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MACRO PRUDENTIAL POLICY: A COMPARISON BETWEEN THE US AND UK, AND THE LESSON FOR NIGERIA

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ABSTRACT
Over the years the focal point of prudential policies has been on micro-issues. But the consequences financial crises made advances economies proactive on addressing inadequacies of existing prudential guidelines. In doing that, prudential guidelines are expanded to include macro-issues (Basel III), which focus on the macro-prudential regulation, ensure the resilience and stability of the financial system and lessen the overreliance on taxpayer money to salvage the banks during these periods. BASEL III requirements however, range from increased in capital adequacy and common equity ratios, deposit insurance, introduction of TLAC, Bail-in/living will, Buffers and countercyclical buffers among others. This paper made the comparison of UK and US prudential guideline with the view of drawing lessons for Nigeria.
Keywords: *Financial crisis, Macro prudential policy, financial stability, capital buffers*

INTRODUCTION

Policymakers around the world documented that focusing separately on price stability and on micro prudential regulation of individual firms and markets were not sufficient. The global financial crisis has underscored the importance of financial stability as a prerequisite for monetary stability and broader economic condition. The policy debate focuses on macro-prudential tools, their usage, and their relationship with respect to risk management (Iana, Barrell and Davis, 2010). A broader approach such as macro prudential policy was therefore, needed to ensure the resilience and stability of the financial system and lessen the overreliance on taxpayer's money. This paper made a comparison of the implementation of the regulatory guidelines (Basel III) in the UK and U.S and the lesson relevant to Nigeria.

The US and UK Comparison

Basel III framework (2013) shows that in July 2013, the Board of Governors of the Federal Reserve System (the "Fed") and other bank regulatory agencies ratified final rules ("Final US Rules") that organised the US Federal regulatory agencies' regulatory capital rules into a single, comprehensive regulatory framework. The Final US Rules implement the Basel III capital framework as well as relevant provisions of the Dodd Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). Other changes include: the Final US Rules assign a 50 or 100 per cent risk weight to exposures secured by one-to-four family residential properties.In the UK however, the Bank of England (BoE) would have to go by the EU requirement in some cases, which has implemented Basel III. Through two legislative acts, the Capital Requirements Regulation ("CRR") and Capital Requirements Directive ("CRD")

However, according to Tucker et al(2013), the BoE had Financial Policy Committee (FPC) which is tasked with assisting the Bank meet that objective and as such, also

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supporting the Government's economic policy, including its objectives for growth and employment. The FPC has a statutory responsibility to identify, monitor, and take action to eliminate or reduce risks that intimidate the resilience of the UK financial system as a whole. This is also maintained by the objectives of the micro prudential regulators. The FPC is also with two other sections namely; the Prudential Regulatory Authority (PRA) and financial Conduct Authority (FCA) plus Monetary Policy Committee (MPC). According to Cunliffe (2015), the Committee developed the use of stress testing to assess macro-prudential as well as micro-prudential risk. The FPC, together with the PRA ran the first ever stress test of the UK banking sector as a whole in 2014. The aim was to test not just the resilience of individual banks but what happened to the system if all of the major banks faced a severe but plausible stress scenario at the same time?

LEGAL REQUIREMENTS

Capital Requirements:

The capital requirements adopted in the Basel III final rule include most but not all of the BCBS recommendations. Overall T1 minimum requirement increased from 4% to 6% under for the US. In the UK also, the Tier 1 capital requirement was increased to 6% of RWA (from 4% under Basel II). While section 10 Final US Rules adopted a minimum requirement of 4.5% for common equity, the UK adopts core capital (chiefly equity) 4.5% RWA. In addition, the Bank of England (2009) maintained that the PRA and FCA consider an appropriate Tier 1 equity requirement for the system, in aggregate, to be 11% of risk-weighted assets. The FPC contemplates the suitable level of common equity Tier 1 (CET1) to be 9.5% of risk-weighted assets. These buffers function as macro-prudential. By absorbing the influence of stress, they lessen the need for banks to pull out services such as credit facility, to the real economy. Intended requirements will, after being fully implemented by 2019, is likely to move the equity requirement of the UK banking system as a whole to about 11% of risk-weighted assets including 6% minimum, a 2.5% capital conservation buffer that establishes a baseline ability to absorb stress across the system..

