AND FORGERIES IN BANKS (1990 – 1993)

YEAR	AMOUNT INVOLVED (₦/m)
1995	804.2
1996	388.5
1997	411.7
1998	1,419.0

Source: (Bank Returns)

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Table 4.3 above shows that reported cases of frauds and forgeries since 1990 involved amounts that fluctuated yearly without any clear pattern.

The expectation would have been a significant reduction in amounts since 1990 when the prudential guidelines were implemented.

However, the amount involved in reported frauds and forgeries in 1993 more than tripled the average for the previous four years.

4.4 OFF BALANCE SHEET RISK AND THE PRUDENTIAL GUIDELINES.

The prudential guidelines requires full provisions to be made in respect of losses from off balance sheet (OBS) transactions. These transactions consist of Acceptance, Documentary Credits and Guarantees.

Table 4.4 shows the value of OBS activities and relates some to the volume of loans and advances.

TABLE 4.5 BANKS OFF BALANCE SHEET ACTIVITIES 1990 –1993.

YEAR	OBS VOLUME (₦ /bill)	LOANS AND ADVANCES VOLUME(₦ /bill)
1995	12.5	32.9
1996	21.2	40.0
1997	29.1	54.8
1998	32.7	56.7

Source: (Banks' Monthly Returns)

It is evident in table 4.5 above that OBS activities in banks grew from ₦12.5 billion 1990 to ₦ 32.7 billion in 1993 for an average annual growth rate of about 41%; while loans and advances grew at an annual rate of 30%. When the volume of OBS activities is compared to the volume of loans and advances, the results are even more startling.

Yet OBS activities expose banks to such risks as interest rate risk and credit risk in ways that are not very obvious.

4.5 ANALYSIS OF THE QUESTIONNAIRE

A total of twenty questionnaire administered on the staff of Union Bank Nigeria PLC. This encompasses staff from the various departments in the bank and it cuts across the management, senior and junior staff.

TABLE 4.5(A) RESPONDENTS CATEGORIZED ACCORDING TO SEX

ALTERNATIVE	RESPONSES	PERCENTAGE
MALE	14	70%
FEMALE	6	30%
TOTAL	20	100%

Sources: (Questionnaire administered on staff of UBN PLC.).

The above table shows that 14 of the respondents were male representing 70 percent, while the remaining 6 staff were female representing 30 percent of the total respondents surveys.

TABLE 4.5 (B) RESPONDENTS CATEGORIZED ACCORDING TO AGE GROUP

ALTERNATIVE	RESPONSES	PERCENTAGE
21 – 30 YEARS	11	55%
31 – 40 YEARS	6	30%
40 YEARS AND ABOVE	3	15%
TOTAL	20	100%

Source: [same as 4.5 (A)]

The above table shows that 11 of the respondents surveyed were between the ages of 21 – 30 years representing 55%, 6 were between the age of 31 – 40 years representing 30%, while the remaining 3 respondents were between the age of 41 years and above constituting 50% of the total respondents surveyed.

TABLE 4.5 (C) RESPONDENTS CATEGORIZED ACCORDING TO POSITION

ALTERNATIVE	RESPONSES	PERCENTAGE
Management Staff	5	25%
Senior Staff	6	30%
Junior Staff	9	45%
TOTAL	20	100%

Source: [same as 4.5 (A)]

Table 4.5 (C) above shows that 5 of the respondents surveyed were in the management cadre representing 25%, 6 were in the senior staff position representing 30%, and the remaining 9 respondents were Junior staff representing 45% of the total respondents surveyed.

TABLE 4.5 (D) HOW WILL YOU DESCRIBE THE PERFORMANCE OF THE BANK WITH THE INTRODUCTION OF PRUDENTIAL GUIDELINES.

ALTERNATIVE	RESPONSES	PERCENTAGE
OUTSTANDING	7	35%
AVERAGE	8	40%
POOR	5	25%
TOTAL	20	100%

Source: [same as table 4.5 (A)]

The above table shows that 7 of the respondents described the performance of the banks to be outstanding with the introduction of the prudential guidelines, representing 35% 8 respondents rated the performance to be average representing 40% while the remaining 5 respondents considered the banks performance to be poor constituting 25% of the total respondents surveyed.

TABLE 4.5 (E) HOW PRUDENT IS THE BANK'S IN THE MANAGEMENT OF ITS AFFAIRS.

