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Moderating Effect of Contraventions on Regulatory Requirements and Performance of Deposit Money Banks in Nigeria

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Abstract
A deposit money bank provides the mechanism for sourcing and allocation of financial resources towards the promotion and sustenance of global economic development. Meanwhile, banking operations are strictly regulated by extant laws, rules, regulations, and instruments that facilitate financial flows of which lack adherence to these tenets have resulted in payments of huge penalties for infractions to the regulatory authorities over the years leading to sub-optimal performance. This study adopted an ex post facto research design. Validated data used for the study was extracted from audited financial statements of ten (10) DMBs and made use of pooled and panel regression across the ten (10) deposit money banks in Nigeria to analyze the data. Findings revealed that the ρ-value of F-statistics of 0.00, which is significant because it is less than the chosen significance level of 5%, and the value of adjusted R-squared of 0.2018 explains the power of the explanatory variables. This implied that contraventions have a moderating effect on the relationship between Regulatory requirements and Performance (Perf) of selected deposit money banks in Nigeria.

Keywords: Contraventions, regulations, compliance and bank performance.

Introduction
1.0 Background
Banks in most economies are the principal depositories of the public's financial savings, the nerve center of the payment system, the vessel endowed with the ability of money creation and allocation of financial resources and conduit through which monetary and credit policies are implemented. Meanwhile, legislation was absent in the Nigerian banking system from August 1894 that marked the establishment of commercial banking in Nigeria to 1952 when the banking ordinance was enacted. This period was regarded as the first banking era but was characterized by tremendous failures of several banking institutions in Nigeria (Okpara, 2009). The intermediation function of banking institutions requires mobilization of resources from surplus units in the form of deposits, and allocating these funds to deficit units, that is those who need it for borrowing and/or for making productive investment opportunities at a competitive rate of returns (Teshomeet. al, 2018). To perform its intermediation function, financial institutions need to be liquid and at the same time be profitable enough (Asfaw, 2018). However, Okoye and Richard, (2013) posited that, there are daily reports of how Nigerian banks are exploiting their customers through various excess charges and sundry unethical practices. Most often-times, this has attracted customers complain and demand for appropriate regulatory intervention but unfortunately, their complaints seem to fall on deaf ears, because of lack of any positive regulatory action that will address their yearnings. Also, Okafor (2011), asserted that when a customer secures loan from a bank, the latter fixes a negotiated lending rate based on the prevailing interest rate approved by the Central Bank of Nigeria and in case of any change in the interest rate earlier agreed, this should be communicated to the borrower except otherwise agreed in Nigeria. Meanwhile, the lending rate is rarely negotiated and, when it is reviewed upwards by the CBN, the average bank automatically applies the new rate to the outstanding loan without notifying the borrower. Ironically, the same bank hides the fact of any downward review of the lending rate from its

mostly uninformed customer, thereby illegally subjecting the customer to an alleged higher interest regime.

The Central Bank of Nigeria (CBN) in 2015 imposed a total of N2.978 billion penalties on deposit money banks for failure to remit public sector funds into the government treasury single account (TSA) apart from other fines. These huge amounts paid as fines and penalties by banks have been predicted to increase as the years go by, thus, questioning the ability of fines in deterring wrongdoings (Yusuff & Ekundayo, 2019). Therefore, the need for compliance with banking requirements has thrown up several challenges on bank risk management policies and penalties for infraction of regulations by banking operators in the banking and financial services industry thus Oji (2019) posited that banks shareholders have bemoaned the huge fines slammed on Nigerian banks by the regulatory authorities as the penalty for various contraventions during the 2018 financial year. Their disapproval comes as seven banks - GT Bank (24million); Access Bank (N20 million); United Bank for Africa (UBA), (N30 million); FBN Holdings (N32.65 million); Sterling Bank, (N15.33 million); Fidelity Bank (13.01); and Zenith International Bank (10 million), all quoted on the Nigerian Stock Exchange (NSE), paid about N145 million in fines to regulators in 2018 for various offenses. The fines were paid to the Central Bank of Nigeria (CBN), the Securities and Exchange Commission (SEC), the Financial Reporting Council of Nigeria (FRC), and the Corporate Affairs Commission (CAC). However, the body of Nigerian shareholders association has argued that the imposition of penalties on contraventions has impacted negatively the bottom-line of banks which was presumed to have affected their dividend payout and therefore urged the regulators to work out other ways of sanctioning them.