Capital Conservation Buffer Size:

In the US, it must be in an amount of CET1 greater than 2.5% of total RWAs to avoid pay out restrictions following phase in: 2016 (0.625%), 2017 (1.25%), 2018 (1.875%), and 2019 (2.5%) while in the UK, 2.5% capital conservation buffer that serve as standard ability to absorb stress throughout the system is adopted.

Capital Surcharge for Largest Banks:

Globally Systemically Important Banks [G-SIBs] of between 0% and 2.5% for UK banks depending on their systemic impact while 0% -4.5% is proposed for the G-SIBs in the US.

Countercyclical Buffer:

US buffer applied only to Advanced Approaches Banks.. Also, a buffer of greater than 2.5% may be imposed in certain scenarios.

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Liquidity Leverage Ratio (LCR):
Also introduced to contain the build-up of leverage in the banking sector and restrict the level of obligation. It will in time be a 100% requirement, starting at 60% in 2015 reaching 100% on 1 January 2019.

Liquidity Requirement:
In the US, the implementation of Basel III liquidity requirements has not been addressed up to date; a proposal under Section 165 of the Dodd-Frank Act would require banking institutions with total consolidated assets equal to or greater than $50 billion to maintain liquidity buffers of highly liquid assets, a concept that is generally consistent with the goals of the Basel III liquidity ratios. In the UK however, they follow EU approach which follows Basel III on both LCR and NSFR liquidity standards but without prescribing the minimum required liquidity ratios (Art 411 CRR).Since liquidity shortfalls at the level of one individual bank can have serious systemic repercussions, supervisors are concern with its position than capital if you like (Lannoo and Casey, 2005).

Cyber Risk:
Claudio and Drehmann (2009) argue that cyber-attack is a severe and growing threat to the resilience of the world financial system including UK. Cyber-attack is likely to threaten the vital services that the financial system provides to the real economy. The risk from cyber-attack has grown over time, indicating increased use of technology in financial services. The UK and international authorities have currently taken measure against cyber risk including a joint UK/US cyber exercise in November 2015. The FPC will receive a report on a work programme implemented by UK authorities by summer 2016.

RISK MANAGEMENT BY BANKS AND THE IMPLICATION ON STAKEHOLDERS INCLUDING THE TAXPAYERS

Unarguably, banking crises have caused disaster in both developed and under-developed economies alike, producing direct loss of wealth/capital to bankers, depositors, and taxpayers resulting to harmful indirect effects on economic growth through unexpected credit crunches. In response to these crises, governments have allowed these insolvent banks to continue operations, transferring the burden of bank insolvency to taxpayers. The substantial costs shouldered by taxpayers and the obvious moral hazard incentives that accompany bank bailouts make it necessary for Basel Committee on Banking Supervision (BCBS) and other regulatory body, to come up with measures to curtail or mitigate the risk of such events (Guillermo, 2006). Measures such as minimum capital requirement, liquidity position, and buffers among others already discussed above.

BAIL-IN, ITS IMPLICATION ON STAKEHOLDERS:

The bail-in tool is a key component of the set of resolution powers that national authorities should have in place to deal with failing financial institutions. The bailing-in of creditors when a financial institution is to be found in a resolution provides an alternative to a bail-out (using taxpayer funds) and to liquidation under ordinary insolvency events. The conversion into equity of creditors' claims provides a means of meeting losses and of recapitalising a failing financial institution hence, the stakeholders as well as taxpayers are protected (E.g. **COCOS**).

DEPOSIT INSURANCE, THE IMPLICATION ON STAKEHOLDERS:

The FDIC guaranteed the customers about the safety of their deposits by promising to pay back their deposits in an event of bank failure. Hence, customers no longer frighten by information patterning banks whether good or bad. The US deposit insurance protection increases from $100,000 to $250,000. While in the UK, Bank customers' deposits are guaranteed up to £75,000 ($108,315) [per bank] as of 2016. The introduction of deposit insurance is aimed to protect against bank run resulting from massive withdrawal by the customer for fear of losing their hard earned money as in the case of "Northern Rock". Though, moral hazard problem is perceived with the introduction of this scheme, the advantage is enormous.

