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# THE UNFINISHED REVOLUTION IN THE BANKING SYSTEM

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## Outline

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- i. Introduction
- ii. The Banking Sector Of Yesterday
- iii. The Revolution: Vision, Agenda and Strategy
- iv. We Have Come A Long Way: Outcomes
- v. The Unfinished Business

## I. Introduction....

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**Finance Plays Key Role In Economic Growth:**

- There is a substantial body of literature on the link between finance sector development (FSD), and economic growth and poverty reduction (King and Levine, 1993), (Levine and Zervos, 1998), (Rajan and Zingales, 1998) and (Levine, Loayza and Beck, 1999).
- Calomiris and Mason (2003) estimated an elasticity of real income growth to bank loan supply growth of 45% where a one standard deviation decrease in loan growth over three years (17.9%) reduces output growth over three years by about 7 percentage points.
- Strong correlation between output and credit.

## I. Introduction....

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**Rationale For Developing The Banking System**

- Mobilization of deposits and intermediation – Redistribution of funds from surplus spending units to deficit spending units.
- Implementation of monetary policy – channel through which monetary impulses are transmitted to the real economy.
- Funding of infrastructural development.
- Improvement in the payment system
- Employment generation.
- Financing Investment in the real Sector
- Facilitate Trade Financing

## I. Introduction....

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- Banking sector as the financial system in Nigeria
  - Banks have been the main sources of financing in the Nigerian financial market.
  - Bank loans were the predominant sources of debt financing in the economy

## II. The Banking Sector Of Yesterday....

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- The statutory capitalisation requirement for Nigerian banks was N1 billion expected to rise to N2 billion by end of 2005.
- Total capitalisation of all Nigerian banks stood at N293 million, which was just the size of the No. 4 in South Africa
- No Nigerian bank could finance major transactions in the growing oil & gas and telecom sectors
- No Nigerian bank was in the top 1000 in the world

## II. The Banking Sector Of Yesterday ....

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- Prior to 2004, the Nigerian banking system could not deliver on its defined roles and was characterized by:
  - Low aggregate banking credit to the domestic economy (18.4% as percentage of GDP)
  - Systemic crisis – Banks were frequently out of clearing
  - Inadequate capital base
  - Oligopolistic structure - 10 (out of 89) banks accounted for over 50% of total banking system asset
  - Poor corporate governance
  - Low banking/population density - 1:30,432
  - Payment system that encouraged cash-based transactions
- *Clearly, Nigeria's banking system was ill-suited for the task at hand*

## II. The Banking Sector Of Yesterday...

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- The choice was between the 'evolutionary' and 'revolutionary' approaches to banking reforms
  - The ground to cover was just too large for the evolutionary approach
  - The potential losers in the impending reform had the capacity to scuttle a long drawn out reform programme
  - Previous attempts at the evolutionary approach did not yield much results

### III. The Revolution: Vision, Agenda & Strategy

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#### The Vision:

- To implement a revolutionary transformation of the banking system to achieve the following objectives:
  - Establish a banking system that will rapidly drive Nigeria's economic growth and development
  - Integrate the Nigerian banking system into the global financial system
  - Target at least one Nigerian bank in the top 100 banks in the world within the next 10 years
  - In the long term make Nigeria Africa's financial hub
  - To create a new CBN for the 21<sup>st</sup> century that is best managed and most effective

### III. The Revolution:

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#### The 13-point Reform Agenda

- Announced on 6<sup>th</sup> July, 2004 with the key elements as follows:
- Minimum capitalisation raised to N25 billion on or before end of December 2005
- Consolidation of banks through mergers and acquisition
- Adoption of a risk-focused and rule-based regulatory framework
- Adoption of zero-tolerance in the regulatory framework, especially in the area of data/information rendition and reporting
- The automation of the process of rendering returns by banks and other financial institutions through the e-FASS
- Strict enforcement of the contingency planning framework for systemic banking distress

### III. The Revolution:

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#### The 13-point Reform Agenda (Action Steps)

- CBN took some actions for success of the consolidation programme and these included the following:
- Issuance of guidelines and incentives to banks to guide and encourage implementation
- Establishment of the Technical Advisory Committee on Banking Sector Consolidation
- Establishment of a help desk at the CBN office in Lagos
- Establishment of a Banking Consolidation Implementation Committee
- Collaboration with SEC, CAC, FIRS and other relevant government agencies
- Issuance of the procedure manual and circular on consolidation timeframe and returns