ALTERNATIVE	RESPONSES	PERCENTAGE
VERY PRUDENT	16	80%
PRUDENT	3	15%
NOT PRUDENT	1	5%
TOTAL	20	100%

Source: [same as table 4.5 (A)]

Table 4.5 (E) shows that 16 of the respondents rated the banks competence in the management in the bank's affairs to be very prudent representing 80%, 6 respondents considered it to be prudent (that's average) representing 15%, while the remaining one (1) respondent considered the management of the affairs of the bank not prudent representing 5% of the total respondents.

TABLE 4.5 (F) WHAT IS YOUR ASSESSMENT OF THE LEVEL OF FINANCIAL RISK IN THE BANK'S

ALTERNATIVE	RESPONSES	PERCENTAGE
HIGH	5	25%
MODERATE	6	30%
LOW	9	45%
TOTAL	20	100%

Source: [same as table 4.5 (A)].

The above table shows that 5 of the respondents rated the assessment of the financial risk in the bank's high representing 25%, 6 respondents rated it moderate representing 30%, while the remaining 9 respondents considered it low, constituting 45% of the total respondents surveyed.

TABLE 4.5(G) DOES THE DEREGULATION OF THE FINANCIAL SERVICES INDUSTRY BRING ABOUT COMPETITIVENESS IN THE BANKS.

ALTERNATIVE	RESPONSES	PERCENTAGE
YES	16	80%
NO	4	20%
TOTAL	20	100%

Source: [same as table 4.5 (A)]

The above table shows that 16 of the respondents considered deregulation of the financial service industry to bring about competitiveness representing 80%, while 4 respondents considered it otherwise representing 20%, of the total respondents surveyed.

4.6 RESEARCH FINDINGS

The research findings reveals that upon full implementation of the guidelines, some banks were not prudent in the management of their affairs and that some licensed banks remain grossly under capitalized for the volume of business done.

The implementation of the guidelines also has the effect of exposing banks that were inadequately capitalized and were not classifying their assets properly. The provisions required to be made on such banks' non performing assets were such that would have driven the banks into insolvency.

The findings also reveals that banks face a multitude of risks which are usually identified as having serious effect on the growth and profitability of the bank. Some example of the source include credit, interest rate, purchasing power, exchange rate, leverage, liquidity, asset concentration, off balance arrangement e.t.c. This list can be long since unanticipated outcomes can arise from virtually all areas of banking.

Another major findings of the researcher was the deficiencies in the Nigerian banking system to recognize problem assets through classification,

provisioning and write off. This failure in assets classification resulted into the inability classification resulted into the inability of bankers to establish realistic provisions for potential losses and suspend interest on the non-performing assets. Consequently, the balance sheet of such banks most often failed to reflect the true positions of the bank's statement of affairs.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 SUMMARY

The deregulation of the Nigerian financial system in 1987 until recently, magnified some risks in banks that were hitherto minimal. The deregulation policy increase the number and growth of the banking industry and competition become stiffer and intense.

The deregulation policy allowed these individuals or group of individual who had no business and prior banking experience to establish financial institutions which they subsequently used as trading outfits to dupe depositors or lenders.

The systematic risk of banks increased due to this regulatory reforms and the subsequent growing concern on the need to focus more attention on the operations of banks, their risk exposures and ways to eliminate or minimize such risks.

It can also be argued that the issue of the prudential guidelines was aided by the failure of the market mechanism not only to reflect a bank's financial risk exposure but more importantly to control such exposures. Even in the efficient financial markets, the market mechanism has been known to fail to perform these functions timely and properly, hence the need for the guidelines to protect the interest of depositors and the nation's financial system become imperative.

The guidelines requires banks to undertake "proper appraisal" of the off balance sheet engagements with a view to determine the extent of loss the banks are likely to sustain in such engagements. The guidelines require that certain factors such as the date increased, expiry date, performance of other facilities enjoyed by the customer, as well as the perceived risk must be taken into consideration in recognizing losses in banks arrangement.

Risk taking is central to the business of banking and it is a necessary companion of bank's profitability in other words, the banking business's coin has profitability one on face and risk on the other.

Perhaps one reason so very little is known or written about risks is because of the difficulty of measuring it exact. Even when measurement proxies have been evolved, few practitioners care to use them. Instead, such practioners depend on questimates.