OVERVIEW OF BANKING SUPERVISION AND MACRO-PRUDENTIAL POLICY IN NIGERIA

The Nigerian banking sector had undergone series of reforms in the past one decade with the aim of making the system more stable, safe, effective and resilient to shocks Emmanuel (2012). The CBN introduced the universal banking scheme in 2001 to create a level-playing field for financial sector operators, encourage greater efficiency through economies of scale and foster competition by opening up various lines of business, which included retail banking, wholesale banking, capital market activities and insurance agency to banks. Before then, in 1991, the government promulgated the Banks and Other Financial Institutions Decree (No. 24) and the Central Bank of Nigeria Decree (No.25), which spelt out comprehensive guidelines for bank regulation, supervision and liquidation. The supervisory role of the CBN, aimed at promoting sound banking and financial system, was also statutorily expanded to cover non-bank financial institutions. Consequently, the activities of all the regulatory and supervisory authorities in the Nigerian financial services sector were brought under the coordination of the Financial Sector Regulation and Coordinating Committee (FSRCC), under the chairmanship of the CBN (Born, etal, 2011). The monetary authorities also adopted the Code of Good Practices in Monetary and Financial Policies, the International Accounting and Auditing

Standards and initiated a private sector funded "life-boat" facility accessible to all deposit money banks in temporary liquidity problem. Again, in line with international best practice, the CBN adopted the Core Principles of the Basel Committee on Banking Supervision, including the prudential guidelines for licensed banks to promote banking soundness and financial sector stability. As alluded to earlier, the experience from the recent global financial crisis has made it necessary for countries to find means of strengthening their financial, regulatory and supervisory framework. In this regard, the CBN has taken a variety of new measures to improve the efficiency and resilience of the nation's financial system. Prior to the crisis, most policies that were in place focused mainly on price stability and were micro-prudential in nature, focusing on individual institutions. The Bank has, however, taken steps to ensure the stability of the banking sector in particular and the financial system as a whole, in its pursuit of price stability, which is the primary thrust of monetary policy.

According to IMF (2012), supervision of the banking system has become very robust to ensure that banks maintain sufficient capital and loan loss provisions as well as avoid poor lending decisions that could lead to high levels of non-performing loans. In addition, the Bank adopted the Risk-Based and Consolidated Supervision framework to address observed shortcomings and limitations of the traditional compliance–based supervisory approach. The new supervisory framework is expected to adequately address the contemporary challenges and risks faced by banks. The appropriateness of this approach is underscored more by the realisation that the collapse of most big institutions during the global financial crisis was due to the failure of the supervisory authorities to properly anticipate, identify, evaluate and hedge against risk exposures, among others. The Bank also established a Financial Stability Committee (FSC) to Design and Implementation of Macro-prudential Policy in Nigeria assist it in the promotion of a sound financial system in the country. The Committee plays a pivotal role in the Bank's effort at ensuring stability in the financial system. As alluded to above, there is also the Financial Services Regulation Coordinating Committee (FSRCC) which is an umbrella body of all regulators in the financial system with one of the mandate of co-ordinating the activities in the system for the purpose of achieving its stability. The two bodies work together very closely in the pursuit of the objective of ensuring the resilience of the financial system without halting the continuous functioning of the entire financial system. Furthermore, there exists another level of interaction between the Financial Stability Committee and the Monetary Policy Committee to ensure that monetary policy is influenced by trends in systemic risks. Part of the outcome of the interaction was the identification of Systemically Important Banks (SIBs) on which the authorities focus more for intensified supervisory oversight. Beyond these semi-institutional arrangements, the CBN, like

