Principles-Based or Rules-Based System? A Case for Reform of the Regulatory Approach to Corporate Governance in the Nigerian Banking Sector.

by

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A Thesis submitted to the Faculty of Graduate Studies of The University of Manitoba in partial fulfillment of the requirements of the degree of

MASTER OF LAWS (LL.M)

Robson Hall

University of Manitoba

Winnipeg

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ABSTRACT

The corporate world over the past few decades has been plagued with instances of corporate mismanagement which resulted in the collapse of several companies. In Nigeria several banks have collapsed, with the most recent being in 2018, and these failures have been largely credited to weak corporate governance practices. Banks are key in the development of emerging economies; therefore, good corporate governance of banks has far-reaching implications. To regulate corporate governance in Nigeria’s banking industry, the principles-based approach is utilized. However, a critical examination would reveal that it has proven inadequate in achieving the regulatory objectives in light of current challenges faced. This study proposes a restructure of the current system of regulating governance in the Nigerian banking industry. To achieve this, I engaged in a comparative analysis of the traditional principles-based and rules-based approach to governance regulation, using Canada and the United States as case study. Taking into consideration lessons from this cross-jurisdictional analysis, as well as the peculiarity of the Nigerian banking environment, the study explores new perspectives for regulating corporate governance within Nigerian banks and proposes the adoption of a unique approach.
ACKNOWLEDGMENTS

I would like to say special thanks to my supervisor, Professor Bryan P. Schwartz for his unwavering support throughout my graduate program. I would also like to thank my family, most especially the women in my life – my wife and my mum, for their loving support. I am grateful to my friends and everyone who has contributed in making this research a success.
DEDICATION

This thesis is dedicated to the Almighty God.
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CHAPTER 1

A. INTRODUCTION

The concept of corporate governance flows from the basic principle on which corporate law is founded – a distinct legal entity. This concept, founded in case law, was laid down in the 1987 landmark case of Salomon v. Salomon and Co. Ltd. Following this, corporate governance has since gained more significance as publicly owned companies became the dominant legal form for business enterprises. This law was created to prevent personal liability when a group of people come together as a single entity to pursue an economic goal. It also occurs as mechanisms devised to safeguard the interests of the owners, as well as to control management behaviour because of limitations to the contracting process, which may create an avenue for managers to take advantage of shareholders. In its simple form, “Corporate Governance” refers to the mechanisms surrounding how a company is governed. The 1992 Cadbury Committee defines it as "the system by which companies are directed and controlled." It is the “a process and structure for managing the business of a corporation” which encompasses governing laws, practices and entire regulatory environment. Corporate governance can be said to have existed since the inception of the concept of a corporate entity but has evolved with time.

A review of key factors in the evolution of corporate governance illustrates the crucial role played by the United Kingdom (UK) in the development of modern corporate governance beginning with

1 Salomon v A Salomon & Co Ltd, 1897 UKHL 1
5 Peter Dey, "Where Were the Directors?", the TSE Committee Guidelines on Corporate Governance, ed (Ottawa: Department of Finance and Treasury Board of Canada, 1994).
the Cadbury Committee Report. Nigeria developed its corporate governance laws modeling the principles-based UK code of corporate governance. The 2003 Securities and Exchange Commission Code of Corporate Governance for Public Companies (SEC Code) was the first code of corporate governance published in Nigeria. This was followed by the 2006 Central Bank of Nigeria (CBN) Code of Corporate Governance for Banks and Discount Houses which was designed to regulate corporate governance practices and was mandatory for all banks. Afterward, corporate governance in Nigeria gained so much traction to the extent that it led to a proliferation of codes within the country.

The importance of corporate governance cannot be overstated. According to the OECD, "the purpose of corporate governance is to help build an environment of trust, transparency, and accountability necessary for fostering long-term investment, financial stability, and business integrity, thereby supporting stronger growth and more inclusive societies." It helps to prevent mismanagement of the organization which may damage its reputation or create some form of liability. I chose to focus on the banking sector because the industry is widely perceived as the engine for economic development especially among developing counties like Nigeria, therefore, good corporate governance of banks has far-reaching implications.

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B. AIM OF THE THESIS

The corporate world over the past two decades has been plagued with instances of corporate mismanagement which resulted in the collapse of several companies, with Nigeria being no exception.\(^\text{10}\) Miguel and Gaizka summarize it as follows; “The 2007–2008 financial crisis is considered the most serious and disruptive economic downturn since 1929. The debate about the causes of the break down often starts with the perception that financial institutions suffered from severe corporate governance problems. In particular, the managers of these institutions are believed to have taken excessive risks to enrich themselves, in the process destroying the long-term value of their companies and generating systemic risk.”\(^\text{11}\) In 2009, the Central Bank of Nigeria (CBN) dismissed the entire board of directors of eight banks and had their management replaced for various reasons including mismanagement and poor corporate governance practices.\(^\text{12}\) Despite the existence of corporate governance regulations, a common denominator in the banking crisis was poor corporate governance practices. The banking sector was branded by several fragilities and failures which have principally been ascribed to poor corporate governance practices.\(^\text{13}\) This raised a series of questions which form the crux of this thesis - Whether the current

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\(^\text{10}\) Between 1994 and 1995, five banks collapsed, and their licenses were revoked by the Central Bank of Nigeria and between 1998 and 2002 a further thirty licensed banks were also closed down. See RO Akingunola, Adekunle Olusegun & Adedipe Oluseyi, "Corporate Governance and Bank’s Performance in Nigeria (Post – Bank’s Consolidation)" (2013) 2:8 European Journal of Business and Social Sciences, online: <http://www.ejbss.com/recent.aspx>.


regulatory system is effective in guaranteeing good corporate governance practices are in place in Nigeria’s banking sector? If not, which alternatives may be considered?

The broad objectives of this research include to carry out:

- An evaluation of the present framework for corporate governance regulation in the banking sector in view of creating a compelling case for reform.
- An analysis of rules-based and principles-based approach with the aim of identifying the more ideal system of regulating corporate governance regulation in Nigeria’s banking sector.
- A cross-jurisdictional analysis of the application of the principles-based and rules-based approach using two case studies and;
- An exploration of whether a principles-based or rules-based system would be more effective to realize this objective, or rather, if a unique response, based on the harmonization of both principles and rules would be better suited.

Using a comparative and evaluative methodology, this thesis shall assess the adequacy or otherwise of the current principles-based system of corporate governance. Additionally, it shall consider whether a different system such as a rules-based system or a certain harmonization proposal would succeed after taking into account important divergences in the Nigerian banking system. To achieve this, I shall review the legal history, evolution and challenges of corporate governance in the Nigerian banking sector in order to put into perspective the current state of corporate governance practice in Nigeria. With the use of Canada and the United States of America studies, I shall then carry out a cross-jurisdictional analysis to see if there are lessons from Canada (which utilizes a principles-based system of corporate governance) and the United States of
America (which utilizes a rules-based system of corporate governance) that can learnt and applied to improve corporate governance within Nigerian banks. In the course of analyzing the most suitable system of regulation, I shall take into consideration social and political factors, the inherent systemic flaws in Nigeria and the effect they would have on the regulatory system of corporate governance within the Nigerian banking sector. This aims to create a compelling case for the redevelopment of a corporate governance model tailored to the Nigerian banking sector’s legal and socio-economic peculiarities.

C. WHY BANKS? THE DISTINCTIVE GOVERNANCE FEATURES

Banks as financial institutions are regarded as special types of corporations and this has generally led them to be subject to higher levels of supervision. A number of these attributes have been well enumerated in literature related to bank governance. The Office of the Superintendent of Financial Institutions (OSFI) lists these factors as follows in Annex A.

• The soundness of the financial industry has a direct effect on the economy. Its failure compared with other non-financial institutions, has higher implications on the public which may either be the average individual who has savings, non-financial corporations who require the financial services to thrive as well as potential investors in the country’s economy;

• The disparity in terms of their assets and liabilities makes them more exposed to unexpected adverse events because of their high debit-to-equity ratio;

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14 Miguel and Gaizka, supra note 3; see also, Caprio and Levin, supra note 9
• Financial institutions require the confidence of the public to create the long-term commitments necessary to ensure their stability. On the contrary, if the public loses its confidence in them, severe liquidity concerns may arise;

• Bank managers have more scope to deal in complex financial instruments and investment risks which may make it trickier to evaluate decision-making in comparison with other companies;

• Banks have complex organizational structures with a large number of entities, used to deliver financial products and services, which may not be as equally regulated.

The list is not exhaustive. Due to these distinctive factors, corporate governance for banks are justifiably closely-monitored. The unique challenges require specially designed regulation for effective governance; therefore, a clear understanding is required to make any proposals for reform.

D. A SYNOPSIS OF CORPORATE GOVERNANCE LITERATURE IN NIGERIA

Corporate Governance in Nigeria gained prominence after the debacle in America and Europe that saw the collapse of huge corporations. If this was not enough to draw attention in Nigeria to the topic, the collapse of several Nigerian banks between 1994 and 2008 did the trick. Prior to this, not as much attention was paid to corporate governance in Nigeria as a whole. Therefore, it was no surprise to learn that poor corporate governance practice was attributed to most, if not all of the banks that collapsed. A lot of studies on corporate governance in Nigeria\textsuperscript{16} have been carried out,

albeit, largely from a socio-economic point of view.\(^\text{17}\) Only a handful of corporate governance research in Nigerian banks have been done from a legal or regulatory perspective. Yakasai\(^\text{18}\) examines the history and development of corporate governance in Nigeria in Nigerian banks while Simisola explores the impact of weak regulations on the banking sector and the role of legal, cultural and social factors in corporate governance regulation.\(^\text{19}\) Olayiwola addresses compliance and disclosure in banks and argues that while codes are being enacted there is greater need to ensure that the socio-political, economic and cultural environment support the proposed corporate governance reforms.\(^\text{20}\)

The approach to regulation is important to corporate governance. It is even more necessary to create a regulatory approach which reflects a country’s idiosyncrasies. Bruno and Claessens conduct an examination of the relationship between corporate governance practices and the regulatory system by using companies in different countries as case studies.\(^\text{21}\) According to Adegbite, the discourse on the regulatory approach to corporate governance is centered on two opposing propositions.\(^\text{22}\) One side of the argument favours the utilization of principles such as codes and best practices which gives companies some degree of flexibility in complying with the

\(^{17}\) See, Amos N Dombin, "Role of Corporate Governance in Attracting Foreign Investments in Nigeria" (2013) 19 Journal of Educational and Social Research 148.

\(^{18}\) Alhaji G A Yakasai, "Corporate Governance in a Third World Country with Particular Reference to Nigeria" (2001) 9:3 Corporate Governance 238 at 241.


regulations while at the other side of the spectrum is the opinion that presupposes the application of more stringent rules and punishments dictated through usage of statutes.  

In light of the above, my research aims to fill the current literature gap in the legal and regulatory system of corporate governance in Nigeria with particular emphasis on the banking sector. The study shall go further to explore the development of a unique approach. This shall be done using learning points gathered from a comparative analysis of governance regulation among Canadian and U.S. banks, and then tailoring it into the Nigerian context, in order to serve the needs of the society to create more sustainable development.

E. CONCLUSION

In response to the rampant corporate malpractices different authorities around the world evaluated the need for better regulatory frameworks and followed up by establishing new governance requirements as well. By carrying out this research, I am hoping to make two substantial inputs within corporate governance in Nigeria. First and foremost, the research seeks to make a significant contribution to improve the regulatory system of corporate governance in Nigeria’s banking industry by exploring the conditions in which a regulatory approach can succeed thus preventing it from becoming a “box-ticking” exercise, but rather, a catalyst for financial stability and economic development. Secondly, the thesis adds to existing literature on corporate governance within Nigerian banks from a legal and regulatory perspective.
CHAPTER 2

CORPORATE GOVERNANCE IN THE NIGERIAN BANKING SECTOR

A. INTRODUCTION

Corporate governance has taken on renewed significance globally since the corporate scandals in 2002. This term is not a novel concept in Nigeria, most especially within its financial sector which took upon itself the initiative to develop policies which would enable it to carry out good governance practices more effectively.¹ This paper focuses on corporate governance regulation in Nigeria’s banking sector. To carry out this study and to gain contextual understanding, it is pertinent to begin my analysis from the basics - the evolution and development of the concept in the Nigerian banking sector.

B. A HISTORICAL OVERVIEW OF CORPORATE GOVERNANCE IN NIGERIA.

The term “corporate governance” did not become popular until the 1980s as a distinct concept,² and its development in Nigeria is inseparable from the growth of company law. This development has generally been referred to as “Anglo-Saxon” and a “reflection of its colonial heritage”.³ Nigeria was a British protectorate from 1901 lasting until 1960 when independence was gained. A direct consequence of being a British protectorate was the receipt of English laws into the country. The

¹ Separate codes of corporate governance have been established in the financial industry by the banking, insurance, and pension sectors to regulate their affairs.
Companies Ordinance of 1912\(^4\) was the first enacted legislation which regulated corporations. Following it were the Companies Ordinance of 1922\(^5\) and the Companies Act of 1968\(^6\) which mirrored existing legislation in England,\(^7\) and made provisions for certain principles which currently form the basis of modern corporate governance.\(^8\)

In spite of this, defects in the ordinances meant they were severely criticized and eventually repealed\(^9\). In 1987, a commission\(^10\) was established to undertake a company law reform process which resulted in the Companies and Allied Matters Decree No. 1 of 1990 (CAMD).\(^11\) The promulgation of the CAMD repealed the Companies Act of 1968. In its attempts to create an effective means of regulating companies in Nigeria, the CAMD contained some provisions which encouraged good governance, similar to modern principles contained in present corporate governance regulation.\(^12\) It also created a Corporate Affairs Commission to administer the act\(^13\).

Up until 2003, company law was the primary legal framework for regulating governance among companies in Nigeria. In 2003, the Securities and Exchange Commission (SEC) published a Code of Best Practices on Corporate Governance\(^14\). This SEC code was the first attempt by a regulatory

\(^4\) *Companies Ordinance (Repealed)*, 1912.

\(^5\) *Companies Ordinance (Repealed)*, 1922.

\(^6\) *Companies Act (Repealed)*, 1968.

\(^7\) The Companies Ordinance of 1922 mirrored the United Kingdom's Companies Act of 1929 while the Company Act of 1968 was mainly based on the United Kingdom's Companies Act of 1948.

\(^8\) Such as enhanced accountability of executives.

\(^9\) Among other reasons, it was repealed for not being adequately tailored to the Nigerian environment and favoring the British companies over the local companies. See George Nwangwu, "The Influence of Companies on the Legal, Political and Economic History of Nigeria" (2018) 9:12 Journal of Economics and Sustainable Development 120.