### III. The Revolution:

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#### The 13-point Reform Agenda (Action Steps)

- Debt forbearance for some banks to make them attractive for merger/acquisition
- Technical support from the IMF and other international agencies
- Capital verification to ensure that no illicit or borrowed funds from the banking sector were used to finance the purchase of bank shares
- Interactive meetings with banks to ascertain the progress made
- Establishment of the Consultative Committee on Banking Sector Reform at the highest level to monitor implementation of reform

### III. The Revolution.....

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- There were complementary reforms which followed the 13-point agenda
  - ▣ Exchange rate policy – Liberalisation of the foreign exchange market
  - ▣ Currency restructuring – Issue N1,000 notes and lower denominations
  - ▣ Payment system reforms
  - ▣ Corporate governance – strengthened across the industry

### III. The Revolution:

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#### The Strategy

- Shock Therapy – Big Bang Approach to engineer a new equilibrium
- Size matters in banking
  - ▣ It helps eliminate 'marginal' banking
  - ▣ It protects against shocks and volatility
  - ▣ Raises size of single obligor limit
  - ▣ Ushers in new competition – locally and globally

### IV. We Have Come A Long Way: Outcomes

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#### Nigerian Banking Sector

- Asset Base grew by approx. 277% between 2003 and 2007
- 11 banks with over \$1 billion in Tier 1 capital, by end February, 2008.
- Microfinance Banks – 716 already licensed. More banks on the way
- Branch Expansion – 16 in Africa and 7 beyond Africa
- Share of Banks in NSE rose from 30% of the 20 capitalised stocks in the stock market in 2003 to 65% 2007%
- Fitch Rating:
  - Banking System Indicator (BSI) - 2 countries rated same as Nigeria and 2 below Nigeria
  - Macro-Prudential Indicator (MPI) – 4 countries rated same as Nigeria

### IV. Outcomes.....

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- Nigeria was recently rated BSI 'D' and MPI '1' along with Morocco & Benin; Morocco and Nigeria are new entrants on the Bank Systemic Risk Report by Fitch Ratings.
- The assessment period for MPI under the current rating is 2004-2006, though 2007 developments were also considered.
- BSI – based on current bank individual Ratings, both published and unpublished for systemically important non-rated banks
- Four other African countries – Egypt, Tunisia, Benin and South Africa – have been on the rating list by Fitch before now.
- South Africa ranked BSI "B" along side most of the developed countries e.g. Canada, Germany, Japan, and France, and rated MPI "3" along with Canada, Korea and Iceland.
- The Challenge for Nigeria, now under Fitch Rating, is to improve on both MPI and BSI parameters over the next 3-5 years. This is consistent with VISION 2010

## IV. Outcomes...

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BSI AND MPI RATED AFRICAN COUNTRIES			
Banking System Indicator (BSI)	Macro-Prudential Indicator (MPI)		
	1	2	3
B			SOUTH AFRICA
D	BENIN		
D	MOROCCO		
D	NIGERIA		
E	EGYPT		
E	TUNISIA		

Source: Fitch Ratings: Bank Systemic Risk Report, September 2007

## IV. Outcomes...

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Real Effective Exchange Rate Index (2000=100)						
COUNTRY	2002	2003	2004	2005	2006	2007
BENIN	108.6	113.1	116.0	118.9	121.9	121.9
EGYPT	83.4	69.1	56.7	61.5	64.5	67.6
MOROCCO	95.6	94.6	93.5	91.8	91.8	91.8
NIGERIA	111.0	105.0	107.8	123.8	133.6	137.6
TUNISIA	97.4	92.5	89.4	84.7	82.0	81.0
SOUTH AFRICA	73.9	97.3	107.6	108.5	104.2	97.0

Source: Fitch Ratings: Bank Systemic Risk Report, September 2007

## IV. Outcomes...

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	2003	2004	2005	2006	2007	2008*
Average Time Deposit Interest Rate (%)						
One Month	13.72	11.76	9.14	9.99	10.18	9.83
Three Months	14.79	12.80	9.10	10.25	10.29	10.19
Six Months	13.75	11.65	8.72	9.93	9.53	10.03
Twelve Months	13.52	12.71	8.77	7.45	7.92	9.80
Over Twelve Months	12.26	10.67	6.13	8.53	9.67	9.62
Lending Rates (%) – Prime	19.58	18.91	17.78	17.33	16.46	16.48
Maximum	21.61	20.42	19.54	18.66	18.21	18.24
Inflation Rate (%) – Year on Year						
Headline	23.80	10.00	11.60	8.50	6.60	7.70
Core	34.80	5.90	2.40	17.30	3.60	5.70

\* Estimate (January 2008)

## IV. Outcomes...

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### WHY ARE LENDING RATES STILL "HIGH"?

