CENTRAL BANK OF NIGERIA

# FINANCIAL STABILITY REPORT

January 2009 - June 2010

Maiden Edition

# CBN's Vision and Mission

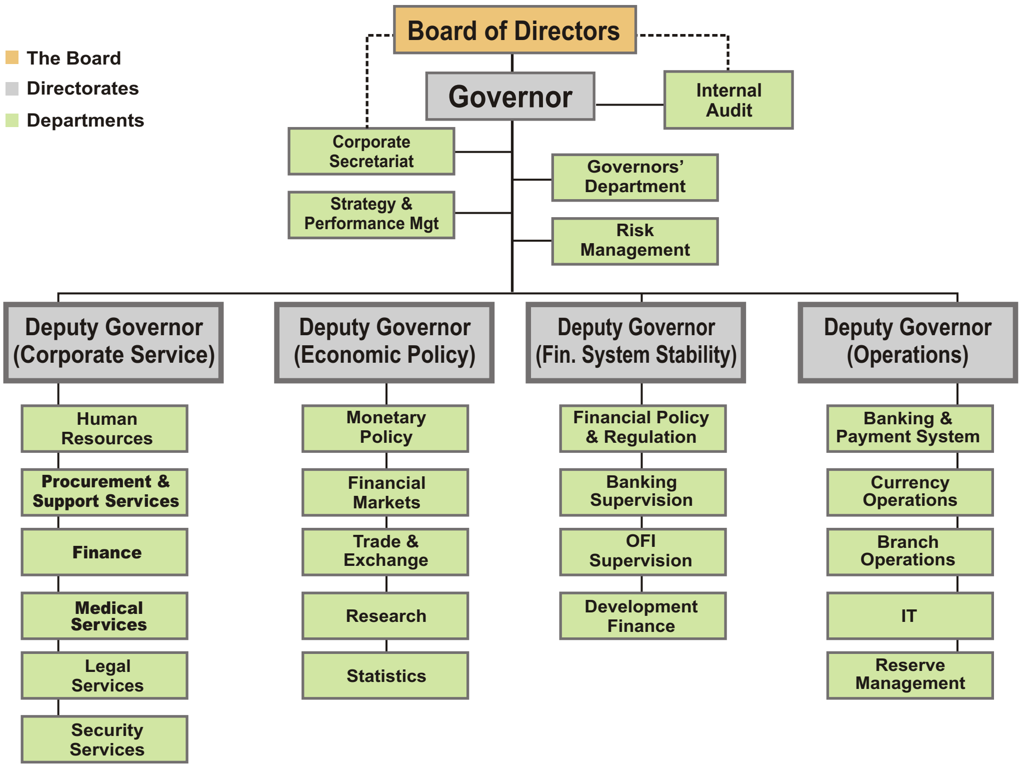
## Vision

To be one of the most efficient and effective of the world's central banks in promoting and sustaining economic development

## Mission

To be proactive in providing a stable framework for the economic development of Nigeria through the effective, efficient and transparent implementation of monetary and exchange rate policy and management of the financial system

# CBN's Organogram



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# Preface

Financial stability is the resiliency of the financial system to unanticipated adverse shocks while enabling the continuing smooth functioning of the financial system intermediation process. A stable financial system contributes to broader economic growth and rising living standards. The financial system performs one of the most important functions in the welfare of its citizens by supporting the ability of households and firms to hold and transfer financial assets with confidence.

The Central Bank of Nigeria (CBN) is committed to promoting the economic and financial welfare of Nigerians by actively overseeing a stable and efficient financial system. The CBN promotes this objective by providing central banking services, including: liquidity and lender-of-last-resort facilities; overseeing key domestic clearing and settlement systems; conducting and publishing analyses and research; and collaborating with various domestic and international policy-making bodies to develop policy. CBN's contribution complements the efforts of other federal, state and local agencies that bring unique expertise to the management of the economy.

*The Financial Stability Report (FSR)* is one of several avenues through which the CBN seeks to contribute to the resiliency of the Nigerian financial system. The *Report* combines the Bank's ongoing work in monitoring developments in the system, with a view to identifying potential risks to the overall soundness, as well as highlighting the efforts of the Bank and other regulatory authorities, to mitigate those risks. The *Report* aims at promoting informed public discussion on some key aspects of the Nigerian financial system and providing an assessment of the downside risks, rather than the most likely future path for the financial system. In addition, the *FSR* summarises recent financial sector policy actions as well as aspects of the financial system's structure and functioning of the CBN. It is hoped that the *Report* would assist financial institutions and the relevant authorities in mitigating risks to the system.