Therefore, the main objective of this study is to evaluate the moderating effect of contraventions on bank regulations and performance in Nigeria.

1.1 Hypothesis Development

As advocated by Becker (1989), corporate penalties ‘should be a multiple, rather than simply equal to, the harm caused’. This is because allowing companies to pay for only the damages caused makes deterrent ineffective because only companies caught will be fined. In justifying the size of fine, Becker (1974) posits that criminals rationally compare the benefits of their crime and the cost such as the probability of apprehension, conviction, and punishment against their current set of opportunities. He further argued that the cost of increasing fine is trivial when compared to the cost of increasing surveillance, thus, the best policy is to maximize the fine and minimize surveillance. Thus, financial sanctions should be such that it will harm the budget of the violating firms to serve as punitive measures at the same time as a deterrence mechanism. Based on the above arguments, the study, therefore, hypothesized that: Moderating effect of contravention on regulatory requirements and performance of DMBs Nigeria is not significant.

2.0 Literature Review

2.1.1. Bank performance

Bank performance according to Okafor (2012) depends on the level of efficiency exhibited in the application of human, financial, and material resources available to a bank. It is, however, a known fact that the management of banks does face several risks in the process of managing the resources available to their respective banks. Hence, Okafor (2012) added that banks operate on the premise of minimizing risks since any bank that assumes all risks cannot adequately serve the credit needs of her customers and in the long run, may not be able to respond appropriately to the demands of economic development owing to liquidity and capital adequacy problems. Also, Yeboah and Mensah (2014) posit that an array of performance indicators is necessary to expose the different aspects of the performance of a bank. Performance in banks encompasses specific areas of firm’s outcomes: (a) financial (profits, net interest margin, return on assets, operating income, profit before tax, return on capital employed, retained earnings); (b) market performance (sales, market share); and (c) shareholder return (total shareholder return, economic value added (Sowunmi, Eleyowo, Salako & Oketokun, 2015). In the same vein (Ezike, 2013) asserted that the principal objective of banks is earning more profits and this is essential for paying corporation tax like any other company, paying interest to depositors, wages to staff members, dividends to shareholders and meeting other expenses. Similarly, Otieno and Onditi, (2016) posit that different stakeholders of a bank see a performance from different perspectives. Depositors are more likely to be concerned with the bank’s long-term capability to ensure their savings; equity investors are concerned about bank’s profitability while creditors pay more attention to how the bank can repay its financial obligations.

In the global economic system, banks are the largest owner of financial assets Oladejo and Oladipupo, (2011) which makes them an important element of firms’ operations in the real sector as a performance of banks tends to have a direct impact on the development and stability of the economy (Greenberg & Simbanegavi, 2009). Thus Bassey, Tobi, Bassey, and Ekwere (2016) posited that finance in a banking system is as important as blood in the human system and adequate circulation of it in the body means the human system will function well resulting into good health while its inadequacy will also mean that human system will be weak.

2.1.2. Contraventions

Over the years, banking regulators have been monitoring compliance, and where non-compliance is found banks are penalized. Penalties take the form of monetary or non-monetary: monetary penalties are paid from the income generated by these banks, therefore, expected to have an impingement on their overall profitability (Yusuff & Ekundayo, 2019). According to Slater (2015) twenty (20) of the world’s biggest banks have paid fines and compensation to the tune of $235 billion in the last seven years, which is believed to have affected capital rebuilding efforts, dividend payout and capacity to lend. In research conducted by Conduct Costs Project (CPP) Research foundation using data from twenty (20) global banks drawn from the UK, US, France, Germany, Switzerland, Australia and Netherlands covering the period 2011-2015 reported £252.25 billion total cost and provisions relating to fines and penalties (CCP,2016). Similarly in the UK, FTSE 100 financial companies spent £12.6billion in settlement for legal and regulatory penalties in the 2014 fiscal year. These penalties are for offenses like manipulation of Libor, forex, Isdafix, and precious metals rates, mis-spelling payment-protection insurance, money laundering violations, and client money failings (Fortado, 2015).