- Cost of funds for banks still high (See Deposit Rates)
- In a risky business environment, banks price risks differently for different borrowers
- Uncertainty about future inflationary trends
- Poor Infrastructure means that banks' operating costs are very high
- High overhead costs for banks - emoluments
- Financing of budget deficits – crowds out the private sector

#### IV. Outcomes....

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Sectoral Share in Total Real GDP (%)					
Sectors	2003	2004	2005	2006	2007
Agriculture	41.01	40.98	41.19	41.72	42.21
Min. & Quarry	0.25	0.26	0.27	0.28	0.29
Manufacturing	3.57	3.68	3.79	3.91	4.04
Communication	1.06	1.27	1.53	1.91	2.38
Oil & Gas	26.53	25.72	24.26	21.85	19.38
Others	27.58	28.09	30.84	34.25	38.09

#### IV. Outcomes....

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Sectoral Share in Total Real GDP and in Private Sector Credit					
Sectors	2003	2004	2005	2006	2007
Agriculture	41.01 (5.16)	40.98 (4.46)	41.19 (2.44)	41.72 (1.96)	42.21 (3.11)
Min. & Quarry	0.25 (7.98)	0.26 (8.63)	0.27 (8.66)	0.28 (9.96)	0.29 (10.19)
Manufacturing	3.57 (24.46)	3.68 (21.86)	3.79 (17.68)	3.91 (17.66)	4.04 (10.13)
Communication	1.06 (24.41)	1.27 (25.19)	1.53 (18.87)	1.91 (19.82)	2.38 (24.06)
Oil & Gas	26.53 (19.05)	25.72 (18.27)	24.26 (21.67)	21.85 (23.23)	19.38 (26.32)
Others e.g Trade, Services, Tourism, etc	27.58 (18.94)	28.09 (21.59)	30.84 (30.68)	34.25 (27.37)	38.09 (26.19)

Note: Figures in parenthesis are share of credit to the private sector (%)

#### IV. Outcomes...

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Banking System: Key Facts (Data for 2006 - 2007)				
COUNTRY	Non Performing Loan Ratio (%)	Risk weighted capital ratio (%)	Public Ownership as % Assets	Foreign Ownership as % Assets
BENIN	12	8	90	n.a
EGYPT	20	10	58	14
MOROCCO	16	12	24	16
NIGERIA	32	25	5	9
TUNISIA	19	12	42	26
SOUTH AFRICA	2	13	0	30

Source: Fitch Ratings: Bank Systemic Risk Report, September 2007

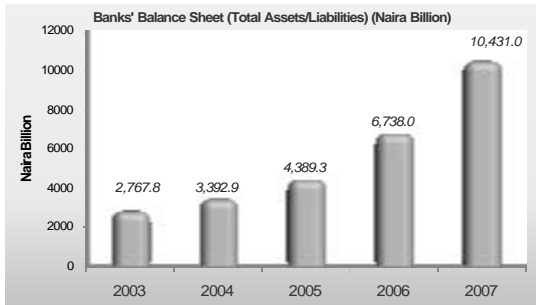
#### IV. Outcomes....

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DMBs' Credit to SMEs As Percent of Total Credit			
Year	Credit to SMEs (N'Bn)	DMB Total Credit (N'Bn)	Credit to SMEs as % of DMBs Total Credit (%)
2003	38.51	1,203.20	3.20
2004	26.31	1,519.24	1.73
2005	66.28	1,991.15	3.33
2006	134.68	2,524.30	5.34
2007	203.58	4,813.49	4.23