The ability of banks to detect much earlier any act of fraud and financial malpractices is a significant consequence of the prudential guidelines implementation. Because non-performing facilities must be classified after 90 days, it follows that any fraudulent act in loans and advances would likely be detected within such period, as the facility would become a subject of investigation as soon as it is found to be non performing.

5.2 CONCLUSION

The prudential guidelines were issued to reduce the risk of systematic failure and avoid the disruptions caused by financial crises in banks. The

guidelines required banks to classify their assets and make stipulated provisions for each classification, including bank's off balance sheet engagements. Also, banks were required to suspend interest on non-performing assets and to reverse previously accrued but uncollected interest.

The implementation of the guidelines first had the effect of exposing banks that were inadequately capitalized and were not classifying their assets properly. The provisions required to be made on such banks non-performing assets were such that would have driven the banks into insolvency. The supervisory authorities co-operated with the banks to find a temporary solution to the initial difficulties.

However, the problem capital inadequacy and the attendant risk remained and are getting worse, inspite of almost four years of the guidelines implementation.

From available secondary data there is no indication that the financial risk in banks were significantly been minimized as a result of the guidelines. What has been achieved has been increased awareness of the risk by both operators and supervisors.

Also, the guidelines have minimized misunderstanding between the operators and supervisors concerning assets classification and the required provisions to be made.

The guidelines can only succeed to the extent that bankers are willing to be guided by them. Where bankers look for, and can find creative ways of

avoiding the provision of the guidelines, then little can be expected in term of the impacts of the guidelines on banks' financial risks.

Banks face a multitude of risks, which are usually identified with the sources of such risks. Some example of such risks including: Credit, Interest rate, Purchasing power, Exchange rate, Leverage, Investment capital, Liquidity, Off balance sheet engagements e.t.c,. The list can be long since unanticipated outcomes can arise from virtually all areas of banking operations and activities.

5.3 RECOMMENDATION.

In view of the research finding the researcher found it necessary to offer the following recommendation.

1. Banks should make concerted effort to recognize problem assets, and realistic provisions for potential losses should be establish for it through proper assets classification, provisioning and write off.
2. The provisions of the prudential guidelines should be strictly adhere to by banks, in all aspect of their operations.
3. The Basle recommendation on common and effective accounting standard for banking globally, should be implemented, this will re-enforce the need to strive to attain internationally acceptable prudential standards.
4. All principal repayments that are due on performing credit facilities should be fully guided and recognized on cash basis only, while the interest due

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on them should be suspended and treated in the same way as the principal.

5. Banks' should ensure that the outstanding principal unprovided for should not exceed 50% of the estimate net realizable value of collateral security, for credit exposure where the principal is arrears by more than 6 months.
6. Banks should undertake proper appraisal of off balance sheet engagements so as to determine the extent of loss the banks are likely to sustain in such arrangements.
7. Effective credit policies such stringent evaluation, adequate collaterization, diversification and limiting the proportion of funds committed in low quality assets e.t.c, should be put in place to minimize and manage financial risks.
8. Banks should continuously monitor and manage cash out flows, funds needs, and the ability to meet obligation as at when due, as a means of controlling liquidity risks.
9. Banks must learn and develop a technique of forecasting interest rate variability on its net income and market value of its equity, such forecasting will act as tool for hedging against the interest rate fluctuation.
10. Efforts should be directed at improving the quality of management of the banks and improve the effectiveness of its internal control system.
11. Finally, banks must ensure that non-performing facilities are classified after 90 days, this will provide a basis of detecting any fraudulent acts in

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loans and advances and proper investigation should commence as soon as it is detected.



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APPENDIX I

QUESTIONNAIRE

1. Sex
   a. male
   b. female

2. Age Group
   a. 21 – 30 years
   b. 31 – 40 years
   c. 41 years and above

3. Position
   a. management staff
   b. senior staff
   c. junior staff

4. How will you describe the performance of the Bank's with the introduction of the Prudential Guidelines.
   a. outstanding
   b. average
   c. poor

5. How prudent is the bank's in the management of its affairs.
   a. very prudent
   b. prudent
   c. not prudent

6. What is your assessment of the level of financial risks in the banks.
   a. high
   b. moderate
   c. low

7. Does the deregulation of the financial services industry bring about competitiveness in the Bank's.
   a. yes
   b. no