Fines and legal settlements were paid by US global banks since the financial crises amounted to $162.2 billion (Stabe and Stanley, 2015). The South African Reserve Bank (SARB) imposed financial penalties to the tune of R15 Million on two banks in the 2015 financial year for non-compliance with Know-your-customer and not reporting cash-threshold transactions above limits (Banking Supervision Department, 2015). In his assessment, Tella (2019) asserted that banks do weigh the cost of complying against paying penalty and decide to pay if the former is quite high as there would be a time the banks would prefer to pay penalty than lend to the agriculture sector because of the failure of many farmers to pay back due to bad weather, long gestation period and possible mismanagement. He further stated that this development is attributed to delay in responding to requests by some banks due to unnecessary bureaucratic measures. Igbrude (2019), stated that shareholders were not comfortable with the various fines paid by the financial institutions as no company would decide to break the law to pay penalties unless such act must have brought some unseen benefit otherwise why would management do that when they know the reputational risk associated with it and couple with queries that would come from shareholders at Annual General Meeting?

2.1.3. Banking Regulatory Requirements in Nigeria

Regulation of banks has been defined as a body of specific rules or agreed with behaviour either imposed by some government or other external agency or self-imposed by explicit or implicit agreement within the industry that limits the activities and business operation of financial institutions (Ogunleye, 2010). The banking industry is highly regulated to ensure discipline, discourage misconduct and to protect the interest of depositors, investors, and creditors on one hand while elevating the integrity and reputation of the system on the other hand (Zeidan, 2012). Similarly, the necessity for regulatory requirements in the economy has traditionally been justified by the need to correct market imperfections and unfair distribution of resources, hence, the main objective of regulations pursuit of stability, equity of resource allocation and efficient use of resources (Adam, 2009). The use of regulatory instruments is to inform and improve policy formulation and decision-making has various dimensions and an array of tools must be deployed in a consistent and mutually supporting manner if systemic quality improvement is to be assured. The tools include regulatory impact analysis, the consideration of regulatory alternatives, and administrative simplification for compliance purposes, regulatory transparency, and ex-post evaluation of existing regulation (Deloitte, 2015). Therefore, policymakers continue to seek new ways to rectify the damage caused to economies due to the failures of financial institutions by adopting a large set of regulatory reforms (KPMG, 2016). Besides, Abdullahi (2015) posited that reform of the regulatory and supervisory framework is aimed at aligning the institutional framework governing the regulation and supervision of financial institutions to the needs of a growing and complex financial system. It involves issues of regulating independence, risk-focused, and rule-based supervision while safety arrangements in reforms embrace the traditional lender resort role, deposit insurance arrangement which caters to prudential regulation and supervision.

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2.0 Theoretical Review

2.2.1. Liability management theory holds that it is unnecessary to adhere strictly to traditional standards since reserve money can be borrowed or obtained in the money market using short term debt instruments whenever a bank experiences reserve deficiency. However, it does not mean that the bank manages only its liabilities and but passive concerning its assets as the theory continues to recognize that the asset structure of the bank has a prominent role to play in providing the bank with liquidity. The drawback of this theory is that liability management theory does not depend on a particular theory but rather hybrids of theories that are usually employed to obtain optimality.

2.2.2. Empirical Findings Review

Osaka et al (2004) studied the impact of regulatory sanctions imposed on deposit money banks in Nigeria for their non-compliance with foreign exchange guidelines. Similarly, several studies on regulatory sanctions are concentrated in developed countries and also across industries. Zeidan (2012) study used data from the US banking industry while Osaka et al (2004) studied the banking industry in an emerging economy. Osaka et al (2004) study is limited to sanctions arising from the violation of foreign exchange guidelines. Some other studies such as Zeidan, (2012) have examined the effects of illegal corporate; Seuraj and Watson (2012) studied compliance with regulations while Finnerty et al (2016) examined effect of corporate fraud on financial performance. Armour et al (2011) examined the impact of regulatory sanctions on reputational damage and; (Kirat and Rezaee, 2015) studies regulatory sanctions on firm reputation. Nourayi (1995) posited that other scholars have studied SEC enforcement; while Karpoff et al, (2008) identified payment of penalties on financial reporting violations and corporate crime on stock market Song and Han, (2015). Also, Murphy et al (2009) examined corporate misconduct on changes in profitability and risk and Xi (2016) reviewed the impact of violation disclosure on the firm value.