# Governor's Statement

The world economy was hit by an unprecedented financial and economic meltdown of 2007-2009, tipped into recession by the subprime crisis in the US in August 2007. The meltdown led to the collapse of many world renowned financial institutions and resulted in the bankruptcy of a nation. In Nigeria, the economy faltered and the banking system experienced a crisis in 2009, triggered by global events. The stock market lost approximately 70 per cent of its value in 2008-2009 and many Nigerian banks had to be rescued. In order to stabilise the system and return confidence to the markets and investors, the CBN injected ₦620 billion of liquidity into the banking industry and replaced the leadership of eight banks. Since then, the sector has stabilised considerably. The global financial and economic crises have significantly altered the way financial markets function and changed the way central banks operate in most economies.

The Nigerian banking sector has witnessed dramatic growth in the post-consolidation period. However, neither the industry nor its regulators were sufficiently prepared to monitor and sustain the sector's explosive growth. Prevailing sentiment and economic orthodoxy encouraged the rapid growth, creating a blind spot to the risks building up in the system. Prior to the crisis, the sentiment in the industry was that the banking sector was sound and that its growth should be encouraged.

In my view, eight major interdependent factors led to the creation of an extremely fragile Nigerian financial system that was tipped into crisis by the global financial crisis and recession. These factors were:

i. Macro-economic instability caused by large and sudden capital inflows;
ii. Major failures in the corporate governance at banks;
iii. Lack of investor and consumer sophistication;
iv. Inadequate disclosure and transparency about the financial position of banks;
v. Critical gaps in the regulatory framework and regulations;
vi. Uneven supervision and enforcement;
vii. Unstructured governance & management processes at the CBN
viii. Weaknesses in the business environment.

Each of these factors is serious enough in its own right. Acting together, they brought the entire Nigerian financial system to the brink of collapse.

## Economic and Macro Prudential Management

Although there is some evidence of economic diversification, oil maintains an overly dominant position in the Nigerian economy, introducing volatility and posing significant challenges to macro-economic stability. As oil prices increased steadily between 2004 and 2008, Government spending tracked the price of oil, making fiscal policy highly pro-cyclical adding to the volatility.

The economy was not able to absorb the excess liquidity from oil revenues and foreign investments into the productive sectors. This resulted in significant flows to non-priority sectors and to the capital markets, mostly in the form of margin loans and proprietary trading, camouflaged as loans. As a result, market capitalisation of the Nigerian Stock Exchange (NSE), which was at its peak in 2007, represented 5.3 times of its position in 2004, with market capitalisation of bank stocks increasing ninefold during the same period. This set the stage for a financial asset bubble, particularly in bank stocks. The rapid rise in asset prices and the over-concentration of bank shares in the stock market index were clear indications of an accident waiting to happen. Surprisingly, these developments did not raise concern among regulators. For instance, in 2007, the Nigerian Stock Exchange was believed to be "the best performing" bourse in the world though there was no evidence to suggest a commensurate improvement in the fundamentals of real sector corporations.

## Corporate Governance at Banks

The huge surge in capital availability occurred at a time when corporate governance practices in Nigerian banks were extremely weak. In fact, the failure of corporate governance contributed significantly to the financial crisis. Consolidation created bigger banks but the process failed to overcome the fundamental weaknesses in corporate governance in many of the banks.  It was well known in the industry that since consolidation, some banks had been engaging in unethical and potentially fraudulent business practices; the scope and depth of such activities were documented in recent CBN examinations.

## Investor and Consumer Sophistication

Bank boards are hardly the only ones to blame for failure to deal with the sudden surplus in capital. A lack of investor and consumer sophistication also contributed to the crisis by failing to impose market discipline and allowing banks to take undue advantage of consumers. Investors, many of whom were new to investing, were unaware of the risks they were taking and consumers were often subjected to poor service and sometimes hidden fees. Nigeria does not have a tradition of consumer activism or investor protection, and, as a consequence, many Nigerians made investments without a proper understanding of the risks. A limited consumer protection framework did exist in Nigeria. However, the framework was inadequate and as a result consumers' rights were not sufficiently protected.