UNION BANK

UNION BANK OF NIGERIA PLC

1999 ANNUAL REPORT & ACCOUNTS

F BALANCE SHEET
30 SEPTEMBER 1999

	The Group		The Company	
	1999	1998	1999	1998
	N'm	N'm	N'm	N'm
sh and short term funds	8,402	5,742	8,354	5,660
alances with other banks and financial stitutions	60,294	57,789	53,330	54,002
ills discounted	27,158	6,361	22,581	4,404
ther investments	192	261	192	255
vestments in subsidiary and associated mpanies	105	60	569	402
ans and advances	28,667	26,148	27,874	25,078
ther assets	4,939	5,178	5,228	4,986
quipment on lease	95	188	95	188
xed assets	8,495	7,730	8,011	7,456
oodwill on consolidation	-	129	-	-
OTAL ASSETS	138,342	109,586	126,234	102,431
anced by:				
IABILITIES				
eposits, current & other accounts	102,775	83,093	93,035	77,239
axation	926	520	861	474
vidend	1,402	1,016	1,402	1,016
ther liabilities	22,080	15,800	20,304	14,950
	127,183	100,429	115,602	93,679
APITAL AND RESERVES				
alled-up share capital	629	629	629	629
are premium account	1,666	1,666	1,666	1,666
tatutory reserve	2,425	1,918	2,328	1,859
eneral reserve	3,209	1,840	2,956	1,619
	7,929	6,053	7,579	5,773
xed assets revaluation surplus	1,493	1,493	1,493	1,493
xchange difference reserve	1,560	1,486	1,560	1,486
APITAL FUNDS	10,982	9,032	10,632	8,752
ty interest	177	125	-	-
	11,159	9,157	10,632	8,752
	138,342	109,586	126,234	102,431
ntingent liabilities and other obligations behalf of customers and customers' liabilities creon	28,567	12,827	28,121	12,408

ROUP PROFIT AND LOSS ACCOUNT
R THE YEAR ENDED 30 SEPTEMBER 1999

	The Group		The Company	
	1999	1998	1999	1998
	N'm	N'm	N'm	N'm
oss Earnings	21,162	14,973	18,250	13,772
t Profit before taxation	4,046	2,318	3,860	2,083
xation	(797)	(394)	(733)	(350)
OFIT AFTER TAXATION	3,249	1,924	3,127	1,733
nority Interest	(52)	(45)	-	-
OFIT AFTER TAXATION AND MINORITY TEREST	3,197	1,879	3,127	1,733
PROPRIATIONS				
nsfer to statutory reserve	507	431	469	400
vidend	1,321	881	1,321	881
	1,828	1,312	1,790	1,281
ained profit transferred to general reserve	1,369	567	1,337	452
	3,197	1,879	3,127	1,733

KALU U. KALU — CHAIRMAN

G.A.T. OBOH — GROUP MANAGING DIRECTOR/ CHIEF EXECUTIVE

T.O.I. AKINOLA — EXECUTIVE DIRECTOR

REPORT OF THE JOINT AUDITORS TO THE MEMBERS OF UNION BANK OF NIGERIA PLC

We have audited the above balance sheet as at 30 September, 1999 and profit and loss account for the year ended on that date.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The company's directors are responsible for the preparation of the financial statements. It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

BASIS OF OUR OPINION

We conducted our audit in accordance with generally accepted auditing standards. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary to provide us with sufficient evidence to give a reasonable assurance that the financial statements are free from material mis-statement. In forming our opinion, we also evaluated the overall adequacy of the presentation of information in the financial statements. The financial statements are in agreement with the books of accounts which have been properly kept and we obtained the information and explanations we required and have received proper returns from branches not visited by us.

During the year, the bank contravened some sections of the Banks and Other Financial Institutions Decree, 1991 (as amended). The contraventions have been reported to the Board of Directors of the bank.

OPINION

In our opinion, the financial statements give a true and fair view of the state of affairs of the bank and the group as at 30 September, 1999, the group profit and cash flow for the year ended on that date, and have been properly prepared in accordance with the provisions of the Banks and other Financial Institutions Decree, 1991; all relevant circulars issued by the Central Bank of Nigeria; all relevant Statements of Accounting Standards and the Companies and Allied Matters Decree, 1990.