\(^10\) Nigerian Law Reform Commission headed by Hon Justice Dr. Olakunle Orojo (Rtd.)

\(^11\) The decree was replaced by the *Companies and Allied Matters Act*, 1990 (as amended), Laws of the Federation 2004. [CAMA].

\(^12\) Such as provisions defining disclosures of equity ownership beyond a certain percentage, accounting standards, auditing standards, etc. See, *Ibid* at ss 6, 94, 95 275, 277, 339.

\(^13\) *Ibid* at Section 1.

body to specifically address the complexities of regulating corporate governance in public companies.\textsuperscript{15} The formulation of a purposeful means of regulating corporate governance had become necessary following the series of scandals which had been attributed to poor governance practices. The code was developed as a means to encourage good governance practices.\textsuperscript{16} Compliance with the code was to be determined by the board of directors alongside the shareholders and then the SEC, in that order.\textsuperscript{17} The SEC code became the catalyst for the development of corporate governance codes in Nigeria. After its establishment various industries, especially in the financial industry, developed their own codes to regulate corporate governance.\textsuperscript{18} These exclusive codes contained additional guidelines on issues peculiar to those industries which the SEC guidelines did not provide for or was unable to due to the distinctiveness of the different industries.

C. DEVELOPMENT OF CORPORATE GOVERNANCE IN THE NIGERIAN BANKING SECTOR

The 1990s was a significant period in the development of corporate governance within Nigerian banks. During this time, financial scandals blamed mostly on poor corporate governance practices plagued the banking sector.\textsuperscript{19} Consequently, many banks and financial houses failed and were liquidated, leading to the loss of investors’ capital, customers’ funds amongst others.\textsuperscript{20} There was a clear need to implement structures to regulate how the banks were governed.

\textsuperscript{15} The most recent amendment of the code was carried out in 2011. See the preamble to the Securities and Exchange Commission, \textit{Code of Corporate Governance for Public Companies in Nigeria} (2011) [SEC code]
\textsuperscript{16} Ibid at section 1.3 (a).
\textsuperscript{17} Ibid at section 1.3 (c).
\textsuperscript{18} This includes the Banking, Insurance and Pension sectors. The downside to this development is that it has led to a proliferation of corporate governance codes in Nigeria.
\textsuperscript{20} Ibid.
Prompted by this lacuna in regulation, the Bankers Committee, a voluntary and self-regulatory organization, in August 2003 came up with corporate governance guidelines for banks and other financial institutions within the country. This corporate governance code issued was the first of its kind in Nigeria. However, they were simply “guides” and without any regulatory or statutory authority, it did not achieve the desired level of good governance practices it sought to instill.

The SEC code of corporate governance which was implemented shortly after created a better general structure for regulating corporate governance practices among public companies. The code applied to all public companies and by implication, served as the first formal means of regulating corporate governance among most banks within the Nigerian banking industry. Despite the establishment of the SEC code, there was a popular consensus that governance mechanisms which applied to the banking industry were either weak or non-existent.

Due to the uniqueness of the financial industry, there remained the need to enhance corporate governance practices, specifically within the banking industry with regulations tailored to the peculiarities of the financial sector. More work needed to be done to improve governance practices.

According to the Central Bank of Nigeria (CBN):

In Nigeria, a survey, by the Securities and Exchange Commission (SEC) reported in a publication in April 2003, showed that corporate governance was at a rudimentary stage, as only about 40% of quoted companies, including banks, had recognized codes of corporate governance in place. Specifically, for the financial sector, poor corporate governance was identified as one of the major factors in virtually all known instances of a financial institution’s distress in the country.

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22 By extension of its application to all public companies, meaning it applied to banks in Nigeria which were public corporations.
23 Guidelines for corporate governance have been established by regulators such as, the Central Bank of Nigeria (CBN), National Pension Commission (PENCOM), Nigeria Deposit Insurance Corporation (NDIC) etc. to cater for specific industry-issues not taken care of by the SEC code
24 Bankers’ Committee, supra note 21.
Acting in its regulatory and supervisory capacity\textsuperscript{25}, Nigeria's central bank on March 1, 2006, published a principles-based Code of Corporate Governance for Banks Post Consolidation for Banks and other Financial Institutions.\textsuperscript{26} Similar to the SEC code, compliance was made mandatory. The CBN cited amongst others, the financial scandals which occurred in the United States and the obligation to preserve public confidence as reasons for developing this code.

In addition to the CBN and SEC codes, the Nigerian Code of Corporate Governance\textsuperscript{27} was recently issued with the aim of harmonizing the codes of corporate governance currently existing in the country. With the establishment of these codes, it is evident that the Nigerian corporate governance framework continues to be greatly influenced by the United Kingdom.

D. MECHANISMS FOR CORPORATE GOVERNANCE IN NIGERIAN BANKS

The establishment of good governance practices is an important way of reassuring and ensuring that the public continues to have confidence in the financial sector. The cornerstone of good governance practices is the separation of management and ownership. This, in turn, necessitates the presence of mechanisms that would ensure the company is run effectively and efficiently.

These mechanisms are instruments which are instilled to uphold good governance of Nigerian banks. They can be broadly divided into two - Internal and External Mechanisms\textsuperscript{28}.

a) Internal Mechanisms

\textsuperscript{25} This power is conferred on the CBN by section 1 of the 1991 Banks and Other Financial Institutions Act (as amended), Laws of the Federation 2004. [BOFIA]

\textsuperscript{26} Central Bank of Nigeria, Code of Corporate Governance for Banks Post Consolidation for Banks and other Financial Institutions (2016). The code became effective on April 3, 2006. [CBN code]


According to Alvaro, “the foremost sets of controls for a corporation come from its internal mechanisms.”\textsuperscript{29} This type of control is found within the banks through its directors, executive officers and shareholders, etc. who ensure the “progress and activities of the organization and take corrective actions\textsuperscript{30}” when necessary. The Board of Directors, as a mechanism for ensuring governance, played a crucial part in the formative years of governance regulation in Nigeria. The first set of codes which applied to the banking sector bestowed the ultimate responsibility of ensuring good corporate governance on the Board of Directors.\textsuperscript{31} Its effectiveness is in question. The Latin phrase - \textit{Nemo iudex in causa sua} which means “no-one should be a judge in his own case” summarizes my opinion on this. The voluntary codes which were established to ensure the board of directors practiced good governance, ironically empowered that same board ultimately to determine if good governance was being practised.

b) External Mechanisms

External control mechanisms are put in place by establishments outside a company such as industry associations, regulators, governments in the form of rules or regulatory guidelines. Some external establishments such as regulators and industry associations may suggest guidelines for best practices, which are usually voluntary, and banks can choose to follow them or not. An example is the Bankers’ Committee’s Code of Corporate Governance issued in 2003. Often legislation and some corporate governance guidelines issued by regulators (such as the CBN code), demand mandatory compliance from its subjects.

\begin{flushright}
\textsuperscript{29} \textit{Ibid.}
\textsuperscript{30} \textit{Ibid.}
\textsuperscript{31} See Bankers’ Committee, \textit{supra} note 19; See also SEC code, \textit{supra} note 12
\end{flushright}
E. THE FRAMEWORK FOR CORPORATE GOVERNANCE IN THE NIGERIAN BANKING SECTOR

On recommendation of Mr. G.D. Paton, a Bank of England official who was mandated to carry out a review of the astronomical rate of bank failures in Nigeria, the 1952 Banking Ordinance was established as the first effort at regulating banks in Nigeria. Since that time, several regulations have been implemented to regulate core banking operations and activities, as well as governance practices. The corporate governance regulation in the Nigerian banking sector is principle-based. The approach also combines some elements of rules which can be found in statutory enactments such as company law provisions which make general, indirect and sometimes not industry-specific provisions relating to governance within banks. The legislation provides the foundation on which the more specific governance principles are hinged. The various applicable rules and principles, which impact the banking industry in Nigeria would be discussed further below in summary.

a) The Legal Regime/Statutory Framework

This comprises of the following legislation which contains direct or indirect corporate governance provisions and is mandatory.

- **Central Bank of Nigeria Act**

The *Central Bank of Nigeria (CBN) Act* makes provisions for a Central Bank of Nigeria as the apex bank in Nigeria. The CBN is empowered by the Act and the *Banks and Other Financial Institutions Act* to promote to ensure the country’s financial system is healthy. To achieve this...
objective, the CBN is empowered to make necessary regulations to govern banks\textsuperscript{37}. The CBN Code of Corporate Governance is an example of the exercise of this power to make regulations.

- **Banks and Other Financial Institutions Act**

The *Banks and Other Financial Institutions Act* (BOFIA) was enacted “to regulate banking and other financial institutions and for matters connected therewith.”\textsuperscript{38} It confers the Central Bank of Nigeria with regulatory authority over banks and financial institutions in Nigeria under the overall supervision of the Minister.\textsuperscript{39} The Act details the functions, powers, and duties of the Central Bank of Nigeria;\textsuperscript{40} the duties of banks - including the officers who carry out this duty on behalf of the bank, its legal personality and directors fiduciary duty.\textsuperscript{41} BOFIA makes provisions for the prosecution of directors that violates stipulated requirements. It lists offences in sections 49 and 50, with applicable penalties in sections 50 and 55(2) in order to deter and prevent corporate mismanagement.

- **Investments and Securities Act (ISA)**

The *Investments and Securities Act* (ISA) establishes the Securities and Exchange Commission (SEC) as the highest regulatory authority for the securities market.\textsuperscript{42} The ISA was established to put in place measures “to ensure the protection of investors, maintain fair, efficient and transparent market, reduction of systemic risk and other related matters.”\textsuperscript{43} The SEC code is an exercise of the discretionary powers conferred on the SEC. The ISA vests the board of directors with the authority to safeguard the integrity of internal control measures and financial reporting.

\textsuperscript{37} *Ibid* at Section 51. Also see, BOFIA, *supra* note 22 at section 57. - Power to make regulations. Where any of the provisions of the BOFIA is inconsistent with CAMA in relation to banks, the provisions of the BOFIA shall prevail. See, BOFIA, *supra* note 22 at section 55.

\textsuperscript{38} BOFIA, *supra* note 22.

\textsuperscript{39} *Ibid* at section 1 (2).

\textsuperscript{40} *Ibid* at section 1.

\textsuperscript{41} *Ibid* at section 16 -23.

\textsuperscript{42} *Investments and Securities Act, 2007 Investments and Securities Act* at section1 (1). [ISA Act]

\textsuperscript{43} *Ibid.*
• **Financial Reporting Council of Nigeria Act**

The FRCN Act establishes a "Financial Reporting Council of Nigeria charged with the responsibility for, among other things, developing and publishing Accounting and financial reporting standards to be observed in the preparation of financial statements of public entities in Nigeria and for related matters."\(^{44}\) It creates a Directorate of Corporate Governance\(^{45}\) whose objectives include “to develop principles and practices of corporate governance” as well as “to promote the highest standards of corporate governance”.\(^{46}\) In Section 51, it goes further to charge the directorate to “assess the need for corporate governance in the public and private sector” and to “issue a code of corporate governance and guidelines and develop a mechanism for periodic assessment of the code and guidelines”\(^{47}\).

• **Companies and Allied Matters Act.**

The *Companies and Allied Matters Act* (CAMA) establishes the Corporate Affairs Commission and deals with a range of issues from the inception of a company to its winding up.\(^{48}\) It outlines the structure, operation, powers and duties of a company.\(^{49}\) It makes provisions for the appointment of directors;\(^{50}\) duties of directors;\(^{51}\) the exercise of vested powers in accordance with the memorandum of association, articles of association and the provisions of the law;\(^{52}\) and the removal of directors.\(^{53}\) CAMA also lays out the requirement for good governance and accountability by creating mandatory requirements for disclosure and financial reporting.\(^{54}\)

\(^{44}\) See the preamble to *Financial Reporting Council of Nigeria Act, 2011 [FRCN Act]*

\(^{45}\) *Ibid* at section 49.

\(^{46}\) *Ibid* at section 50.

\(^{47}\) *Ibid*.

\(^{48}\) CAMA, *supra* note 8 at section 1.

\(^{49}\) *Ibid* at sections 63, 65 -67.

\(^{50}\) *Ibid* at section 244

\(^{51}\) *Ibid* at section 279, 284.

\(^{52}\) *Ibid* at section 27, 33.

\(^{53}\) *Ibid* at section 262

\(^{54}\) *Ibid* at section 331 - 333.
specifies penalties in the event of default. Recently, a bill was passed for the repeal of the 1990 CAMA and its re-enactment to reflect best practices and current realities. The bill, currently awaiting presidential assent, seeks to create a more efficient means of controlling businesses by acknowledging that an operational legal framework which ensures good governance, is necessary for the economy to progress.

b) Regulatory Framework for Corporate Governance in Nigerian Banks.

Besides the legislated framework, there exists a regulatory framework comprising of guidelines in the form of codes issued by non-statutory as well as statutorily-established regulators which seek to promote best practices and regulate corporate governance within Nigerian Banks. These codes are not legislated, but rather a set of norms, practices, and principles. The key institutions which regulate corporate governance in the Nigerian banking industry are discussed below:

- The Banker’s Committee - Code of Corporate Governance

The Code of Corporate Governance for Banks and other Financial Institutions in Nigeria was issued in 2003 by the Sub-Committee on Corporate Governance of the Bankers’ Committee - a self-regulated association of banks in Nigeria. It impacted corporate governance in Nigeria by issuing the first set of guidelines specifically aimed at regulating governance within the country. It also made a crucial contribution to the financial sector, already besieged with a series of financial

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55 Ibid at section 544.
57 Ibid.
58 Bankers’ Committee supra note 19.
59 The irony is that some banks, (such as Platinum Bank Ltd which merged with Habib Bank to become Bank PHB, and Fortune Bank), who served as members of the sub-committee that created the guidelines are now defunct due to poor governance practices and allegations of malpractices by its directors. See, ”Bank PHB Was in Distress Before CBN Examination, Says Witness | Sahara Reporters”, (2019), online: Sahara Reporters<http://saharareporters.com/2018/10/12/bank-phb-was-distress-cbn-examination-says-witness>. 
crisis, by issuing governance guidelines tailored to the needs and requirements of the banking sector. This principles-based voluntary guideline applied to all banks and financial institutions. It provided recommendations on best practice and placed the onus of exercising good corporate governance on the Board of Directors.\textsuperscript{60}

- Securities and Exchange Commission - Code of Corporate Governance

The Securities and Exchange Commission (SEC) is established by the \textit{Investment and Securities Act}.\textsuperscript{61} Its code of corporate governance\textsuperscript{62} was developed as a result of the mandate given by the Commission to a committee led by Artedo Peterside, to develop a code of best practices for public companies in Nigeria. It was the foremost code of corporate governance published by a statutorily established regulator in Nigeria.