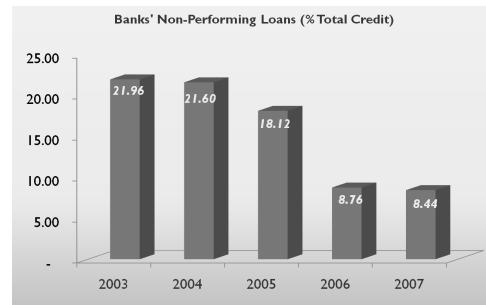
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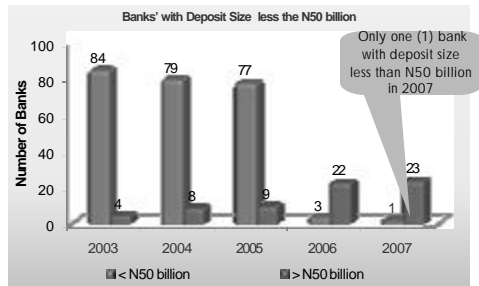
## IV. Outcomes

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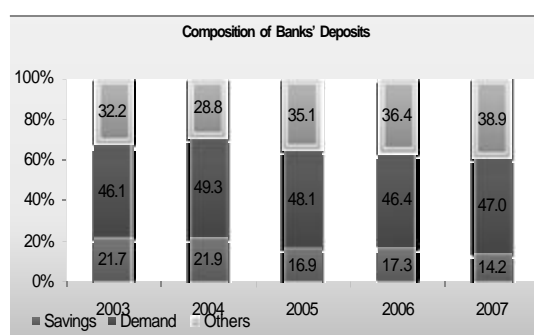
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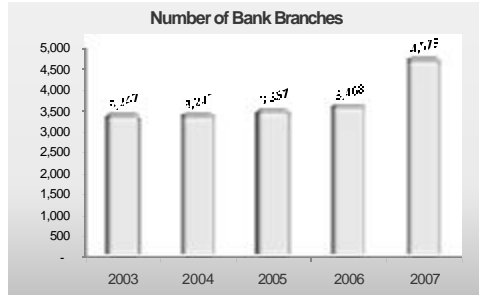
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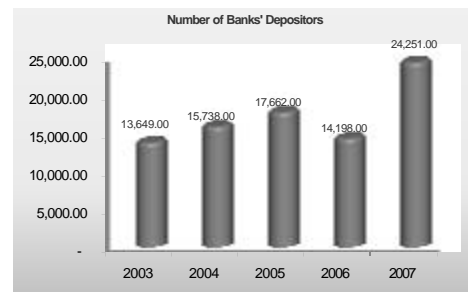
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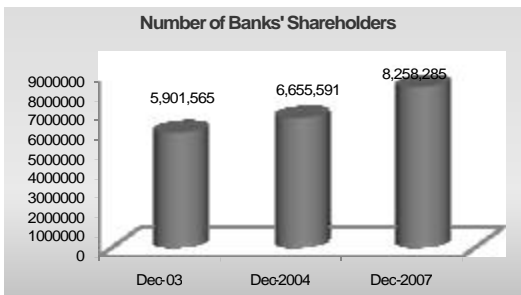
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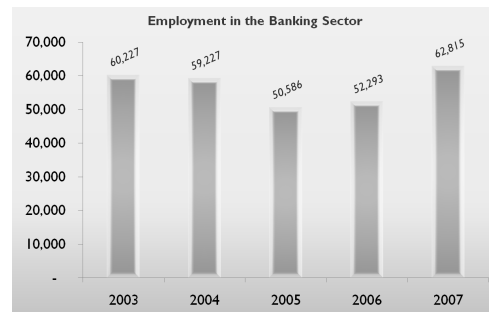
## IV. Outcomes.....

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## IV. Outcomes...

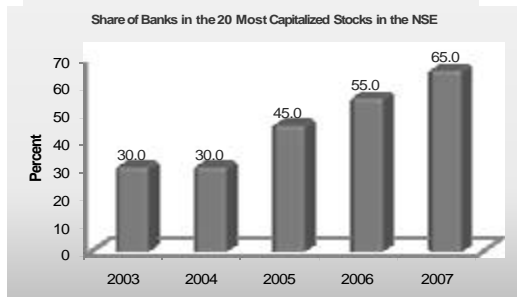
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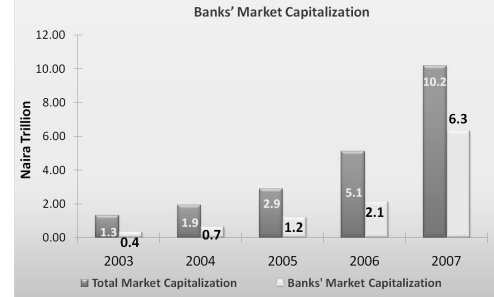
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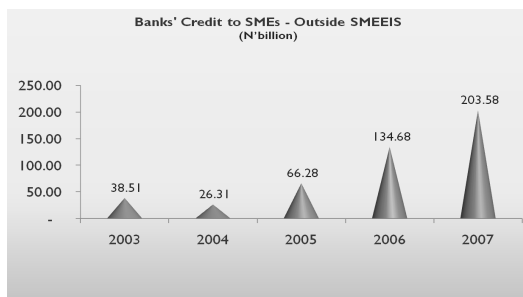
## IV. Outcomes...