KPMG Audit
CHARTERED ACCOUNTANTS

Ogelami, Soetan, Adeleke & Co.
CHARTERED ACCOUNTANTS

LAGOS, NIGERIA

December 9,1999

DIRECTORS

KALU U. KALU

G.A.T. OBOH

M.A. AJOMALE

T.O.I. AKINOLA

M.L. ALABI

Y.G. ALI

B.B. EBONG

G.S. JAJO

B. MANU

B.U. NDIOKHO

E. NWUDE - ODINIGWE

S.I. SODANGI

G.A. YAKASAI

AASHIM IBRAHIM LIBRARY

UNION BANK

UNION BANK OF NIGERIA PLC

Annual Report & Accounts

GROUP BALANCE SHEET AS AT 30 SEPTEMBER, 1998

	The Group		The Company	
ASSETS	1998 N'm	1997 N'm	1998 N'm	1997 N'm
Cash and short term funds	5,742	5,963	5,660	5,935
Balances with other banks and financial institutions	57,789	39,345	54,002	37,481
Bills discounted	6,361	6,388	4,404	4,190
Investments	261	157	255	96
Investments in subsidiaries and associated companies	60	60	422	358
Loans and advances	26,148	23,364	25,078	22,530
Other assets	5,178	4,174	4,986	3,885
Equipment on lease	188	251	188	251
Fixed assets	7,730	6,019	7,456	5,828
Goodwill on consolidation	129	129	-	-
TOTAL ASSETS	109,586	85,850	102,431	80,503
Financed by:				
LIABILITIES				
...sit, current & other accounts	83,093	62,654	77,239	58,310
...tion	520	370	474	313
...dend	1,016	523	1,016	523
Other liabilities	15,800	14,965	14,950	14,233
CAPITAL AND RESERVES	100,429	79,512	93,679	74,379
Called-up share capital	629	397	629	397
Share premium reserve	1,666	-	1,666	-
Bonus issue reserve	-	132	-	132
Statutory reserve	1,918	1,487	1,659	1,459
General reserve	1,840	1,273	1,619	1,167
	6,053	3,289	5,773	3,155
Fixed assets revaluation surplus	1,493	1,493	1,493	1,493
Exchange difference reserve	1,486	1,476	1,486	1,476
CAPITAL FUNDS	9,032	6,258	8,752	6,124
Minority interest	125	80	-	-
	9,157	6,338	8,752	6,124
	109,586	85,850	102,431	80,503
CONTINGENT LIABILITIES	12,827	12,298	12,408	11,993

GROUP PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 30 SEPTEMBER, 1998	The Group 1998 N'm	1997 N'm	The Company 1998 N'm	1997 N'm
Net Profit before taxation	2318	1615	2083	1511
Taxation	(394)	(318)	(350)	(302)
PROFIT AFTER TAXATION	1924	1297	1733	1209
Minority interest	(45)	(20)	-	-
PROFIT AFTER TAXATION AND MINORITY INTEREST	1879	1277	1733	1209
APPROPRIATIONS				
Transfer to statutory reserve	431	315	400	300
Dividends	881	437	881	437
	1312	752	1281	737
Retained profit transferred to general reserve	567	525	452	472
	1879	1277	1733	1209

Kalu U. Kalu } CHAIRMAN

Muhammed Imam Yahaya } MANAGING DIRECTOR & CHIEF EXECUTIVE

Olusegun Olusanya

UNION BANK
UNION BANK OF NIGERIA PLC

REPORT OF THE JOINT AUDITORS

473908

We have audited the above financial statements which have been prepared on the basis of the accounting policies

Respective Responsibilities of Directors and Auditors

The company's directors are responsible for the preparation of the financial statements. It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

Basis of Opinion

We conducted our audit in accordance with generally accepted auditing standards. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary to provide us with sufficient evidence to give a reasonable assurance that the financial statements are free from material mis-statement, whether caused by fraud, other irregularity, or error. In forming our opinion, we also evaluated the overall adequacy of the presentation of information in the financial statements. The financial statements are in agreement with the books of accounts which have been properly kept and we obtained the information and explanations we required and have received proper returns from branches not visited by us.

During the year, the bank contravened some sections of the Banks and Other Financial Institutions Decree, 1991. The contraventions have been reported to the Central Bank of Nigeria and the appropriate penalties paid.