The principles-based code was introduced at a time when the country was in dire need of a formal and deliberate framework centered on regulating corporate governance. When it was introduced in 2003, the code was voluntary and merely a set of guidelines devised to embed good governance practices in public corporations, banks inclusive.\textsuperscript{63} However, in 2011, the code was reviewed and became mandatory for all public companies as minimum standards of corporate governance.\textsuperscript{64}

The code entrusts the Board of directors with the duty to ensure that the guidelines are observed, while shareholders are tasked to familiarize themselves with the guidelines and ensure the company adheres to the codes.\textsuperscript{65} Where the that a company has defaulted, the code makes provisions to notify the company by stating the area of concerns and the actions required to remedy

\textsuperscript{60} Bankers’ Committee, \textit{supra} note 19.

\textsuperscript{61} ISA Act, \textit{supra} note 39.


\textsuperscript{63} \textit{Ibid}.

\textsuperscript{64} See Section 1 of the Securities and Exchange Commission, \textit{Code of Best Practices on Corporate Governance in Nigeria}.(2011), [SEC Code]

\textsuperscript{65} \textit{Ibid} at section 1.3 (b).
the non-compliance. The code defines minimum standards accepted for public companies, and therefore states in section 1.3 (g) that “where there is a conflict between this code and the provisions of any other code in relation to a company covered by the two codes, the code that makes a stricter provision shall apply.”

- Central Bank of Nigeria (CBN) Code of Corporate Governance

In its regulatory capacity, the Central Bank of Nigeria (CBN) issued a principles-based code of corporate Governance which serves as the primary regulatory framework for corporate governance within banks and other financial institutions in Nigeria. The code comprises of an introductory section that elaborates on the rationale for the establishment of the guidelines, while the second section contains the codes of best practice which is divided further into subsets.

This code was intended to address governance defects peculiar to the banking sector which had contributed to the financial crises and to help banks overcome the difficulties bound to occur post-consolidation. Compliance with the code is compulsory for all banks in the country. The code acknowledges the existing weaknesses in corporate governance of Nigerian banks, recognizes the post-consolidation challenges which would be faced and enumerates principles and practices which promote good governance including the regulation of equity ownership, organizational structure, auditory and disclosure requirements. The latest review and update of the code was carried out in 2014.

- Financial Reporting Council of Nigeria – Nigerian Code of Corporate Governance 2018

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66 Ibid.
67 CBN code, supra note 26.
68 Ibid.
69 Ibid at section 1.2.1.
70 Ibid at section 5.
The Financial Reporting Council of Nigeria (FRCN) is established by the Financial Reporting Council of Nigeria Act and authorised to issue guidelines to safeguard good practices in both public and private sectors of Nigeria. On the recommendation of the Council and in the exercise of the powers conferred on the Minister by Section 73 of the Financial Reporting Council of Nigeria Act of 2011, the Nigerian Code of Corporate Governance 2018 was established.

In response to the perceived proliferation of corporate governance codes in the country, this code seeks to institutionalize and unify corporate governance best practices within Nigerian companies. Thus, companies are required to include a report on the application of the Code in their annual reports for financial years ending after January 1, 2020, in the form and manner prescribed by the Financial Reporting Council of Nigeria. The code’s philosophy explains its approach to governance as follows:

Companies should adopt the "Apply and Explain" approach in reporting on compliance with this Code. The ‘Apply and Explain' approach which assumes the application of all principles and requires entities to explain how the principles are applied. This requires companies to demonstrate how the specific activities they have undertaken best achieve the outcomes intended by the corporate governance principles specified in the Code. This will help to prevent a ‘box-ticking’ exercise as companies deliberately consider how they have (or have not) achieved the intended outcomes. Although the Code recommends practices to enable companies to apply the principles, it recognizes that these practices can be tailored to meet industry or company needs. The Code is thus scalable to suit the type, size, and growth phase of each company while still achieving the outcomes envisaged by the principles.

Due to the potential complexities which may occur across industries and companies of varying sizes in complying with this code, it provides for a level of flexibility in its application by adopting

71 FRCN Act, supra note 41.
72 FRCN Act, supra note 41 at section 11(c) and 51(c).
74 Ibid.
75 Ibid.
76 NCC, supra note 24.
this principle-based approach which specifies the minimum standards of practice that companies should adopt.\textsuperscript{77} The FRC is tasked with the duty of monitoring the implementation of the Code.\textsuperscript{78}

F. MAJOR CHALLENGES FACING CORPORATE GOVERNANCE IN NIGERIA’S BANKING INDUSTRY

The effectiveness of these legal and regulatory provisions in promoting good governance practices within Nigerian banks have been hampered by several obstacles. Some of these hindrances are not limited to the banking industry, rather, they are a reflection of corporate governance as a whole in Nigeria and even beyond. The following are some of the prominent challenges faced in instilling good governance practices in the Nigerian banking sector:

a) Corruption

Nigeria is not the only country which suffers from corporate corruption, and this phenomenon has been analyzed in corporate governance literature as the primary challenge.”\textsuperscript{79} In Nigeria, corruption is more than just a corporate governance challenge, it is the bane of the Nigerian economy and exists in several of its institutions. This degree of corruption in the Nigerian banking industry mirrors its economic and socio-political environment. The country’s corporate atmosphere is polluted with corruption which has encumbered economic development, sabotaged good governance practices, and aided fraud within the Nigerian banking sector. Corruption was

\textsuperscript{77} Ibid.
\textsuperscript{78} Ibid.
recognized as one of the reasons why CBN dismissed executives of five banks in 2009.\(^\text{80}\) As noted by Yakasai,

> The complexity and trouble with most banks in Nigeria are that the directors work to the answer, mark their own examination scripts, score themselves distinctions and initiate the applause. But to the stakeholders (especially the equity owners), the excellent report sheets are openly fudged or at best engineered and indeed the activities of the board are so varied and deceptively intractable that the more critically you look, the less you see.\(^\text{81}\)

b) Weak Legal and Regulatory Institutions

It is asserted that regulators in Nigeria do not possess the necessary capacity to carry out their prescribed functions\(^\text{82}\). In a presentation to the U.S. House of Representatives Subcommittee on International Monetary Policy and Trade Committee on Financial Services Committee by the CBN Governor, it was stated that the poor coordination among regulators of the banking sector was one of the major shortcomings of the CBN prior to the financial crisis.\(^\text{83}\) According to Simisola and Sunday,

> Regulators were ineffective in foreseeing, anticipating and supervising the changing phase in the industry or addressing the prevalent corporate governance failures such as granting of unsecured loans. For example, the Supervision Department within the CBN was not structured to supervise effectively and to enforce regulation; therefore, no one could be held accountable for failing to address issues such as risk management, corporate governance, fraud, cross-regulatory coordination, money laundering, enforcement, and the likes.\(^\text{84}\)

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\(^\text{81}\) Alhaji G A Yakasai, "Corporate Governance in a Third World Country with Particular Reference to Nigeria" (2001) 9:3 Corporate Governance 240.

\(^\text{82}\) Okaro Sunday & Tauriangana Venacio, "From SAS to IFRS - an investigation of transition road map implementation problems" in Venacio Tauriangana & Musa Mangena, ed, Research in Accounting in Emerging Economies, ed (Emerald Group Publishing Limited, 2019).


Furthermore, regulatory frameworks have deficiencies which hinder the ability of the regulatory institution to function efficiently. For example, the code of corporate governance established by the Securities and Exchange Commission contains no compliance procedures; while the Central Bank of Nigeria’s code of corporate governance, which is mandatory does not provide how compliance would be measured by regulators or enforced. For a country replete with institutional corruption, the use of meager fines is inadequate, and banks easily got away with non-compliance by payment of the prescribed fines.

c) Lack of Proper Enforcement

According to Vincent, a major hindrance to corporate governance in Nigeria is the disconnect between the existence of law and its execution.\(^{85}\) Even where proper regulations are in place, enforcement of the law to the letter has always been lacking. This is another concern of corporate governance in the banking sector which is a reflection of its economic and socio-political environment

This lack of proper enforcement is two-fold. First, is the lack of proper provision of enforcement mechanisms in corporate governance regulations within the banking sector. The second is the overshadowed authority of the regulators emanating from inefficiency in the powers exercised by the regulators, as well as an indirect consequence of the endemic corruption which exists in the country. There is the need for proper enforcement mechanisms in the framework for governance that takes into consideration the idiosyncrasies of the environment and the economic and socio-political challenges which banks face.

d) Poor Disclosures

Another major challenge faced by corporate governance is the level and quality of disclosures. This poor disclosure culture does not exist in isolation but closely linked to several other challenges and concerns. There is a lack of transparency associated with disclosures which are another by-product of the menace of corruption which plagues the corporate environment.\textsuperscript{86} Also, the level of information readily available to the public contributes to this problem. Even where this information may exist, retrieval or access to it may prove to be a stumbling block.\textsuperscript{87} This hoarding of information provides a breeding ground for the perpetration of fraud and corrupt practices. It can also be used to create a false or misrepresented projection of the company’s affairs.

The framework for corporate governance in the banking industry requires disclosure mechanisms beyond the modest statutory provisions of the \textit{Companies and Allied Matters Act and the Banks and Other Financial Institutions Act}.\textsuperscript{88} Also, there is a lack of continuous disclosure review programs to keep up with development trends in governance. This includes the quality and consistency of disclosures via the internet and social media.

\textbf{G. CONCLUSION}

The challenges discussed above are only some of the challenges facing corporate governance in Nigeria’s banking sector and the list is not exhaustive. An analysis of the historical background, current framework and challenges being faced sets the tone for this research and the proposals for reform. The thesis proposes that one way to overcome these challenges is by having in place, the


\textsuperscript{87} For instance, difficulties have intensified over the past few years at the Corporate Affairs Commission with the retrieval of public information or corporate documents filed by companies. The filing system is rudimentary and the turn-around time to receive information is lengthy. To speed up the time for retrieval, it is common practice to pay a small bribe to facilitate the request.

\textsuperscript{88} For example, the CBN code merely encourages banks to make disclosures in its annual report beyond statutory requirements. See section 5.1.1 of the CBN code, \textit{supra} note 26.
right approach to corporate governance. The term “right approach” does not imply that the method
to be employed is universally more efficient than any other approach to governance. Rather, in the
circumstances, the approach which would be best suited to succeed in promoting good governance
practices within Nigerian banks in the face of the difficulties confronting it.
CHAPTER 3

RULES-BASED AND PRINCIPLES-BASED SYSTEMS OF CORPORATE GOVERNANCE

A. INTRODUCTION

Considering the challenges facing corporate governance, one of the questions this thesis seeks to determine is whether a principles-based or rule-based system of governance would better suit the Nigerian banking industry. There has been a lot of debate over the relative merits and superiority of each system.\(^1\) While rules have a detailed and specific regulatory process, principles do not follow that blueprint and tend to focus primarily on outcomes with less information on how to achieve it.\(^2\) The system of corporate governance in the Nigerian banking sector, as seen from the previous chapter, employs both forms of regulations – rules and principles. In my opinion, a critical observation would reveal that this is a result of an accident rather than design and there was no deliberate intent to structure corporate governance regulation in such a manner.

This chapter does not seek to engage in the theoretical debate of the more superior system of regulation. Rather, this chapter seeks to analyze both regimes with the aim of determining which system possesses inherent characteristics which could provide for a more effective means of government regulation within the Nigerian banking sector. To achieve this, I will engage in a comparative analysis of both regulatory approaches, and then proceed to analyze their application to corporate governance. I will focus on some selected parameters as key considerations motivating the adoption of either approach. This will help to determine which of these forms of


regulation would be more effective in the realization of good governance practices within Nigeria’s banking sector. Alternatively, how both systems may be combined to harness and develop a unique, albeit, effective system of regulation.

B. THEORETICAL BACKGROUND

Rules and principles in governance are often classified as hard law and soft law, respectively. The definitions of hard law and soft law is not conclusive; however, a distinction is usually drawn using the “binding factor”. According to Ronald Dworkin, hard law in the form of rules is "applicable in an all or nothing fashion." He argues that once the facts or conditions laid down by a rule is met, the legal consequences prescribed automatically apply. In contrast, soft laws such as principles, do not prescribe legal consequences which arise by default when the conditions provided are met. Some theorists disagree with Dworkin's basis of distinction between rules and principles on the basis of the possibility of conflict or the way conflict is resolved. They contend that the rational distinction separating them is not related to the likelihood of conflict or its means of resolution. According to Joseph Raz, “rules prescribe relatively specific acts; principles prescribe highly unspecific actions.” He states that a new rule can arise from one single judgment and as a result, it becomes a precedent that all other similar cases must follow, unlike principles which have

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4 Jan Klabbers, "The Redundancy of Soft Law" (1996) 65:2 Nordic Journal of International Law. [Jan Klabbers]. For the purpose of this research, principles as a type of soft law, in contrast to rules, refer to guidelines which may have practical effects but possess no legally binding force.
6 Ibid.
7 Joseph Raz, "Legal Principles and the Limits of Law" (1972) 81:5 The Yale Law Journal 838. [Joseph Raz]
evolved over time through practice and become binding when they possess substantial authoritative backing.\(^8\)

In this jurisprudential sphere of the debate between rules versus principles, three major theories emerge – Legal Positivism, Rationalism and Constructivism. Gregory (2008)\(^9\) does a decent job of classifying and simplifying the ideologies of these schools of thoughts. He states that positivists lean towards hard law because it connotes legal duties which are formally binding, while soft law denotes those that don’t legally bind even though they might subsequently lay the foundation of a binding hard law.\(^10\) The legal positivists do not readily accept the idea of “soft law” which is generally not binding because it contradicts with the definition of “law” which according to the positivists is binding”.\(^11\) Positivists perceive “soft law as inferior to hard law, as a way station on the way to hard law, or as a fall back when hard law approaches fail.”\(^12\) On the other hand, Rationalists assert that both possess distinctive characteristics which states prefer for diverse circumstances and in regard to these distinctive traits, complement one another. Meanwhile, Constructivists contend that “state interests are formed through socialization processes of interstate interaction which hard and soft law can facilitate”\(^13\). According to Gregory and Mark, Constructivists are more disposed to soft law as against hard law because of the ability of soft law to "generate shared norms and a sense of common purpose and identity, without the constraints raised by concerns over potential litigation”\(^14\). This, as well as rigidity, is often argued to be major disadvantages of hard law.