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## IV. Outcomes....

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## IV. Outcomes....

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### Other Indicators of Financial Deepening

Year	M2/GDP Ratio (%)	CIC/M2 Ratio (%)	COB/M2 Ratio (%)	CIC/GDP Ratio (%)	CIC/Non-oil GDP Ratio (%)	COB/GDP Ratio (%)	COB/Non-oil GDP Ratio (%)
2003	20.0	25.3	20.8	5.1	8.7	4.2	7.1
2004	19.8	24.1	20.3	4.8	7.6	4.0	6.4
2005	19.3	22.8	20.0	4.4	7.2	3.9	6.3
2006	19.8	21.2	18.8	4.2	6.7	3.7	6.0
2007	21.0	20.0	15.2	4.2	6.1	3.2	4.6

M2 is broad money stock (end period)

GDP at current basic prices

CIC is Currency in Circulation (end period)

COB is Currency Outside Banks (end period)

## V. The Unfinished Business

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### Managing macro vulnerability and volatility

- With open markets and globalisation, the Nigerian economy is susceptible to incidents in the international financial markets
- Nigeria faces the risk of real exchange rate overvaluation which needs close monitoring
- Hot money (portfolio) flows can cause shocks and need close attention as foreign portfolio investors seek out profit opportunities in the Nigerian market

## V. The Unfinished Business....

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- Enforcing CBN's renewed mandate
- The five principal objects of the new CBN Act 2007 are:
  - Ensure monetary and price stability
  - Issue legal tender currency in Nigeria
  - Maintain external reserves to safeguard the international value of the legal tender currency
  - Promote a sound financial system in Nigeria
  - Act as banker and provide economic and financial advice to the Federal Government

## V. The Unfinished Business...

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### CBN's Mandate:

- Keep the CBN more focused on macroeconomic policy with inflation fighting as its primary concern - *(Without low & stable inflation, financial deepening will not occur and single digit interest rate will not be sustainable)*
- Outsource non-core functions like facility management, currency processing and distribution, transportation, health, printing etc
- Keep reinventing the institution and its people (*skills training*) to meet the challenges ahead – Project EAGLES 2 -ERP, Temenos 24, eFASS, IDMS,

## V. The Unfinished Business...

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- Revamping the payment system
  - Real Time Gross Settlement System (RTGS) and improving the overall clearing system (NACS)
  - Boosting electronic banking
  - More efficient use of the cheque for payment
  - Improving the collection system for government funds and revenues
- Financial Deepening:
  - Credit to GDP ratio still at a paltry 31%
  - Deposit mobilisation
  - Building institutions to improve efficiency of credit market
    - Credit Bureaux
    - National identification
    - Commercial courts and legal reforms

## V. The Unfinished Business...

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### CBN's Mandate:

- New emphasis on risk-based supervision
  - Greater emphasis on CBN's use of discretion and judgement as opposed to rigid rule-based regulatory framework
  - Strict corporate governance regime
  - International benchmarking of supervisory oversight activities
  - Supervision of the international subordinates of Nigerian banks
  - Implementing Basel II provisions

## V. The Unfinished Business...

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### CBN's Mandate:

- Branch expansion to all states of the Federation (with the objective of banking services to all). First with currency centres and full-fledged branches following

## V. The Unfinished Business...

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### Challenge of Currency Issuance and the Mint

- CBN took over the Mint in 2005 with results so far encouraging, but challenges exist:
  - Increasing production level and avoiding import of currency. Using spare capacity for other countries
  - Keeping the Mint debt-free
  - Keeping cost of production low
  - Determining an appropriate future for the Mint

## V. The Unfinished Business...

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- The FSS2020 Programme
  - There is need for an integrated, holistic and consistent approach to the reforms and developments in the financial system.
  - All stakeholders in the financial system are involved in crafting and implementing a new road map for the Nigerian economy