Opinion

In our opinion, the financial statements give a true and fair view of the state of affairs of the bank and the group as at 30 September, 1998, the group profit and cash flow for the year ended on that date, and have been properly prepared in accordance with the provisions of the Banks and Other Financial Institutions Decree, 1991; all relevant circulars issued by the Central Bank of Nigeria; all relevant Statements of Accounting Standards and the Companies and Allied Matters Decree, 1990.

KPMG AUDIT CHARTERED ACCOUNTANTS

GYELAMI SOETAN ADELEKE & CO. CHARTERED ACCOUNTANTS

LAGOS, NIGERIA

December 2, 1998

DIRECTORS

KALU U. KALU (Chairman)

MUHAMMED IMAM YAHAYA (Managing Director & Chief Executive)

MOBOLANLE ADEMOLA AJOMALE

MARTIN PATRICK UWOMAHO OBARO

FLORENCE OLUFUNKE OYESAN (MRS)

SABO IBRAHIM SODANGI

YUSUF GARBA ALI

GODWIN AHABUE THOMSON OBOH

GARBA ATUULKADIR YAKASSAI

EMMANUEL NWUDE ODIHIGWE

GBOLAHAN OLUKAYODE FOLAYAN

GIBSON SAMDA AALO

OLUSEGUN OLUSANYA

BABS[illegible] OGO MONORU

UNION BANK

UNION BANK OF NIGERIA PLC

Annual Report & Accounts

BALANCE SHEET
30 SEPTEMBER 1997

	The Group		The Company	
	1997	1996	1997	1996
	N'm	N'm	N'm	N'm
nd short term funds	5,963	10,363	5,935	10,348
's with other banks and financial ons	42,166	35,147	40,302	35,124
counted	6,388	9,736	4,190	7,590
ients	217	194	403	116
nd advances	23,364	16,704	22,530	16,628
ssets	4,174	4,084	3,885	4,090
ent on lease	251	200	251	200
ssets	8,019	3,627	5,828	3,579
ill on consolidation	129	-	-	-
ASSETS	88,671	80,055	83,324	77,675
ed by:				
TIES				
's, current and other accounts	63,854	56,914	59,310	55,141	
	370	261	313	226
d	523	447	523	447
abilities	17,786	18,259	17,054	17,782
	82,333	75,881	77,200	73,596
APITA	L AND RESERVES			
alled	ss capital			
Ordinar	y shares of 50k each			
Author	sed - N500,000,000)	397	397	397	397
Bonus	issue reserve	132	-	132	-
Statutor	y reserve	1,487	672	1,459	659
General	reserve	1,273	1,380	1,167	1,327
		3,289	2,449	3,156	2,383
ixed at	sets revaluation surplus	1,493	228	1,493	228
Exchan	ge difference reserve	1,476	1,468	1,476	1,468
CAPITA	L FUNDS	6,258	4,145	6,124	4,079
INORI	TY INTEREST	80	29	-	-
		6,338	4,174	6,124	4,079
		88,671	80,055	83,324	77,675
ontingent liabilities and other obligations on behalf of customers and customers' liabilities thereon		12,298	8,033	11,993	8,033

GROUP PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 30 SEPTEMBER, 1997

	The Group		The Company	
	1997	1996	1997	1996
	N'm	N'm	N'm	N'm
et profit before taxation	1,615	1,257	1,511	1,134
ixation	(318)	(115)	(302)	(88)
OFIT AFTER TAXATION	1,297	1,142	1,209	1,046
nority interest	(20)	(21)	-	-
OFIT AFTER TAXATION AND NORITY INTEREST	1,277	1,121	1,209	1,046
PROPRIATIONS				
nsfer to statutory reserve	315	327	300	314
idend	497	397	437	397
ained profit transferred to general erve	765	397	772	335
	1,277	1,121	1,209	1,046

KALU) Chairman

YAHAYA) Managing Director

REPORT OF THE JOINT AUDITORS TO THE MEMBERS OF UNION BANK OF NIGERIA PLC

We have audited the above balance sheet as at 30 September, 1997 and profit and loss account for the year ended on that date.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The company's directors are responsible for the preparation of the financial statements. It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

BASIS OF OPINION

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KPMG Audit
CHARTERED ACCOUNTANTS

Z.O. OSOSANYA
CHARTERED ACCOUNTANTS

LAGOS, NIGERIA.
DECEMBER 11, 1997.