\(^8\) Ibid.
\(^9\) Gregory and Mark supra note 3
\(^10\) Ibid at 707.
\(^11\) Jan Klabbers supra note 4.
\(^12\) Ibid.
\(^13\) Gregory and Mark, supra note 3 at 708.
\(^14\) Ibid.
The rationalist view aligns best with my perception of the roles of rules and principles in corporate governance in Nigeria. Irrespective of the ideologies of the three schools, they share the belief that both hard law and soft law can act as accompaniments. This study aims to understand and explore the conditions in which rules and principles interact and thrive. By doing so, I seek to determine if rules or principles or a combination of both is better suited to achieve the principles of corporate governance in the Nigerian banking sector.

C. DISTINGUISHING RULES AND PRINCIPLES

The difference between rules and principles may not be as apparent as it seems.\textsuperscript{15} Several instances which show the blurry lines have been cited to support this position such as questions of validity or binding nature.\textsuperscript{16} Legal theorists have gone further to describe them as opposite ends of a continuum.\textsuperscript{17} However, there are some basic characteristics of rules and principles which separate them. These would be examined subsequently.

a) Principles-Based Approach to Corporate Governance

The principles-based approach to corporate governance, which is often discussed in contrast to a rules-based approach, is a form of regulation premised on the idea that a set of rules would be insufficient to meet the complexities of governing a company. In its most common form, it mixes voluntary compliance of the prescribed guidelines with a mandatory requirement to disclose compliance or explain deviations from the guidelines.\textsuperscript{18} Principles include policies, standards, best

\textsuperscript{15} Brigitte Burgemeestre, Joris Hulstijn & Yao-Hua Tan, "Rule-based versus Principle-based Regulatory Compliance" (2009). [Brigitte] Available online at: <https://pdfs.semanticscholar.org/c719/dee38b2653cf7c22e915822e02664c0ceed2.pdf>

\textsuperscript{16} Ibid.


\textsuperscript{18} The mandatory requirement may be in form of an enacted law, listing rule or regulation.
practices, established in codes which are issued to ensure good governance practices. This system of regulation deviates from the traditional method of governance through detailed and prescriptive legislation rather, it focuses on principles which set the standards by which companies should operate. Because it is outcome-focused, it places more emphasis on achieving the desired objects and intents of regulations. Principles-based regulations “give firms the responsibility to decide how best to align their business objectives and processes with the regulatory outcomes we have specified”. Principles, which are usually employed in a system of self-regulation, provides less information which permits the subject of the regulation to decide the best method of implementing the guidelines to achieve the desired regulatory outcome. A well-known example is a regulation to “Drive responsibly when it is snowing”. It formulates a guideline to ensure the safety of the driver but does not provide more information pertaining to what responsible driving is or specify the exact means of implementing it. The driver uses the best means possible to achieve the desired result. Firms must then document and report to the regulator how their conduct achieves compliance.

Proponents say this approach has become necessary due to the failures of prescriptive standards in regulating governance effectively and the relative cost of regulation. The volatile nature of the

19 Anita Anand, supra note 2.
21 FSA, supra note 20.
23 FSA, supra note 20
24 Brigitte, supra note 15
25 Ibid.
27 FSA, supra note 20
finance industry and the rate of technological development are some of the reasons used to support their claim that a flexible approach is even more pertinent\textsuperscript{28}. This view was summarised as follows;

It is important that regulation can respond rapidly to the pace of change in markets and so allow them to continue to develop for the benefit of their users. We believe regulation that focuses on outcomes rather than prescription is more likely to support the development and innovation. Any set of prescriptive rules is unable to address changing market circumstances and practices at all times, and it inevitably delays, and in some instances prevents innovation. In a quickly changing marketplace, principles are far more durable. The complexity of a very prescriptive regime with thousands of detailed rules is also likely to make it inaccessible to many firms’ senior management. Particularly for smaller firms, who do not generally have access to deep compliance or legal expertise, the amount of detailed rules can be bewildering\textsuperscript{29}

This regulatory system is based on a notion that rules should set “no more than basic legal parameters within which firms will operate” allowing the internal policies of the company guided by the regulatory principles to give effect to these parameters within the context of the company’s business and capability.”\textsuperscript{30}

Unlike rules, principles have a broader perspective of governance regulation. Regulators state the general governance guidelines and objectives which companies should seek to attain. The responsibility of achieving these goals is then placed on the set of people who oversee the company’s activities with a substantial amount of discretion. The company uses the guidelines to create internal processes and business practices to attain the regulatory objectives and like every successful relationship, both parties must maintain mutual trust for this regulatory bargain to succeed.\textsuperscript{31} A deviation may be allowed in instances of variation from the guidelines, so long as it is appropriate and justifiable in the circumstances\textsuperscript{32}. In such cases, the company is usually required to make these reasons for non-compliance known to the appropriate regulatory body and its

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\textsuperscript{29} Ibid. See also, Julia Black, \textit{supra} note 26.

\textsuperscript{30} Anita Anand, \textit{supra} note 2.

\textsuperscript{31} Julia Black, \textit{supra} note 26. This is referred to as the “self-reflective approach”

Despite the strengths of this system, it has been criticized amongst others for bestowing too much discretion on the subjects of regulation which may lead to under-compliance. It also has a tendency to create negative public opinion, arising from controversies in enforcing principles that are not clear-cut.

b) Rules-Based Approach to Corporate Governance

A rule-based approach is a regulatory system where guidelines for governance are predominantly statutorily enacted laws which evolve with case law and administrative process. It seeks to promote compliance through detailed procedures. The rules are mandatory, stating what actions may be done and what is prohibited. They are legally enforceable and may attract retribution for non-compliance. This approach can usually be seen in the form of state regulation where an enactment prescribes the governance guidelines in specific detail including permitted exceptions, which restricts the discretion of companies on how to achieve the stated regulatory objectives.

Rules are pre-defined through the administrative or legislative process to guide conduct ex-ante, unlike principles where this process is carried out by regulators ex-post. Because rules are clearly defined and specific, regulators are constrained within its boundaries and unable to carry out their function arbitrarily. The precise nature of rules gives rise to formalism, uniformity and a great degree of rigidity.

Principles lean towards the accomplishment of desired regulatory outcomes, conversely, rules seek to regulate aspects of how companies behave. In order to achieve compliance, both forms of

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33 Ibid.
36 Anita Anand, *supra* note 2
regulation give different levels of information to their subjects. Rules are more definitive, conferring companies with limited discretion on how to achieve stated regulatory objectives. To create some degree of flexibility, rules may include prescribed exceptions or increase discretion by conferring power to a regulatory body or minister.\(^{37}\) With rules, legislators seek to limit the subsequent interpretation and decision-making power. Companies are provided with adequate notice and guidelines on how to comply. To ascertain compliance, facts are applied to the precisely formulated directives to determine if there has been adherence, thereby limiting potential ambiguities\(^{38}\)

A lot has been said about the relative characteristics of rules-based approach. Its predictability and lack of flexibility allow for more certainty and knowledge of what exactly is expected. Long-term goals can be created and centered on the credence of rules.\(^{39}\) The predictability makes it easier to venture into certain activities because there is a forehand knowledge and a better understanding of how to navigate the regulatory waters. In the event of a violation or dispute over the rules, regulators are generally able to enforce the regulations better than the principles-based approach at less cost.\(^{40}\) This approach also ensures that regulators are not able to easily enforce regulations arbitrarily, inconsistently or with bias thus ensuring equality and accountability.\(^{41}\) This method has had its fair share of critics. The rules-based approach does not possess inherent mechanisms to respond very swiftly to changes due to the associated bureaucracies of law-making.\(^{42}\) Also, it

\(^{37}\) Companies and Allied Matters Act, 2004 Companies and Allied Matters Act at section 692. [CAMA].
\(^{38}\) Brigitte, supra note 15
seems virtually impossible for legislation to cater for every possible infraction and this deficiency is highlighted especially in a world constantly evolving technologically.

D. FACTORS IMPACTING THE APPLICATION OF RULES OR PRINCIPLES IN CORPORATE GOVERNANCE.

The perceived advantage or weakness of either in corporate governance is based on the context in which they are applied. For the purpose of this thesis, I would highlight the distinction between rules and principles by exploring some contextual elements which influence their application in the Nigerian banking sector under the following headings:

a) Costs

Rules and principles can be further distinguished based on costs applicable to either regulators or the subject of regulation.\(^{43}\) In assessing this question, the idea of costs may be addressed relatively in comparison with the social benefits which it confers, and the least costly approach may be determined in terms of net social gain.\(^ {44}\) The bulk of the costs associated with rules are incurred upfront by the law-making body bearing the burden of the expenses. Rules are determined \textit{ex-ante}, that is, before they become operational. Because they are designed ab initio to impose specific requirements with next to no margin of error, they can be relatively less expensive to enforce compared to principles which require subsequent determinations of regulatory requirements.\(^ {45}\) Louis Kaplow while analyzing the cost implications of rules argues that as long as a rule has been properly drafted, no matter how complex, the question for determination is rarely whether a rule

\(^{43}\) Anita Anand, \textit{supra} note 2
Because rules tend to regulate behaviors which are likely to reoccur, it provides the opportunity to gain experience and expertise to improve rule enforcement and minimize costs. Unlike rules, principles are mostly determined *ex-post* and do not require an initial heavy outlay of cost. However, because principles are more flexible and allows for the exercise of a greater degree of discretion, its provisions are more open to interpretation and therefore more expensive to enforce together with associated costs incurred in form of legal advisory. James Park argues that enforcement of principles is intensely fact-specific and therefore more expensive because it requires a series of investigation and case development to prove culpable intent. Principles are designed to apply to a wide set of facts. Therefore, each case is more unique, and the cost of enforcement is higher because it may impracticable to apply precedents from similar cases.

b) Sufficiency and Sustainability

The application of rules or principles to regulate governance imposes an obligation to cater to current activities as well as future actions which may occur. The questions arise about the ability to create well-defined laws which cater for every deed or undertakings. Even if this was possible, there would be too many rules to create for every situation, which may be impossible to anticipate and extremely costly to execute. It should also be noted that this would also imply creating new rules every time there is a degree of innovation in governance. Rules are rigid and their formulation can be a lengthy process due to the amount of bureaucracy involved. This raises some doubts.

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47 See Louis Kaplow, *supra* note 45 at 573
48 *Ibid* at 570, 577
49 James Park, *supra* note 46 at 136
50 *Ibid*.
51 See Louis Kaplow, *supra* note 45 at 599
concerning its ability to cater promptly for trends in the ever-changing sphere of corporate governance.

On the other hand, principles are associated with flexibility and permit some level of innovation. The degree of innovation which principles afford makes up for any lack of foresight in formulating regulations to cater to every regulatory situation. The principles-based approach is goal-oriented and gives both the regulator and the subject of regulation a degree of elasticity which may arise in many ways; from determining how companies choose to comply with regulations to the manner in which regulators choose to monitor and enforce the guidelines. Therefore, with principles, there is an increased ability to respond to changes and modern trends in corporate governance. This has become more relevant in modern times filled with technological innovations, to pursue new methods to achieve regulatory goals more diligently and sustainably.

c) Level of complexity

The choice of employing rules or principles may be determined by the degree of complexity of the phenomenon which it seeks to regulate. According to John Braithwaite, “the general theory advanced is that precise rules more consistently regulate simple phenomena than principles. However, as the regulated phenomena become more complex, principles deliver more consistency than rules. A central reason is that the iterative pursuit of precision in single rules increases the imprecision of a complex system of rules.” It is generally asserted that rules are more appropriate to deal with matters in simpler contexts, with homogenous subjects, and activities which are bound with well-defined features that are bound to re-occur. Equally, it is contended that in regulating more complicated situations, among diverse subjects which may give rise to a series of

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52 BEIS, supra note 40
54 Ibid.
consequences, a principles-based approach is better situated.\footnote{Ibid.} This also includes activities which are novel or actions which occur occasionally because principles do not need to be established beforehand to cover every probable scenario.

Banks and other financial institutions engage in complex transactions and activities which require regulations that have the ability to contend with its volatile and fast-paced nature. Because of its specificity, for a rules-based approach to deal with trends, there would be a need to frequently update or enact new laws from the scratch which may not only be cumbersome and costly but may also imply some delay in reacting to the new development which can be crucial. The need to create rules which cater to every situation also raises a situation where there would be a series of regulations which may never become relevant or utilized. Principles, on the other hand, has the ability to meet this level of innovation by giving its subjects the discretion to be creative in complying and achieving the objective of good governance.

d) Compliance incentives

What level of motivation and to what extent do the subjects of regulation require incentives to practice good governance? Rules-based and principles-based approaches to corporate governance provides subjects with varying levels of incentives to comply. One of the features of a rules-based approach is that it has clear lines that demarcate practices which are acceptable, and which is not. In some situations, it may create circumstances for exceptions to erstwhile unacceptable circumstance making it permissible if certain conditions are fulfilled. Where there is non-compliance, it stipulates legally enforceable sanctions and penalties, which act as deterrence for future misconduct. On the other hand, the principles-based approach is less specific, and its generality provides for the exercise of discretion in compliance. It encourages good governance
practices by permitting the subject of the regulation to decide the best method of implementing the guidelines to achieve the desired regulatory outcome.

In determining the best governance approach to employ in consideration of motivational and incentive measures to comply, the risk profile of regulatory subjects plays a major role. In environments where subjects are likely to “box-tick” or circumvent rules, it may be more suitable to employ principles-based mechanisms while in circumstances where there is likely to be no adherence or a tendency to under comply, the use of rules-based regimes to encourage compliance may be more appropriate.

e) Public Opinion

Principles may seem less complicated on the surface however enforcement is likely to elicit conflicted public opinion because unlike rules which are unequivocal, principles more often than not involve impugned standards. Rules are less likely than principles to spur a controversy after enforcement or create arguments contesting the contents or legitimacy of enforcing the rule.56 Rules are designed in a manner which does not necessarily incorporate morally blameworthy conduct, and therefore able to avoid contentious moral debates.57 Rather, enforcement is carried out by the vested authority in accordance with stated provisions to achieve one of the fundamental goals of any enforcement system, that is, deterrence.58 According to Dan Kaha, difficult and controversial value judgments can be avoided “by framing an enforcement case as simply a technical issue of deterring rule violations.”59 Thus, it is less burdensome to enforce rules in a manner that limits negative public opinion, minimizes controversy and creates a positive outlook.