Seuraj and Watson (2012) in their study on regulatory contraventions, applied a panel fixed effects econometric estimator model while studying whether compliance by an individual commercial bank in Trinidad & Tobago with the Basel Core Principles (BCP) 6-15 for effective banking supervision brings about any measurable improvement in its performance and found that effective Banking Supervision do brings about measurable improvement in banking performance. Though GDP growth, inflation, and loan loss provision affect firm performance; exchange rate; prime lending rate and operating cost ratio have a limited and insignificant impact.

3.3.0 Methodology

3.3.1. Research Design

This study adopted an ex post facto research design. The data used for the study was extracted from audited financial statements of ten (10) DMBs understudy as they were officially processed, compliant; and approved by the Central Bank of Nigeria and tax authorities including Financial Reporting Council (FRC) and found suitable for the general purpose of the public, corporate entities, rating agencies, researchers and governments.

3.3.2. Method of Analysis

The study employed a quantitative method of analysis with the aid of STATA Statistical package software. The study made use of pooled and panel regression across the ten (10) deposit money banks in Nigeria to analyze the data collated in a bid to examine the moderating effect of contraventions on the regulation and performance of banks in Nigeria. Descriptive analysis of mean, maximum, minimum, skewness, kurtosis and probability of Jarque-Bera statistic for the secondary data was the first analysis done to find out the average values and standard deviation of both the contraventions dimensions and bank performance variables within the ten (10) Nigerian banks used for the study. In selecting between the two types of panel estimation techniques, the Hausman test was conducted. Also, the hypotheses in this study were analyzed using simple, multiple, and moderating regression methods of analysis wherein tests were conducted at a 5% significance level. The model specified in this study was estimated using both ordinary least square (OLS) pooled and panel least square (PLS) estimation of regression analysis. The VIF test for multicollinearity and while heteroskedasticity was to test for the presence of heteroscedasticity is conducted for each OLS regression models while the Fixed and Random effect estimation techniques were used for our panel regression analysis.

4.0. Analysis of Data

4.1. Moderating Effect of Contraventions on Regulatory Requirements and Performance of Deposit Money Banks in Nigeria

Hypothesis (H_0): There is no significant moderating effect of contravention on the relationship between regulatory requirements and bank performance of selected deposit money banks.

perf = 0.0060072 + 0.159846RegR -0.0121145contr – 0.0850016w

Table 1: Hypothesis (H_0): Moderating Effect of Contraventions on Regulatory Requirements and Performance

Method	**PCSE**		
Variables	**Coeff**	**z-stat**	**Prob**
REGREQ	0.159846	1.29	0.199
CONTR	-0.0121145	-0.16	0.876
W	-0.0850016	-0.19	0.851
Constant	0.0060072	0.05	0.956
R-squared = 0.0179, Wald $chi^2_{(3)}$ = 2.47; Prob > chi^2= 0.4815			
Hausman Test: $Chi^2_{(3)}$ = 0.80 Prob> chi^2 = 0.8494			
Breusch-Pagan LM Test: $Chi^2_{(1)}$ = 25.17, Prob> chi^2 = 0.0000			
Breusch-Pagan/ White Test: $Chi^2(8)$ = 2.92, Prob> chi^2 = 0.9393			
Wooldridge Test: $F_{(1, 9)}$ = 4.769, Prob. >F = 0.0568			
LRAI Test: R-Squared = 0.2823, Adjusted R-Squared = 0.2018; F (9, 107) = 4.327, Prob > F = 0.0000			

Dependent Variable: Performance (Perf) **Significance @ 5%**

4.2. Interpretation

The Hausman result shows that the random-effects model is the best estimate considering the probability value of 0.8494 which is greater 0.05 significant levels; also, the LM test confirmed the result of Hausman that random effect existence with a significant ρ-value of 0.00. Breusch-Pagan/ White Test revealed that there is no heteroskedasticity problem in the model looking at the ρ-value of 0.9393 being insignificant as the null hypothesis specifies that the model is homogeneous; likewise, there was no serial correction as depicted by the result of the Wooldridge test with the ρ-value of 0.0568, which is insignificant and aligned the null hypothesis which states that no serial autocorrelation; thus the model was estimated using Random Effect GLS regression estimates as presented in Table 4.3.7. Also corrected R-Squared and

Adjusted R-squared were calculated using Linear Regression for Absorbing Indicators (LRAI).