Other central banks, took other major steps towards addressing the threat of systemic risk through the adoption and implementation of macro prudential policy. To achieve this, the CBN created the Financial Policy and Regulation Department (FPRD) with a key responsibility for macro-prudential implementation and regulation. The philosophy behind this new policy framework involves strong scenario planning, and the development and implementation of macro-prudential ratios. The Bank, in addition to focusing on individual banks' micro ratios, now computes macro-ratios of the industry in order to arrest any emerging systemic risk in the industry. The Bank also conducts stress test on the banks twice every year, to ascertain/determine the vulnerabilities that could lead to systemic risk and disruption of financial markets. The various reforms measures by the CBN have not only strengthened the financial markets infrastructure, but has also provided the necessary environment conducive for the growth of the industry in 22 Design and Implementation of Macro-prudential Policy in Nigeria particular and macroeconomic stability of the economy at large. Macro-prudential regulation is an economy-wide concept and does not fall exclusively within the jurisdiction of the CBN alone as a monetary authority. For the policy to be effective, the need for the structure to encompass all other regulatory authorities in the financial sector to ensure its robustness and success has been provided by the Financial Services Regulation Coordinating Committee (FSRCC). Some analysts believe that the achievement of macroeconomic stability in recent times (relative stability of exchange rate, interest rate and inflation) was not unconnected with the monetary policies of the Central Bank of Nigeria and enhanced by the collaboration provided by the platform of the FSRCC through which the Bank and other regulators in the financial services industry interact. The Bank must continue to assume major role in the achievement of its policy mandate. In addition, critical issues of building requisite analytical skills for identifying and measuring systemic risk and building a sound institutional framework must be addressed. The focus must be to build a policy framework that optimises the strengths and limits the weaknesses of whatever model/structure model is adopted with aim of making the best of available options. Whereas prudential tool based model is confined primarily to the regulated financial system, macro-prudential authority have a wider range of instruments which potentially expand the scope to address systemic risks beyond the regulated financial system. Adopting and co-opting these tools would therefore come at the price of a greater need to change the operational frameworks of other policy areas. Overall, as is found in more developed jurisdictions, the macro-prudential policy mandate is best shared among several public agencies including the central bank (IMF Policy Paper IMF, 2013). From the above foregoing, it could be deduce that Nigeria and central Bank in particular have not provided any reasonable measures to meet up the target of the Basel committee

On banking supervision (BCBS) deem for full implementation by 2020. It is still assumed that stress test mentioned by the CBN above were done on old liquidity standard instead of the new proposed capital adequacy and other buffers. It is pertinent to note that even the developed countries with high level of financial stability as compare to the developing ones, still could not relent in implementing any new policy of the regulatory authority aimed at strengthening the liquidity position of the financial institutions. This can be seen from the measures already taken by the U.S and the U.K as compares above. The need to go beyond the micro prudential is not limited to certain countries and excluding others since the world have already been integrated through financial dealings. The systemic impact of any financial crisis hit much on developing economy with high level of involvement in derivatives and Nigeria cannot be exempted on this. To mitigate any possible effect of any such crisis, Nigeria and in particular the CBN saddled with the responsibility of maintaining financial stability must wake up to the call for improve capital buffers, countercyclical buffers etc. proposed by the BASEL.

CONCLUSION

Basel III is an initiative for internationally harmonized regulatory change that is designed to offer a response to some of the inadequacies of the regulatory framework as it was before the recent financial crisis of 2007/2008. The new regulations cover a variety of areas including most importantly the liquidity management by the banks. The frequency of financial crisis at both domestic and global perspectives has gained a colossal attention from the government, public/private companies, and regulatory authority; mainly due to the substantial amount of it negative impacts, leading to panic and economic meltdown. The recent financial crisis of 2007/2008 was an indication that the effort put in place by the

Basel Committee on Banking Supervision (BCBS) through the introduction of Basel I and II which focuses largely on micro prudential regulation and other regulatory bodies are not enough to address this menace. This however, necessitates the BCBS to go beyond the Basel II, thereby bringing in Basel III which focuses on the macro-prudential regulation, ensure the resilience and stability of the financial system and lessen the overreliance on taxpayer money to salvage the banks during these periods (Iana, Barrell and Davis, 2010). These requirements however, range from increased in capital adequacy and common equity ratios, deposit insurance, introduction of TLAC, Bail-in/living will, Buffers and countercyclical buffers among others. Being a global respond, guidelines are provided for the implementation of this policy, which saw US/UK having their own evaluated on this piece of work. Though some of the requirements have already been implemented and adhered to, Gabriele and Moessner (2013) observed that some of these requirements remain a proposal until they are fully implemented. Nigeria as a country though is been discussing how this new policy will be implemented, not much is being done on this area. It is hope that not being exempted from the effect of any financial Crisis; the apex bank (CBN) will be proactive in taking measures for the implementation of the new macro-prudential regulations.

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