56 James Park, supra note 46
57 Ibid.
59 See, Robert Cooter, "Prices and Sanctions" (1984) 84:6 Columbia Law Review; See also, James Park, supra note 46 at 138;
In comparison to rules, enforcement of principles has a greater tendency to lead to controversy and debates because there is a likelihood of reaching varying conclusions as a consequence of the degree of flexibility attached with the mode of compliance Enforcement of principles often includes an element of value judgment. In this instance, to create a standard benchmark for evaluation may be a Herculean task, hence, the probability of considerable variance in enforcement. Consequently, it may not be uncommon to see entities resisting on the basis of the vagueness of the principles or complexity of a transaction leading to the possibility of creating a controversy. Principles may be more effective in tackling grey areas of regulation but may not be ideal if the objective is deterrence because unlike rules, it my lack a clearly recognized pattern of enforcement. Precedents may not be as effective because it is easier for violators to “rationalize that their situation is different from previous cases of principle-enforcement.” However, this may not necessarily be a negative attribute in the sense it forces subjects to anticipate and act pre-emptively in assessing their actions.

E. CONCLUSION

In deciding which regime of governance is a better fit in the Nigerian banking context, it is important to be able to distinguish between both systems. This is necessary in order to take advantage of their relative strengths in formulating a regime which is equipped to combat the

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62 James Park, supra note 46

63 Ibid.

challenges facing corporate governance. It should be noted that the disadvantages of rules are not necessarily an advantage of principles and vice-versa. The characteristics of each approach should be analyzed side by side with the socio-political and economic factors which influence the practice of governance in Nigerian banks. Only then, can the most appropriate approach to governance regulation be determined.
CHAPTER 4

A CASE STUDY OF THE RULES-BASED APPROACH OF THE UNITED STATES OF AMERICA AND THE PRINCIPLES-BASED APPROACH OF CANADA

A. INTRODUCTION

As discussed in the previous chapter, the system of corporate governance regulation is comprised of two major approaches – principle-based and rule-based. In this chapter, I will carry out a further review of both regimes using Canada and the United States of America (U.S.) as case studies. Canada was selected as a case study because it is a common-law country which practices a principles-based approach to corporate governance regulation which bears similarities with the system in Nigeria. More importantly, Canada has been cited as having one of the strongest securities regulations in the world.¹ On the other hand, the U.S. has been selected for this study as a prime example of a country which employs the opposing rules-based system of regulating corporate governance.

This chapter shall examine the development of the principles-based and rules-based regulatory system of corporate governance respectively in both countries and then proceed to highlight corporate governance provisions which have been established to regulate governance, and which have an impact on the banking industry. The chapter shall also review criticisms which these regulatory approaches to governance have garnered over the years. This comparative analysis is necessary to evaluate the practical application of both approaches to corporate governance in the banking industry.

B. THE UNITED STATES OF AMERICA

The rules-based system of corporate governance practiced in the United States (U.S.). So, instead of voluntary guidelines prescribed in form of standards and best practices, the provisions for corporate governance are mandatory and entrenched in law. There are two major sources of corporate governance laws in the U.S. The first of these are state the corporate laws and court decisions such as those issued by the Delaware Chancery Court. Secondly, federal securities laws which have ousted state law as the dominant means of regulating corporate governance especially with the enactment of the Sarbanes-Oxley Act. I will examine the historical development of the framework for corporate governance impacting the banking sector, up to the enactment of the Sarbanes-Oxley Act, its key provisions and how it has affected corporate governance regulation in U.S. banking organizations since enactment.

a) Historical Overview of the Rules-Based Approach.

The 1929 Wall Street Crash was iconic for many reasons besides being one of the major causes of the Great Depression. The crash led to the formation of the Securities Act of 1933 as well as the Securities Exchange Act of 1934 and commenced the involvement of the U.S. federal government in regulating corporate governance. Prior to their enactment, regulation was by state laws known as Blue Sky Laws, however, the crash was sufficient proof that there was a need for

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3 This was also known as the 1929 Stock Market Crash. It was one of the worst declines in US history comprising of a series of bank failures which crippled the financial system. See, Arthur J Erickson, "Stock Market Crash of 1929: The Week That Broke the American Economy", (2011), online: AssociatedContent.com <http://www.associatedcontent.com/article/47662/stock_market_crash_of_1929_the_week.html>.
5 Securities Act of 1933, PL 115-174. [SEC 1933];
7 The term was first used in the opinion of Justice McKenna in Hall vs Geiger-Jones Co, [1917] 242 US 539.
better regulation of public companies. Creation of the Securities Act of 1933 and the Securities Exchange Act of 1934 was the beginning of the increased role federal legislation would play in the regulation of corporate governance in U.S. corporations, to the detriment of state laws, as company executives became liable to federal criminal penalties. The Securities Exchange Act of 1934 also established the Securities and Exchange Commission and empowered it to regulate and enforce laws. These pieces of legislation serve as the backbone of U.S. securities law as it is today.

In addition, the Banking Act of 1933 established the Federal Deposit Insurance Corporation (FDIC) in response to the many bank failures that took place in the 1920s and early 1930s. After its establishment, records showed that bank failures averaged about 15 annually with this amount escalating in the 1980s to a record high of 280 in 1988. The Federal Deposit Insurance Corporation Improvement Act (FDICIA) was passed in 1991 as a response to predicaments in the banking industry. The latter Act required the FDIC to pre-empt and to take prompt corrective action in regulating the banking industry and in doing so, to choose the resolution method that minimizes the costs to taxpayers of a bank failure.

Establishing of governance mechanisms was not the mainstay of U.S. banking regulation, however, several elements of its regulatory scheme which are relevant to banks relate to corporate

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9 SEC 1933, supra note 5; SEC 1934, supra note 6.
10 SEC 1934, supra note 6.
14 Federal Deposit Insurance Corporation Improvement Act of 1991, PL 102-242,105 Stat 2236, s 143. [FDICIA]
15 Ibid at section 141.

governance. For instance, as far back as 1933, federal banking laws permitted the dismissal of bank directors who conducted unsafe or carried out unsound banking practices. Also, in 1991 federal banking regulators were mandated by the FDICA to establish benchmarks to ensure the well-being of the banks, who were obligated to place internal mechanisms to enhance the ensure compliance. Regulators were also authorized to remove from office, officers and directors of severely undercapitalized banks

With all these regulations in place and a boom in the stock market in the 1990s, it is no surprise that U.S. securities regulation was widely admired - a competitive market to attract corporations, receive increased tax revenues, job creation and relaxed corporate governance. The perception was that the market was most efficient when relying on its self-regulatory mechanisms to dictate governance regulations. However, towards the end of the 20th century, due to varying market conditions, executives started to exercise a lot of unfettered powers. By September 20, 2002, market capitalizations of U.S. stock markets declined by half, following a series of event which

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17 Michael E Murphy, "Assuring Risk Management in Banking: The Corporate Governance Dimension" (2011) 36 Delaware Journal of Corporate Law at 126. David Becher argues that where there is effective regulatory oversight of banks, regulation can be used interchangeably with corporate governance thereby diminishing the need for the board to monitor the management closely. I do not agree with this view and believe that both corporate governance and regulatory oversight are important pieces to the overall scheme and not substitutes. See, David A Becher & Melissa B Frye, "Does regulation substitute or complement governance?" (2011) 35:3 Journal of Banking & Finance.


19FDICIA, supra note 14 at Section 38 (2)(e)


b) Impact of the SOX on the Banking Industry

The corporate scandals in the US can be attributed to prompting a global upheaval of governance regulations, beginning with the enactment of the SOX which sought to restate confidence in the financial markets by establishing an improved system of corporate disclosure and accountability.\(^\text{28}\)

After the enactment of SOX, the Division of Banking Supervision and Regulation of the Federal Reserve System issued a supervisory letter to all banks.\(^\text{29}\) The letter described and summarized the provisions put in place by SOX which applied to domestic and foreign public banking organizations under the supervision of the Federal Reserve.\(^\text{30}\) The letter encouraged supervisory staff and banking organizations to note guidelines on effecting the SOX which the Securities and


\(^{25}\) SOX, supra note 2.


\(^{28}\) Ibid.


\(^{30}\) Ibid.
Exchange Commission provided. In view of the foregoing letter, I shall briefly examine the provisions of the SOX which directly impacts corporate governance regulation among US public banking organizations:

- Accounting oversight

Before SOX was enacted, auditing was mostly a self-regulated profession.\(^{31}\) Audit firms contributed voluntary fees to finance this self-regulation, thereby placing a huge question mark on the independence of the regulatory mechanism.\(^{32}\) Title I of SOX changes this. It establishes a Public Company Accounting Oversight Board (PCAOB)\(^{33}\) and gives it the authority amongst others, to oversee the audit of public companies, create auditing standards for registered accounting firms and investigate violations.\(^{34}\) The board is independent of the industry\(^{35}\) and revenue is generated for PCAOB through mandatory fees paid by audit companies.\(^{36}\)

- Audit Restructuring

US public banking organizations are mandated by SOX to have an audit committee comprised only of independent directors\(^{37}\). It defines a director is independent if it does not “accept any consulting, advisory, or other compensatory fees from the issuer\(^{38}\) or be an affiliated person of the issuer or any subsidiary thereof.”\(^{39}\) The Act then proceeds to spell out the duties and powers of the

\(^{32}\) Ibid.
\(^{33}\) SOX, supra note 2 at section 101.
\(^{34}\) Ibid at sections 101 – 109.
\(^{35}\) Ibid at section 101.
\(^{36}\) Ibid at section 109.
\(^{37}\) Ibid at section 301 (3)(a).
\(^{38}\) Ibid at section 301 (3)(b)(i).
\(^{39}\) Ibid at section 301 (3)(b)(ii).
SOX also ensures auditor independence. Prior to the enactment of the SOX, auditors were paid by the companies they audited and this relationship had the potential to give rise to a conflict of interests especially if a critical audit was carried out. Also, with auditing firms branching into management consultancy services and undertaking the same for companies whom they provided auditing services to, they were placed in a position where they had to audit themselves thereby becoming less objective. SOX attempts to rectify this by prohibiting an auditor for a public company from executing certain services at the same time with the audit. Sections 201, 203 and 206 of SOX are some of the sections which contain provisions to ensure external auditor independence in US public banking organizations.

- Financial Disclosure and Reporting Obligations

The 1934 Act mandates principal executive officers and financial officers of public organizations to ensure certain certifications are contained in both annual and quarterly reports filed by the organization. Likewise, the SOX mandates that “each periodic report containing financial statements filed by an issuer with the Securities Exchange Commission pursuant to section 13(a) or 15(d) of the Securities Exchange Act of 1934 shall be accompanied by a written statement by the chief executive officer and chief financial officer (or equivalent thereof)”.

Ibid at section 301.


Ibid at 49.

Ibid at section 302.

Ibid at section 906.
or willfully files false certifications.\textsuperscript{47} Also, insider transactions by directors, officers or shareholders with more than 10 percent equity must be reported to the Security and Exchange Commission.\textsuperscript{48}

- Inside Lending

SOX, s.402 generally makes it unlawful for public banking organizations and its subsidiaries from extending credit, directly or indirectly, in the form of a personal loan to its director or executive officers subject to a few limitations\textsuperscript{49}. This limitation allows permits directors and executive officers of public banking organizations to receive loans from the company or its subsidiaries which are obtained in the ordinary course of the company's consumer credit business and generally made available to the public by the company and on similar market terms\textsuperscript{50}. The Security and Exchange Commission is empowered by the act to interpret the scope and to issue future guidelines on lending prohibitions in order to limit loan abuses and hidden compensation.

- Security and Exchange Commission’s (SEC) direct Board oversight

Section 107(a) of SOX empowers SEC with authority to supervise the Board of Directors. If the board wishes to implement new governance rules, it shall become only become effective after approval by SEC that such a provision is consistent with SOX.\textsuperscript{51} The SEC is empowered with the authority to amend the rules of the Board in certain instances.\textsuperscript{52} SOX also gives the SEC power to "relieve the Board of any responsibility to enforce compliance with any provision of this Act, the

\footnotesize{\textsuperscript{47} Ibid at section 1350.  
\textsuperscript{48} Ibid at section 403.  
\textsuperscript{49} Ibid at section 402.  
\textsuperscript{50} Ibid at section 402 (2).  
\textsuperscript{51} Ibid at section 107(b)(2-3).  
\textsuperscript{52} Ibid at section 107(b)(5).  
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securities laws, the rules of the Board, or professional standards… and to censure and limit the activity of the Board if it has violated SOX without reasonable justification” and “if it is in the public interest or for the protection of investors, the authority to remove directors from office.53

c) Law Violation Consequences of the SOX

An important aspect of the rules-based system of corporate governance is the consequence attached to violations of the mandated rules in the form of civil and criminal penalties. The SOX creates new corporate offences and significantly increased the consequences of violations of the securities laws, fraud and corporate governance malfeasance54. The new offences, as well as the expanded offences, shall be discussed subsequently.

• New offences

In keeping up with trends and developments, it expands the federal criminal offense of securities fraud55 by requiring the Chief Executive Officers and Chief Financial Officers to certify financial reports for publicly traded companies.56 It creates new offenses concerning obstruction of justice relating to the destruction, alteration or falsification of records in federal investigations or bankruptcy, as well as destruction of corporate audit records.57 It goes further to state the penalties for these offences in Section 802.58 To protect whistleblowers from retaliation, section 1107 states that whoever tries to retaliate by harming whistleblowers is liable for up to imprisoned for up to

53 Ibid at section 107 (d)(1-3).
54 Ibid at section 807 and 901.
55 Ibid at section 807.
56 Ibid at section 906.
57 Ibid at section 802.
58 Ibid.
10 years.\textsuperscript{59} While section 806 provides civil remedies for whistleblowers against retaliation in a fraud case.\textsuperscript{60}

- Increased Penalties for Existing Offences

Besides creating new offences, the SOX increased the penalties on some offences which previously existed. For example, Section 903 changes the maximum criminal penalty for mail and wire fraud from 5 to 20 years and also increased the criminal penalties under the Securities and Exchange Act of 1934 from $2.5m - $25 million in some instances.\textsuperscript{61} Furthermore, section 902 of the Act sanctions any attempt or conspiracy to commit fraud not limited to bank, mail, wire or securities fraud with maximum punishments at par with the actual offense.

d) Criticisms of the SOX

Despite the intentions that motivated the enactment of the \textit{Act}, there have been divided opinions, depending on what side of the spectrum you are viewing from, on its overall positive or negative impact.\textsuperscript{62} A few years after its enactment, the effectiveness of the SOX was put to the test with the 2008 financial crises. It was deemed a failure by some for not preventing events which led to the financial crisis such as the accounting loophole which caused the Lehman Brothers scandal. This was one of the aims for which the legislation was enacted. This calls into question one of the major flaws of the rules-based approach, that is, the inability to be able to foresee and make regulations.