The probabilities and the signs of the z-statistics as presented in Table 4.3.7 showed that regulatory requirements dimensions (REG REQ) having z-statistics of 1.29, which is positive and ρ-value of 0.199, which is greater than chosen significant level of 5%, means that REG REQ has an insignificant positive effect on Performance (Perf); Contrarily, Contraventions (CONTR) with z-statistics of -016, which is negative and ρ-value of 0.876, which is greater than chosen significant level of 5%, evidenced that CONTR has an insignificant negative effect on Performance (Perf); likewise, Moderating Variable (W) having z-statistics of -0.19, which is negative and ρ-value of 0.851, which is greater than chosen significant level of 5%, evidenced that (W) has an insignificant negative effect on Performance (Perf).

Following the ρ-value of F-statistics of 0.00, which is significant because it is less than the chosen significance level of 5%, it evidenced that Contraventions have a moderating effect on the relationship between Regulatory requirements and Performance (Perf) of selected deposit money banks in Nigeria. The value of adjusted R-squared of 0.2018 explains the power of the explanatory variables. It simply means that a variation in the combined powers of the explanatory variables (REG REQ, CONTR, and W) would lead to 20.18% variation in the explained variable, that is, Performance (Perf), while the remaining 79.82% changes that could occur in Performance (Perf) resulted from other factors that are not captured in this model.

4.3 Decision

Therefore, the null hypothesis which states that there is no significant moderating effect of contravention on the relationship between regulatory requirements and bank performance of selected deposit money banks.is hereby rejected while the study accepted the alternate hypothesis that there is a significant moderating effect of contravention on the regulatory requirements and bank performance of selected deposit money banks in Nigeria.

4.4. Discussion

The result shows an overall statistical significance with p = 0.006 ($p<0.05$) which confirmed that banks are always reluctant in making payments out of their profit for contraventions. As a matter of banking practice, most banks have zero tolerance for infractions. Tella (2019) posited that preference of banks to pay penalty instead of complying with CBN directive was an age-long problem as banks do weigh the cost of complying against paying penalty and can decide to pay if the former is quite high and further there was a time the banks would prefer to pay penalty rather than lend to the agriculture sector because of the failure of many farmers to pay back due to bad weather, long gestation period and possibly mismanagement which he attributed the development to delay in responding to requests by some banks due to unnecessary bureaucratic measures. However, increasing the contravention fee may not be helpful but a meeting of the stakeholders in the banking sector arranged by the CBN should also be helpful (Oji, 2019). Also, Osaka et al (2004) studied the impact of regulatory sanctions for non-compliance with foreign exchange guidelines by banks in Nigeria on performance. Most of these studies are concentrated in developed countries and across industries. Zeidan (2012) study used data from the US banking industry while Osaka et al (2004) studied the banking industry in an emerging economy. Osaka et al (2004) studies are limited to sanctions arising from the violation of foreign exchange guidelines. Besides this, most banks often do not report their contraventions for fear of reputational damage, and besides, where such are reported the penalties paid were debited or hidden in other expenses in the statement of comprehensive income when reporting in their annual financial statements.

4.5. Findings and its Implications

The result of the seventh model shows an overall statistical significance with p = 0.006 ($p<0.05$) which implies that the moderating effect of contravention on the relationship between regulatory requirements and bank performance of selected deposit money banks in Nigeria. The result suggests that banks should pay more attention to compliance matters to improve their performance. As a matter of banking practice, most banks do have zero tolerance for infractions as payments for contraventions are usually drawn out of their profit and this will negatively affect shareholders' dividend pay-out and future value of investments. The study will assist the financial system to find its rhythm, consistencies, and stability if the regulatory requirements are scrupulously followed.

5.0 Conclusion and Recommendation

Empirically, banks survive more during regulation than deregulation regime. Therefore, the absence of strict compliance with regulatory laws and extant banking policies, incidents of creative accounting, abuse of trust, lack of ethics, and professionalism have hindered to a large extent the effective performance of deposit money banks in Nigeria. Also, several regulatory agencies that exist in the banking industry are playing more of an overlapping role than complementary roles, hence, the need for CBN to streamline their activities for effective monitoring of the banking system. Most often banks do not report their contraventions for fear of reputational damage and where such are reported, the penalties paid were either debited or hidden in other expenses in the annual financial statements. To prevent incidents of creative accounting that usually shield unethical financial dealings, hence, it is recommended banks must accurately report every item of infractions to enhance transparency and probity. Also, it will in the best interest of banks to enforce and monitor zero-tolerance policies on their staff for infractions that can attract payment of penalties.

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