## V. The Unfinished Business

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- The FSS 2020 Programme
  - There are 400 initiatives some of which include:
    - Making Nigeria Africa's financial hub
    - Creating an International Financial Centre
    - Unleashing the mortgage revolution
    - Boosting Pension (with the Defined Contribution, N800 billion already generated in pension assets)
    - Reforming Insurance – ongoing reforms in line with banking
    - Deepening the capital market – capitalisation is growing rapidly (currently N12.4 trillion up from N300 billion in 1999)

## V. The Unfinished Business...

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- FSS 2020 Initiatives
  - Creating a consumer finance market
  - Establishing credit bureaux and ensuring there is greater credit to the private sector
  - Initiating Legal reforms in various areas, which include:
    - Commercial Courts
    - BOFIA
    - Electronic banking
    - Land laws
    - Property rights

## V. The Unfinished Business...

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Foreign participation in Nigeria's banking

- Foreign capital inflows (FDI and portfolio) have grown significantly. Annual capital importation which by end of 2003 stood at \$433 million grew to \$9.6 billion by end of 2007, up 137% from the 2006 annual inflow
- More foreign (commercial and investment) banks desire to operate in Nigeria and actually acquire existing banks
- There is need for orderly entry for the sake of Nigeria's economic and security interest

## V. The Unfinished Business...

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### Mainstreaming microfinance

- There is the challenge of ensuring that all Nigerians are carried along and no one is left behind in the New Economy
- The new microfinance bank policy along with the launch of the N50 billion microcredit fund completes the primary loop for banking services – DMBs, NEXIM, BOI, NACRDB microfinance banks (with the deposits now insured), bureaux de change, mortgage banks,

## V. The Unfinished Business...

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- Addressing skill shortages
  - The world is now a knowledge society and skills are required for survival and success (Education, education, education)
  - Nigeria's education system is in a major crisis
  - Only 10% of potential entrants secure admission due to limited spaces
  - 60% of its graduates are unemployable
  - Graduate unemployment is unacceptably high

## V. The Unfinished Business...

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### Creating a world class banking system

- The outstanding issues of settling the issues of deposits in failed banks
- Settling the outstanding Purchase & Assumption (P & A) issues
- Encouraging market-determined combinations and alliances

## V. The Unfinished Business...

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### Management of foreign reserves

- Safeguarding and optimising the value of the reserves
- Using the reserves to boost local fund management and investment banking skills (through strategic partnerships)
- Diversification away from the Dollar?
- Time for Sovereign Wealth Funds?

## V. The Unfinished Business...

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### Monetary Policy Management:

- Strengthened Monetary Policy Committee as intended under the CBN Act 2007
- Determining optimal ways of achieving liquidity management objectives. Current methods cost nearly N100 billion per annum
- Establishing a sustainable environment for market determined (exchange and interest) rates

## V. The Unfinished Business....

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### Naira and the West African Monetary Zone

- An acceptable road map must be agreed upon towards a common West African currency. Issues to consider include:
  - How to create awareness for the Eco through healthy debates
  - Timing for the implementation of the Eco
  - Logistics and cost of implementation

## V. The Unfinished Business...

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- Consumer Credit not developed
- Provide financial support to industry in order to expand local productive capacity
- Introduce new products and services, and expand the scope of existing ones to support the local market
- Revolutionize critical support areas like credit and payments system to deepen the financial system
- The challenge of Infrastructure:
  - The cost of doing (banking) business is still relatively high due to poor infrastructure
  - Good infrastructure ultimately helps reduce interest rates also

## V. The Unfinished Business...

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- Shortage of qualified and experienced manpower
- Poor corporate governance and risk management framework in an era where the regulator has become stricter
- Risk-averse operator, regulator-led market
- Total credit as % of Non-Oil GDP just about 31%
- Total credit to SME about 4.2 % of total
- Low savings rate
- Formal banking only covers about 40% of the bankable public
- Mortgage system largely absent – Land/Legal Reforms

## Conclusion

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- The CBN will continue to play its primary role of formulating and implementing the right financial regulations, supervision of financial institutions and ensuring an efficient payment system
- The involvement of all and sundry is required to ensure that the unfinished revolution in the banking sector is concluded to the benefit of all Nigerians

**Thank You For  
Your Attention**