\textsuperscript{59} Ibid.
\textsuperscript{60} Ibid.
\textsuperscript{61} Ibid at section 806.
for every possible scenario or innovations. However, one major failure cannot be used to conclusively evaluate its relative effectiveness or otherwise.

Another major criticism of the SOX refers to it as “an unnecessary duplication of effort and cost with little corresponding benefit”. Banks at this time were already subject to regulatory control of the Office of the Comptroller of the Currency, Federal Reserve Bank, the Federal Deposit Insurance Corporation (FDIC), and the Office of Thrift Supervision, amongst others. The contention is that "some of the basic underpinnings of Sarbanes-Oxley were modeled after the Federal Deposit Insurance Corporation Improvement Act (FDICIA), a statute enacted after the savings and loan crisis of the late 1980s and early 1990s to effectuate reform among the nation's banking institutions." As a result of the duplication, requests have been made for relief from the regulatory burden of the SOX. America's Community Bankers (ACB) which acknowledging certain benefits of the SOX, argued that smaller banks such as the Community Banks do not have the human resources or afford the associated costs required to cope with the duplicative nature of the provisions of SOX. A case in point is Section 404 which directs that a bank's annual reports “include a statement that the bank's management is responsible for ensuring adequate internal control structures and procedures for financial reporting. This annual certification must be attested to by the bank's external auditor.” Banks are already required by existing banking regulations, such as the FDICIA, to carry out the exact same process. As such ACB concluded that the burdensome duplication of Section 404 saddled banking organizations with unnecessary compliance costs with

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63 Stephen Falanga, supra note 27.
64 Ibid.
65 United States Senate Committee on Banking, Housing, and Urban Affairs, Consideration of Regulatory relief proposals (Washington, D.C.: U.S. Government Printing Office, 2006) at 32. [United States Senate Committee on Banking, Housing, and Urban Affairs]
66 The ACB was a national association consisting of community banks.
67 United States Senate Committee on Banking, Housing, and Urban Affairs, supra note 65. See also, Stephen Falanga, supra note 27
68 FDICIA, supra note 14 at section 112(b)(1-2).
little corresponding benefit.\textsuperscript{69} This position was also supported by the American Bankers Association.\textsuperscript{70}

C. CANADA

Canada practices a principles-based system of corporate governance regulation. This involves voluntarily adopting guidelines with compulsory disclosure of the governance practices adopted or an explanation justifying why the company has simply chosen not to adopt the prescribed best practices. In deviating, companies may either choose to use alternative means to achieve the regulatory objective or state why they did not adhere to the guidelines entirely, otherwise they would be in violation. This is referred to as the “comply or explain” approach.\textsuperscript{71}

Canada’s system of corporate governance requirements is derived from multiple sources. On the basis of incorporation, the company may choose to be subject to federal or provincial laws. The legal framework which serves as the foundation for corporate governance in Canada is derived from common law and corporate law.\textsuperscript{72} The Bank Act\textsuperscript{73} and the guidelines published by the Office of the Superintendent of Financial Institutions (OSFI) which explain the provisions of the Act, serves as the primary framework for regulating corporate governance among financial institutions.\textsuperscript{74} Secondly, securities rules and policies of provincial securities regulators serve as another primary source of corporate governance requirements. Public companies in Canada,

\textsuperscript{69} According to the ACB's testimony, for some, there was a 75% increase in audit fees equalling as much as 20% of the bank’s total revenue. See, United States Senate Committee on Banking, Housing, and Urban Affairs, suprad note 65.
\textsuperscript{70} See, United States Senate Committee on Banking, Housing, and Urban Affairs, suprad note 65 at 29.
\textsuperscript{71} This was first practiced in the United Kingdom before spreading to many countries around the world including Canada. See, Financial Reporting Council, The UK Corporate Governance Code (2018).
\textsuperscript{74} Office of the Superintendent of Financial Institutions Canada, Corporate Governance (2018). [OSFI].
including financial institutions, are subject to the National Policy 58-201, Corporate Governance Guidelines (NP 58-201) and the National Instrument 58-101 Disclosure of Corporate Governance Practices. Additionally, stock exchange rule serves as another major source of corporate governance requirements. Most notable is the Toronto Stock Exchange (TSE) manual. The Ontario Securities Commission (OSC) which played a lead role in defining corporate governance practices is considered the dominant provincial regulatory authority because the largest public companies in the country are listed on the Toronto Stock Exchange and thereby subject to its manual. All these sources combine to create a robust system of corporate governance requirements to which financial institutions are subject. I will now review the background to Canada’s system of corporate governance regulation.

a) Development of the Principles-based Approach

The 1990s was a significant period for the development of corporate governance in Canada. Before the adoption of any policies or rules, companies generally had the discretion to adopt corporate governance practices which best suited them. Influenced by the 1992 Cadbury Report in the United Kingdom, the Toronto Stock Exchange (TSE) appointed a committee, chaired by Peter Dey, to evaluate corporate governance among Canadian companies. The committee published a set of recommendations mostly comprised of general non-binding guidelines to improve corporate governance, but stated, however, that public companies should disclose their approach to corporate governance.

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77Peter J Dey, "Where Were the Directors?", the TSE Committee Guidelines on Corporate Governance, ed (Ottawa: Department of Finance and Treasury Board of Canada, 1995). [Dey Report].
The TSE accepted and incorporated these recommendations, utilizing the principles-based “comply and explain” approach. It issued a list of best practices as well as the framework for the disclosure of corporate governance practices to serve as minimum standard; every publicly listed company was obligated to disclose its governance practices in adherence to the guidelines or explain the differences where it departed from the recommended guidelines.

The Canadian Securities Administrators (CSA), a self-regulated organization comprising of securities regulators from all provinces and territories, sought a means to harmonize the various securities regulation in the country. Following a series of negotiations with the provinces which lasted for three years, the Canadian Securities Administrators arrived at a decentralized cooperative standard for regulating governance by means of a National Policy Statement – which is a statement of rules relevant and associated with securities markets.

National Instruments are mandatory and applicable to every province and territory in Canada while Multilateral Instruments are applicable only to the provinces or territories who have agreed to the instrument. National policies are also issued by the Canadian Securities Administrators as guidelines and are voluntary. The Canadian Securities Administrators will update the policy statements periodically, while each provincial regulator would be responsible for its

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78 The recommendations were not to be binding on TSE-listed companies. See Gillies James & Morra Daniela, "Does corporate governance matter?" (1997) 61:3 Business Quarterly 71.
79 TSX Company Manual, supra note 75.
80 Thus, the first recognition of Canadian best practices emanated from the Dey Report of 1994. See, Dey Report, supra note 77. The manual in the now repealed section 474 and 475, proposed guidelines for effective corporate governance and mandated companies to disclose its level of compliance by issuing a “Statement of Corporate Governance Practices” in its proxy circular or annual report. See, TSX Company Manual, supra note 75.
enforcement. The National Policy and Instrument regulating corporate governance for public companies in Canada are as follows:

- **NP 58-201 Corporate Governance Guidelines (April 2005)**

The NP 58-201 prescribes best practices for public companies in Canada and are voluntary. It provides direction by finding a middle ground between competing interests of stakeholders while taking into account the evolving nature of corporate governance and the impact of its developments in the U.S. and around the world. The guidelines are not prescriptive, instead they are to be adopted by companies as a benchmark in personalising its governance practices. As a result, companies are to either comply with the guidelines or explain why they have not complied. These guidelines are to be adapted as required in order to be compatible with emerging trends affecting corporate governance of controlled companies.


The mandatory corporate governance requirements are published in the National Instrument 58-101 Disclosure of Corporate Governance Practices and companies must file and disclose information about their corporate governance practices in order to fulfill the

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84 Ibid.

85 Ibid.

86 Came into effect on June 30, 2005,
requirements of this instrument. These disclosure requirements are enforced by the securities commissions. Public companies may be granted exemptions from the rule by the regulatory authority.

In arriving at the National Instruments, a few alternatives were considered, including the option of employing statutorily-enacted rules to enforce corporate governance practices among companies. However, the perceived need for flexibility to match the pace of development of corporate governance and to provide appropriate guidance ensured that the National Policy was adopted. By implementing these National Instruments, Canada followed the existing trend of establishing more stringent governance.

After the inception of the national instruments, on February 22, 2005, the corporate governance provisions of the TSE Company Manual were amended. The amendments stated “that each listed issuer subject to National Instrument 58-101 Disclosure of Corporate Governance Practices, or any replacement of that instrument, will be required to disclose its corporate governance practices in accordance with that instrument, or any replacement of that instrument.” The amendment also tasked the provincial securities regulators to monitor and state measures to be taken in instances of default. The National Instrument 58-101 increases the degree and range of sanctions

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88 TSX Company Manual, supra note 75.
89 NI 58-101, supra note 87.
91 Ibid.
92 Amendments to Corporate Governance Policy, supra note 82.
93 Ibid.
94 Ibid.
applicable to issuers in events of default. In addition to the broad range of enforcement procedures, the securities commissions have established continuous disclosure review programs whereby a periodical review of the disclosure practices of issuers may require a refilling and/or an explanation where there is an omission.

b) Corporate Governance Regulation in the Canadian Banking Sector

Banks in Canada have been commended for their corporate governance practices. Besides being subject to corporate governance provisions outlined in securities rules and policies, corporate governance in banks is also regulated by the provisions of the Bank Act and the Office of the Superintendent of Financial Institutions’ (OSFI) Guidelines on corporate governance. These provisions shall be reviewed subsequently;

- The Bank Act

The Bank Act is a legislative framework which serves as the foundation for governance and enables banks to fulfill its many functions which make them essential to the economic growth and prosperity of the country. Because of the essential nature of good governance in banks, the Act makes mandatory provisions on corporate governance practices in Part VI. It makes provisions guiding shareholders and members, duties of directors, voting restrictions, corporate

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97 Salterio, supra note 82.
100 Ibid.
101 Ibid at section 136.
102 Ibid at section 157-158.
103 Ibid at section 156.
records, financial statements, auditors and states instances in which banks may be exempted from complying with the provisions of the act.\textsuperscript{104} It also states the conditions for liability, penalties, and remedies which may be available in the event of a breach of certain governance provisions.\textsuperscript{105} The measure of damages is also prescribed by the Act.\textsuperscript{106} The Act goes further to empower the Governor in Council to make regulations in order to give effect to some sections of the Act.\textsuperscript{107}

- OSFI and Corporate Governance

The financial crisis of 2008 uncovered a lot of weaknesses in the regulation of financial institutions around the world.\textsuperscript{108} Canada survived the recession and was not among the worst-hit countries,\textsuperscript{109} however, the Office of the Superintendent of Financial Institutions (OSFI) deemed it necessary that new regulatory measures and enhanced corporate governance supervision needed to be put in place.\textsuperscript{110} Corporate governance among Federally Regulated Financial Institutions (FRFIs) in Canada is regulated by the Office of the Superintendent of Financial Institutions’ (OSFI) Corporate Governance Guideline.\textsuperscript{111} The guideline was created to work hand in hand with the provisions of the Bank Act.\textsuperscript{112} The OSFI was empowered by the Parliament to ensure the conditions for success were put in place, as well as, enable more effective corporate governance of financial

\begin{flushleft}
\textsuperscript{104} For examples, see, \textit{Ibid} at section 143 (5), 270(3).
\textsuperscript{105} \textit{Ibid} at section See section 271.
\textsuperscript{106} \textit{Ibid} at section 272.
\textsuperscript{107} \textit{Ibid} at section 268.
\textsuperscript{109} The effect of the crisis on Canada was lesser than most countries and no banks failed. See, Sami Siva, \textit{supra} note 108.
\textsuperscript{110} Jeremy Rudin, \textit{supra} note 108.
\textsuperscript{111} It excludes branch operations of foreign banks and foreign insurance companies. See, OSFI, \textit{supra} note 74.
\end{flushleft}
institutions including the need to allow them to compete effectively and take reasonable risks. It opted that the best way to use this mandate is to employ principles-based regulation whenever practicable and provide boards with the flexibility to comply with those principles in a manner that best applied to the financial institution. In contrast, the OSFI believes that if it used a rules-based approach to corporate governance instead, it would encourage the boards to comply with the provisions as if it were merely a box-ticking exercise and thus, be ineffective. Due to the factors that separate banks from other non-financial entities which requires them to have a higher standard of regulation, the OSFI states that there is a need for knowledgeable, independent oversight exercised by or on behalf of the board, along with the additional assurance of regulatory oversight. According to OSFI, the principles-based approach is tailored to the size, nature, and complexity of the various financial institutions with the flexibility to set up and conduct their governance structures and practices in a manner that is suitable to them.

To achieve stated governance objectives, the principles-based approach requires companies to disclose their adherence to certain guidelines or to state methods used to achieve those same governance objectives where there is a deviation from the suggested best practices. In consideration of the dynamism of the financial industry, the OSFI needs to constantly update its corporate governance guidelines to adapt to changes in order to be more effective. Since OSFI published the initial guidelines in 2003, governance practices for federally regulated financial institutions have evolved and in order to reflect the continuing evolution of its standards, the most recent revision of the guidelines was released on September 18, 2018. One of the standout

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113 Jeremy Rudin, supra note 107.  
114 Ibid.  
115 Ibid.  
116 Ibid.  
117 Ibid.
features of the updated version is that it is more principles-based. It provides boards of directors of federally regulated financial institutions with a clearer view of their responsibilities and greater discretion as to how they meet OSFI’s corporate governance expectations. It also eliminates a few prescriptive elements of the previous guideline and consolidates expectations relating to board responsibilities set out in OSFI's capital and risk-management guidelines into the revised guideline. The guidelines in their annex further set out some more detailed expectations that should apply to every large and complex institution.

c) Criticisms of the Approach

Canada’s approach to governance is a “comply or explain” system where harmonized provincial regulations mandate disclosure of governance practices. This feature of the regime which requires provincial administrators to reach a consensus has been slated for possessing tendencies not to react or adapt quickly to vital market developments. This approach by the Canadian Securities Administrators (CSA) have also been criticized in some quarters as not having the means to ensure uniformity in regulatory enforcement throughout the provinces.

Another criticism against the approach is the dominant role played by the CSA in the evolution of corporate governance to the detriment of the legislature and the courts. Consequently, it led to minor roles being played by the judiciary and legislators in the recent development of corporate governance in Canada. This dominance of the CSA in developing corporate governance has led

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118 OSFI, supra note 74.
119 Ibid.
120 The revised corporate governance guideline kept up with the announcement made in 2016 by Jeremy Rudin about the OSFI's resolve to simplify regulation for federally regulated financial institutions.
121 OSFI, supra note 74.
123 Ibid.
124 Carol Liao, "A Canadian Model of Corporate Governance" (2014) 37 Dalhousie Law Journal at 587
to some negative public opinion, mostly centering on its intrusion into certain areas conventionally overseen by the Parliaments or the judiciary - For instance, on the subject of special approval thresholds for related-party and other transactions, concerns arose that the CSA was exceeding its authority.\textsuperscript{125} According to Carol Liao, in the words of a practitioner, “They were a specialized securities regulatory body, not a specialized corporate governance body or a corporate law body, so what business did they have in changing what the legislature had enacted in the \textit{Business Corporations Act}?”\textsuperscript{126} Some other practitioners, however, were of the opinion that there was a lacuna in the current regulations and the CSA was within its rights to fill it.\textsuperscript{127}

\textbf{D. CONCLUSION}

After examining the practical applications of the rules-based and principles-based approaches to governance in the United States and Canada respectively, a few observations have been made. Some degree of success can be achieved using either a rules-based or principles-based approach as evidenced by both countries. Corporate failures have played a major role in the development of corporate governance, however, tailoring the regulatory approaches to best suit their environment and respond to emerging trends has been key in achieving success. Further observation would also reveal that the exclusive use of principles or rules exists mostly in theory. In reality, most countries employ the concurrent use of both systems, albeit in varying degrees, in practice. Despite criticisms levied against the regulatory approaches in both countries for perceived flaws, benchmarking them against a perfect system is unrealistic and improbable to achieve. Corporate governance regulation in Nigeria can be improved by emulating certain aspects existing in these two countries. This thesis concludes in the final chapter by examining learning points and the extent to which they can be

\textsuperscript{125} \textit{Ibid} at 590.
\textsuperscript{126} \textit{Ibid}.
\textsuperscript{127} \textit{Ibid} at 591.
applied to overcome the governance challenges currently faced, as well as to sustainably develop corporate governance in the banking industry.
CHAPTER 5

A CASE FOR REFORM

A. AN EVALUATION OF THE PRINCIPLES-BASED APPROACH IN THE NIGERIAN BANKING INDUSTRY

As discussed in earlier chapters, the last two decades witnessed some level of development in corporate governance in Nigeria, especially in its banking sector. The corporate scandals, as well as the banking crisis, have served as a catalyst to speed up the development of governance frameworks to help prevent a recurrence. Various regulatory codes of governance have been established to instill best practices and regulate the financial industry. This indicates a willingness on the part of regulators to put measures in place to promote and ensure good governance practices. The success and effectiveness or otherwise of these efforts has been subject to a lot of debate.\(^1\) I do not agree that it is one or the other. I am of the opinion that at the period and in the circumstances in which this policy intervention was made, considering there barely existed any frameworks to regulate corporate governance besides company law, that it achieved some degree of success.

The solution to the corporate malaise existing in the Nigerian banking industry was the adoption of the principles-based approach. The process involved largely importing governance practices and methods as applied in other countries (most especially the United Kingdom) without adequate regard for the country’s unique environment.\(^2\) For that period, and in the circumstances, perhaps it may be excused. However, as things progressed, the scheme has encountered a fair amount of

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\(^1\) Franklin Nakpodia, "Corporate Governance in the Nigerian Banking Sector: A Bounded Rationality Conundrum" in Belén Díaz Díaz, Samuel O Idowu & Philip Molyneux, ed, Corporate Governance in Banking and Investor Protection From Theory to Practice, ed (Springer International Publishing, 2018) at 278.

challenges which not only threatens but has the capacity to undo all the work which has been done so far\(^3\). At the time when the frameworks were established in Nigeria, the provisions evidently did not anticipate the rate at which governance would develop within the banking industry. As a result, the regulatory approach failed to address and take into consideration some fundamental governance issues affecting banks in modern times. Also, the provisions did not seem to consider and instill adequate measures to cope with socio-political and economic peculiarities of Nigeria. Nevertheless, it has reached a point where stop-gaps or bare minimums will no longer suffice. I am of the opinion that a reform of the current method principles-based regulation has become necessary to enhance good governance practices in the Nigerian banking industry. In this chapter, I evaluate alternative options and make proposals on new perspectives for regulating corporate governance within Nigerian banks. To achieve this, I take into consideration lessons which have been learned from the approaches to governance regulation in the United States and Canada.

B. OBSERVATIONS AND LESSONS FROM GOVERNANCE IN THE UNITED STATES AND CANADIAN BANKING SECTOR.

A comparative analysis of the banking industry’s corporate governance framework in the United States or Canada to Nigeria’s, would reveal some notable differences in terms of regulatory approach. Canada employs a principles-based system comprising of voluntary guidelines with mandatory disclosure while the United States utilizes a rules-based approach with mandatory guidelines and mandatory disclosure. Nigeria, on the other hand, operates a principles-based system comprising of mandatory guidelines and mandatory disclosure. Irrespective of the

approach, there are some identifiable lessons which can be observed. Some of these highlight certain inadequacies of the current governance regime applicable to Nigerian banks, while some others provide an alternative approach to governance different from the current method. I would go ahead to discuss some of these observations and lessons.

One of the central questions of corporate governance is whether the laws establishing it should be mandatory or simply guides to enable the achievement of good practices. Whichever side of the spectrum you are on, a thorough analysis of the two case studies - The United States and Canada, is evidence that relative success can be achieved with either method. There is no singular structure that fits all. However, one common denominator for success or failure of either system to solve the regulatory challenges is the level of compatibility with its history, socio-economic, legal and political climate.

Similar to the United States and Canada, Nigeria operates a federal system of government. Legislation relating to corporations may be made at either state/provincial or federal level in the United States and Canada. However, in Nigeria, the creation of laws relating to corporations is under the exclusive list and only the federal government is authorized to legislate on such matters.4

In arriving at the current approach, the United States and Canada have applied a more deliberate strategy, taking into consideration the peculiarities of their environment including historical, political, social and economic factors, in arriving at the ideal means of regulating corporate governance.5 Regulation of governance in Nigeria, on the other hand, does not appear to have taken the same purposeful approach. The adoption of principles appears to have been swayed by

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the trend, as other countries were adopting the same approach, and it was becoming popular.\(^6\) There is no evidence of deliberation on the ideal approach in the circumstances, or that proper consideration was given to alternative approaches.\(^7\) This supports my opinion that the choice of the principles-based approach is seemingly more accidental than deliberate.

The United States employs a rules-based governance structure which mandates observance of statutory as well as stock exchange requirements. A principles-based system similar to that which obtains in Canada is used to regulate corporate governance in Nigerian banks. However, unlike Canada which places more emphasis on voluntary guidelines, the provisions of the Securities and Exchange Commission and the Central Bank codes of corporate governance are mandatory\(^8\) and lack of compliance with the code would invite sanctions.\(^9\) The utilization of this mechanism, in my opinion, is not the most efficient especially in light of surrounding environmental factors. The use of mandatory guidelines prevents the banks from employing any discretion, as characterized by the principles-based system, in applying the best means of complying with regulatory objectives. Also, without the strong backing of legislation to give it efficacy, it lacks the capacity to deter and provide the desired regulatory goal. For instance, the penalty for non-compliance with the guidelines, which is capped at N100,000 ($300 USD) is too lenient and hardly a deterrent.\(^10\)

Furthermore, the frameworks established to improve corporate governance within banks in Canada and the United States are centered on accountability and disclosure. They both provide for

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\(^7\) Notice, supra note 4


\(^9\) Ibid at section 8.1.3. Also see, Banks and Other Financial Institutions Act, 2 LFN 2004, c B3, s 60. [BOFIA]

\(^10\) BOFIA, supra note 9
elaborate mandatory disclosure whereas this is not the case in Nigeria. For instance, section 5.1.1 of the Central Bank of Nigeria’s corporate governance code merely encourages banks to make disclosures in its annual report beyond statutory requirements. The terminology of the guideline does very little to discourage the laxity associated with compliance within Nigeria’s corporate environment. More importantly, the code sets the minimum requirement for disclosure at par with outdated legislations - the *Companies and Allied Matters Act* (CAMA)\(^{11}\) and the *Banks and Other Financial Institutions Act* (BOFIA).\(^{12}\) Both were enacted about 30 years ago and preceded the global corporate scandals, as well as the banking crisis in Nigeria which prompted a rethink of governance practices.\(^{13}\) Going further, the Canadian Securities Administrators, for instance, raise the bar further on disclosure requirements by making provisions to regulate corporate disclosure via the internet and social media in line with current developments in communication and technology. This raises more questions about the ability of the outdated regulatory framework in Nigeria to empower regulators to tackle prevalent corporate governance issues.

Frameworks in Canada and the U.S. indicate a commitment to periodically review provisions to ensure that they meet up with modern developments in corporate governance. For instance, in the U.S., the securities commissions have established continuous disclosure review programs while the principles-based National Instruments in Canada is also designed to be flexible enough to incorporate and adapt to changes.\(^{14}\) Conversely, the guidelines on which a number of governance practices are premised in Nigeria do not reflect current realities. One aspect in which this is very noticeable is the current deterrent capacity of the *Companies and Allied Matters Act*.\(^{15}\) For

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\(^{11}\) *Companies and Allied Matters Act*, LFN 1990, c 59. [CAMA]  
\(^{12}\) BOFIA, *supra* note 9  
\(^{13}\) The *Companies and Allied Matters Act* is currently undergoing review and is awaiting presidential assent to be signed into law.  
\(^{14}\) Notice, *supra* note 4  
\(^{15}\) CAMA, *supra* note 10
instance, in section 277 (4) the CAMA prescribes a fine of N100 ($0.30 USD) for the failure of directors to disclose interests in contracts.\textsuperscript{16} Another example is the prescription of N500 (less than $2 USD) fine for the contravention of a court order brought by an application for relief on the ground that the affairs of a company are being conducted in an illegal or oppressive.\textsuperscript{17} The Act does not take into consideration the effects of economic inflation which makes the prescribed penalties, a joke. In contrast, the SOX prescribes stringent penalties for failure to comply with mandatory requirements.\textsuperscript{18} By increasing the severity of punishment, this measure serves to fulfill the deterrent aspect of punishment in which individuals balance the benefits and costs of non-compliance.

The corporate governance regime in all three countries provides for the establishment of mechanisms to monitor and enforce the guidelines. In order to give this effect, regulators delegate a sizeable portion of this monitoring duty to the banks themselves which is carried out through their respective internal control unit. In Canada, for instance, banks must not only implement and monitor internal controls over financial operations and reporting, but they are also tasked with providing additional documentation to prove that the internal control system in place is effective. In Nigeria, however, internal control systems are not as effective and there are limited or no measures in place to ensure that they are able to monitor controls without hindrance. In the absence of proper monitoring, guidelines are more difficult to enforce.

Regulatory bodies are saddled with the authority to enforce good governance practices in order to encourage compliance. Compared to the U.S. and Canada, the institutions regulating the banking

\begin{flushleft}\textsuperscript{16} Ibid. \\
\textsuperscript{17} Ibid at s.313. \\
\textsuperscript{18} Sarbanes-Oxley Act of 2002, PL 107-204, 116 Stat 745, s 906. [SOX]\end{flushleft}
sector in Nigeria are weak and less effective.\textsuperscript{19} This has led some to conclude that regulation and enforcement in Nigeria are at variance.\textsuperscript{20} To buttress the effect of weak regulatory institutions in Nigeria, Abdullahi \textit{et al.} (2010) analyzed and compared the regulatory response in the US and Nigeria using the case of Enron and Cadbury Nigeria respectively and observed that the punishment meted out in the later was lenient compared to the former.\textsuperscript{21} Furthermore, Canada and the U.S. have a wider range of penalties which may be meted out as appropriate to defaulters in order to encourage compliance unlike in Nigeria.

\section*{C. PROPOSALS FOR REFORM - AN ALTERNATE APPROACH TO GOVERNANCE}

More often than not, corporate governance regulation is discussed in terms of principle-based and rules-based approaches as competing alternatives. Nonetheless, I am of the opinion that the discourse surrounding the better system of corporate governance is most times perpetuated in idealism. First, I believe that there is not one regulatory system to fit every country or industry. Societies differ, and these dissimilarities may swing the pendulum in favor of either approach. Secondly, in reality, both systems do not function solely without the other, and most countries use legal instruments and principles to some extent, concurrently. The simultaneous use of both suggests the creation of a level of synergy between statutory provisions and self-regulatory instruments provided in codes. The combined use gives birth to a third system of regulation which would be referred to as a “Hybrid approach” for the purpose of this thesis.

\textsuperscript{20} Adegbite, \textit{supra} at note 2.
The appropriate approach is usually influenced by varying factors. For example, the 2002 corporate scandals in the U.S. served as justification for the passage of statutory regulation in the form of the Sarbanes-Oxley Act to regulate corporate governance practices by enhancing accounting practices and corporate disclosures. In contrast, Canada chose not to employ the use of legislative authority to mandate the adoption of certain corporate governance practices over the advantages provided by the principles-based system in meeting the evolving demands of corporate governance.\(^{22}\) In Nigeria, the recurring bank failures triggered the establishment of the corporate governance regulation for the banking industry. However, over the years, the principles-based approach that was adopted has become inadequate to ensure effective governance. In light of these, I shall put forth my argument and propositions for reform by analyzing the alternative approaches to corporate governance in Nigerian banks.

a) Principles-based approach - Comply or Explain

The first proposal for reform is the adoption of the “Comply or Explain” (CEP) approach. Made popular through its adoption in the United Kingdom, CEP involves the use of voluntary governance principles (often referred to as “best practices”) and mandatory disclosure. According to the United Nations Conference on Trade and Development, “there are two core elements of the comply or explain principle:

- The code applying the CEP principle is ‘soft law’, which means it is non-binding and voluntarily implemented. Listed companies are entitled to decide on their own adoption and degree of compliance with the code. Deviation from the code does not breach it; and

\(^{22}\) SOX, supra note 17. Also see, Notice, supra note 4
• No matter how listed companies implement the code, disclosure concerning the compliance or non-compliance is obligatory, with an additional explanation in the case of non-compliance.”  

On the basis of this, UNCTAD goes further to distinguish three different ways in which the principles-based approach may be applied. The first model consists of mandatory mechanisms and mandatory disclosure. This is the model which is currently used to regulate corporate governance within Nigeria’s banking sector. The CBN code prescribes governance guidelines for banks in the form of best practices, however, compliance and disclosure are mandatory. This model is not very common with corporate governance codes but typical with the rules-based approach.  

Among Canadian banks, the regime includes a voluntary mechanism in the form of prescribed best practices, but with mandatory disclosure irrespective of whether there has been compliance or not. This follows the core elements of the “comply or explain” principle and represents the second model as enunciated by the UNCTAD. The core elements of voluntary implementation and mandatory disclosure recognizes the diverse needs of various organizations and helps to prevent an inflexible ‘one size fits all’ approach. As stated by the Canadian Securities Administrators (CSA), the guidelines are not proscriptive because of the evolution of corporate governance and are flexible enough to accept effective alternatives to stated best practices. In other instances, the disclosure by the Bank may simply justify the reason for non-adherence without proffering the use of any alternative measures to comply.

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24 Ibid.  
25 Ibid.  
The third model analyzed by the UNCTAD involves voluntary mechanisms with voluntary disclosure. Disclosure is conditional upon the listed company’s decision to adopt the code or an aspect of it.

Despite the initial relative success, the current regulatory approach has not been able to prevent the reoccurrence of governance-related failures among Nigerian banks. In August 2009, the CBN bailed out eight banks with over N400 billion and dismissed the directors of these banks, accusing its executives of corporate mismanagement and poor governance practices, among others. Most recently in 2018, the license of Skye Bank Plc was revoked due to “unacceptable corporate governance lapses…and the failure to meet minimum thresholds in critical prudential and adequacy ratios.”

What does adopting the CEP model mean for the Nigerian banking industry? This implies the retention of the principles-based system of corporate governance, however, a modification of the current requirement for mandatory compliance. Although it has had its fair share of criticisms, the CEP model has been quite successful, and many countries base their disclosure requirements on it because it provides useful flexibility in code implementation. One of the major hindrances to corporate governance in Nigeria is compliance. Where compliance is not feasible, rigid and compulsory provisions coupled with the systemic weakness in place increases the likelihood of banks to cut corners, abuse processes and controls or simply “box-tick” the mandatory requirements. The CEP approach prevents this conundrum and discourages the need for corrupt practices by providing the required amount of flexibility to allow banks the “freedom of

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27 UNCTAD, supra note 22
28 Ibid.
31 UNCTAD, supra note 22
entrepreneurial action” within the confines of regulation. Studies have shown that this model encourages and indeed leads to a high percentage of compliance among organizations. Canadian banks have enjoyed stable financial systems for the last quarter of this century adopting this model.

One major disadvantage in using the CEP, however, is the existing systemic and regulatory weakness as well as socio-cultural factors associated with the “voluntary” tag. Any reform must incorporate a re-education and re-orientation of corporate governance practice and requirements in order to be able to achieve the set objectives. It is imperative that the provisions relied upon should be updated to reflect modern trends and practices in order for the principles-based CEP approach to succeed. Furthermore, the guidelines need better support, statutory or regulatory which provides for more robust disclosure mechanisms in order to be effective. Existing systemic weaknesses in legislation seem to be on the verge of improvement with the passage of the Companies And Allied Matters Act (Repeal and Re-enactment) Bill, by the Senate of the Federal Republic of Nigeria in 2018, almost 3 decades after it was first passed into law. It is necessary that adequate monitoring and enforcement mechanisms are put in place in order to dilute the effect of negative cultural and social factors associated with non-compliance or corruption.

32 Gerhard Cromme, "Corporate Governance in Germany and the German Corporate Governance Code" (2005) 13:3 Corporate Governance: An International Review at 366.
33 Quantitative analysis carried out shows that most companies tend to adhere to the comply or explain approach. See, Steven E Salterio, Joan E D Conrod & Regan N Schmidt, "Canadian Evidence of Adherence to "Comply or Explain" Corporate Governance Codes: An International Comparison" (2013) 12:1 Accounting Perspectives.
b) The Rules-Based Approach

Proponents of the rules-based approach to corporate governance contend that mere guidelines are inadequate and that for principles to be effective, they must be required and monitored by law with stringent penalties attached in the event of a breach. Consequently, the second proposal for reform is that in order for corporate governance regulation to succeed in the Nigerian banking sector, it must reflect a rule-based approach. To achieve this would imply that guidelines such as those currently contained in the codes must be enacted through legislation to gain the full backing of the law.

What does adopt a rules-based system mean for Nigerian banks? Embracing this alternative implies increased government involvement in corporate governance regulation of banks. This involvement by the application of legislation is substantiated based on the pivotal role played by the banking industry in the economy of the country and, concern over the well-being of the banking industry which emanates from the duty entrusted to banks to manage funds owned by the general public.

There is a contention that where substantial governance challenges exist, the rules-based system is the more suitable mechanism for dealing with and providing solutions particularly in the short-term. Several challenges already identified in this thesis as existing in Nigeria’s banking industry are in need of a quick fix and thus, justify the need for rules. The rate of bank failures in Nigeria due to weak corporate governance practices is unacceptable. This indicates the current regime may

be a bit too lax in addressing the defects. The adoption of rules would send out a strong signal that 
would serve as a deterrent for non-compliance and ensure the benefits of good corporate 
governance is achieved.

In addition, rules would create more explicit guidelines, free from the ambiguity associated with 
the enforcement of principles-based regulation, as well as proffer stiffer penalties to discourage 
poor governance practices. A re-examination of the bank failures which have occurred since the 
adoption of the principles-based approach to regulate governance in the Nigerian banking industry 
would reveal that barring dismissal from office, a number of CEOs and directors accused of 
corporate malpractices have been let off the hook.\textsuperscript{38} This grossly disproportionate reaction is partly 
because the current approach does not contain penalties which are stringent enough to encourage 
compliance, and even at that, several of the punitive measures are either outdated or grossly 
inadequate. Also, the current system in place has little information about the enforcement 
mechanism for governance-related regulatory infractions. Stressing the importance of rules-based 
governance, there is also agreement in some quarters that owing to social and cultural factors, the 
term “voluntary” would further impair compliance and facilitate the maneuvering and abuse of 
processes and controls.\textsuperscript{39} Rather, the certainty of enforcement derived from mandatory rules would 
be more effective in compelling compliance.

As it is, there are no provisions in the \textit{Central Bank Act} or the \textit{Banks and Other Financial 
Institutions Act} that address key governance issues such as independent board configuration, risk 
management or whistle blowing just to name a few. For this reform proposal to be effective, there 
is an utmost need to update current legislation to include current trends while making provisions

\textsuperscript{38} CBN Polaris, \textit{supra} note 29
\textsuperscript{39} Fidelis Ogbuozobe, "A consideration of the impact of the Companies and Allied Matters Act (1990) and the 
Journal of Law and Management 337.
for future developments in governance. Measures must also be put in place to plug lacunae, and
where that is not possible, confer discretion to the appropriate regulatory authority to rule on novel
or grey areas. It is imperative to cover loopholes which can be exploited to minimize or avoid
prosecution. Likewise, offenders should be punished severely enough to discourage infractions or
unethical practices, with sanctions designed in a manner in which the benefits accrued through
non-compliance does not outweigh or compensate for the penalty.

c) Hybrid Approach

Despite the obvious benefits of the principles-based comply or explain approach or the rules-based
approach, they present a fundamental concern in the Nigerian context, which if exploited, makes
them less ideal for regulating governance within its banking sector.\(^{40}\) For instance, notwithstanding
the human inability to cater for every possible governance infraction, the rules-based approach
may also lead to bureaucracies or encourage box-ticking to undercut the system. Similarly, the
lack of certainty attached to the enforcement of principles may encourage the use of weak
explanations to fulfill the emphasis placed on disclosure in order to prevent shareholder or public
backlash against the bank. The limitations of both approaches, exacerbated by innate systemic
weakness which exists not only in the banking sector, but the country in general, makes a case for
reform of the current regulatory approach to corporate governance in the Nigerian banking sector.
The recurrent bank failures provide evidence to support the assertion that Nigeria may not capable
of implementing similar corporate governance regimes which have been successfully applied in
developed countries.\(^{41}\) Rather, its peculiarities should influence the variations in measures which

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\(^{40}\) Eddy Wyneersch, "The Enforcement of Corporate Governance Codes" (2006) 6:1 Journal of Corporate Law
Studies 113 -138. Also see, Adegbite, \textit{supra} at note 2.

\(^{41}\) Factors such as corruption weak regulatory systems as elements which limit the application of these
approaches in Nigeria. See, Adegbite, \textit{supra} at note 2.
are necessary to improve corporate governance within.\textsuperscript{42} In this context, and in view of the shortcomings, the adoption of either a principles-based or rule-based approach may be suboptimal. Therefore, to harness the individual advantages of both approaches whilst mitigating the flaws, this thesis proposes a unique approach borne out of a combination of both principles and rules-based systems.

One may ask how this proposed reform is any different from what already obtains in Nigeria considering corporate governance in Nigeria’s banking industry already comprises of the use of rules in the form of legislation and principles enshrined in governance codes? A study of the current regulatory approach would reveal a system borne out of accident rather than design. There is no evidence of any strategy or intent to create a synergy leveraging the strengths of both systems either in the regulatory text or in action. The legislation relied upon to give the codes legal backing contain limited governance provisions, include outdated penalties, and do not reflect modern developments in governance. On the other hand, the proposed hybrid formulation is a more purposeful approach. It involves a deliberate strategy to harness the strengths of both systems in regulating aspects of governance in which they would be better-suited.\textsuperscript{43} The approach is designed to create a form of symbiosis rather than one approach piggy-backing the other.

Attributes of both approaches are essential in Nigeria’s banking industry. The paradoxical requirement of flexibility to meet the evolving trends in governance practices as well as sufficient rigidity to ensure consistency. Another important advantage of this approach is that it fosters cooperation by making both government and industry regulators, problem-solvers.\textsuperscript{44} According to


\textsuperscript{43} Wymeersch, supra note 39.

\textsuperscript{44} Dennis D Hirsch, "The law and policy of online privacy: Regulation, self-regulation, or co-regulation?" (2011) 34 Seattle University Law Review.
Adegbite, more government involvement through statutory enactments regulating governance would realize more advantages in the short term while elements of the principles-based approach are necessary to achieve the long-term goals of sustainable good governance practices.\textsuperscript{45} Different strategies may be employed to carry out this proposed hybrid approach effectively. For instance, the initial strategy may involve applying a predominantly rules-based approach to achieve certain short-term goals, with gradual inclusion of principles into the regulatory framework, then as rules become norms, transformation to a largely principles-based system that caters for longer-term goals. This balance between the utilization of the “comply or explain” approach and the use of statutory regulation should be flexible enough to change over time as may be required.\textsuperscript{46}

Notwithstanding the strategy utilized, this innovative approach must recognize the peculiarities and characteristics of the banking environment in order to provide for efficient collaboration between principle-based and rule-based regulation. Additionally, irrespective of the success achieved, transplantation of corporate governance regulatory practices contextually from more developed countries may not automatically lead to sustainable development in Nigeria’s banking industry especially where the mechanisms for achieving it are substandard, non-existing or beleaguered by unique challenges such as corruption. There are notable distinctions between the Nigerian banking environment as well as incentives for compliance compared to developed countries. According to Adegbite “in formulating corporate governance regulatory strategies, countries must account for their specific circumstances. These include relevant historical

\textsuperscript{45} Adegbite, \textit{supra} at note 2.
\textsuperscript{46} For instance, Turkey changed the regulatory approach to a more rules-based approach. See, "OECD Corporate Governance Factbook", (2017), online: \texttt{Oecdorg<https://www.oecd.org/daf/ca/Corporate-Governance-Factbook.pdf>}. 
perspectives; corporate ownership structures and characteristics; cultural norms and values; socio-
political and economic climates; and the ethical environment of business conduct.”

The impact of a country’s idiosyncrasies on the efficacy of the adopted approach to corporate
governance regulation cannot be overstated. It is important to consider these factors in order to
ensure that the recommended hybrid approach is perfectly situated to address the regulatory
challenges facing the banking industry. For instance, due to low-level education and poverty
which exists in the country, it is not uncommon to find people resorting to any means necessary to
earn a living. This includes participating in corrupt practices which even though frowned upon,
has gradually been accepted by most people as a norm in the society. For this reason, the ideal
approach requires that explicit rules and stringent penalties are put in place and strictly enforced
to check any corrupt tendencies and to serve as deterrents.

The recurrent bank failures typify the economic struggles of Nigeria. Without doubt, a stronger
banking industry would significantly improve the country’s economic growth. The ideal
governance approach should also ensure that banks are best positioned to follow beneficial global
trends. In circumstances were time is of the essence, the time-consuming and overly bureaucratic
nature of Nigeria’s law-making bodies means legislation may prove to be less effective. For
instance, there are currently no legislative provisions guiding corporate disclosures made over the
internet or social media in Nigeria. Corporate records filed with the Corporate Affairs Commission
are poorly kept and hard to retrieve which makes access to reliable information a difficult task.

Often times, one is left with no choice other than to pay some money as bribe to achieve any
results. In this modern age of technology and communication, it has become necessary to adopt
best practices which address this concern. The most obvious in this case is to expand the

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47 Adegbite, supra at note 2 at 258
requirement for corporate disclosure in Nigeria to include information disseminated through the internet. There is a need to provide continuous disclosure guidance in order to ensure consistent, high-quality disclosures regardless of the medium by which it is made. Furthermore, a governance policy regulating affairs such as the authorization to make disclosures on behalf of the bank via the internet, is also necessary. This ensures that reliable information is easily disseminated and accessed at an even greater reach.

D. RECOMMENDATIONS

The object of this study was to create an inquiry into the most appropriate approach to corporate governance regulation in the banking industry, and in view of the foregoing proposals for reform, the hybrid approach appears most suited to achieve that objective. In integrating elements of both alternative approaches, it is able to create a unique response to the challenges facing corporate governance regulation in the industry. I believe it has become necessary for reform and my recommendations for carrying out the restructuring are simple.

- First, the adoption of a hybrid approach which combines features and the advantages of both principles-based and rules-based regimes;
- An enhancement of accountability and the establishment of more robust disclosure requirements is also necessary;
- An update of the statutory and regulatory frameworks for governance to not only reflect current practices but with sufficient flexibility to be able to integrate and accommodate future developments in corporate governance;
- Lastly, the improvement of monitoring and enforcement mechanisms which currently exist.
It is only when these corporate governance mechanisms are truly functional that the banking industry can fully achieve its pivotal position as the driver of the country’s economy.
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