### Disclosure and Transparency

Given the low level of sophistication among many consumers and investors, inadequate disclosure by the banks was another major contributing factor to the crisis. Bank reports to the CBN and investors were often inaccurate, incomplete and late, depriving the CBN of the right information to effectively supervise the industry and depriving investors of information required to make informed investment decisions.

### Regulatory Framework and Prudential Regulations

Lack of effective co-ordination among the financial system regulators prevented the CBN from having a comprehensive, consolidated picture of its regulatory activities. In addition, the regulations needed to address the major causes of the crisis were often inadequate. Despite the widespread knowledge of bank malpractices and the propensity for regulatory arbitrage, the Financial Services Regulation Coordinating Committee (FSRCC), the coordinating body for financial services regulators, did not meet for two years during the period. Whilst excess capital gave rise to strong growth in lending, banks were also allowed to use the capital to engage in many other non-lending activities, such as stock market investments, most of which were hived off to subsidiaries outside the supervisory purview of the CBN.

### Supervision and Enforcement

Uneven supervision and inadequate enforcement of relevant regulations also played a significant role in exacerbating the problems associated with the crisis. Regulators were lax in anticipating and supervising the massive changes in the industry or in eliminating the pervasive corporate governance failures.

### Governance and Management Processes

Governance and internal processes were not properly structured and this constrained the CBN's ability to supervise the industry. Consequently, issues concerning the stability of the financial sector and economic development, such as global economic risks, federal/state economic development strategies and fiscal policies, the formation of asset bubbles, exchange rate risks, capital market depth, and the informal sector economy were not comprehensively addressed.

## The Business Environment

An insufficiently developed infrastructure and the difficult business environment had a negative impact on the banking industry. The tortuous legal process, the absence of reliable credit rating agencies and poor infrastructure all contributed to poor banking practices. Thus, only a few banks were able to foreclose on borrowers, and such constraints led to borrowers abusing the system. Lack of basic credit information on customers, underscored by the absence of a unique identifier, has held back the development of credit bureaux and hampered customer credit assessment at banks, thereby contributing to an increase in the stock of bad debt in the system.

## The Reform Programme

The blueprint for reforming the Nigerian financial system in the next decade is built around four pillars, as follows:

Pillar 1: Enhancing the quality of banks,
Pillar 2: Establishing financial stability,
Pillar 3: Enabling the evolution of a healthy financial sector, and
Pillar 4: Ensuring that the financial sector contributes to the real economy.

In some areas, the CBN would take the lead in implementing reforms while in others it would play a key advocacy role, as elaborated in the following paragraphs.

## Enhancing the Quality of Banks

The CBN has initiated a five-part programme to enhance the operations and quality of banks in Nigeria. The programme would consist of initiatives to fix the key causes of the crisis. It would also include implementation of risk based supervision, reforms to regulations and the regulatory framework, enhanced provisions for consumer protection, and internal transformation of the CBN. Core to transforming the CBN would be corporate governance within the CBN. The organisation structure of the CBN has been streamlined to enable the Bank to better supervise and regulate the industry. In addition, the CBN would deploy a stronger management information framework to effectively supervise the industry.

### Establishing Financial Stability

The second pillar in the reform programme comprises establishing financial stability. The key features of this pillar would centre on strengthening the Financial Stability Committee within the CBN, the establishment of macro-prudential rules, and further development of the capital market as an alternative to bank funding.

### Enabling the Evolution of a Healthy Financial Sector

The pillar of this reform programme would address key issues, such as banking industry structure and banking infrastructure, including credit bureaux and registries, the cost structure of banks, as well as the role of the informal sector in the economy.

### Ensuring that the Financial Sector Contributes to the Real Economy

Prior to the ongoing reform, development financial institutions which had been set up for specific purposes, such as housing finance, industrial finance, and urban development had not impacted the real economy as envisaged. This situation in Nigeria is unlike in some emerging markets where proactive government action had contributed significantly to the real economy. The fourth pillar of the reform is aimed at ensuring that the financial sector would contribute optimally to the real economy.

The foregoing reform programme represents our vision for the Nigerian banking sector and the road map for the sector's healthy development. The effort to strengthen the Nigerian financial system is consistent with the 'Financial System Strategy FSS 2020 programme' which is aimed at fostering a strong and robust domestic financial system that would serve as a catalyst for the emergence of Nigeria as one of the top 20 economies in the world by the year 2020.

In order to help achieve such noble objectives, the CBN is launching this maiden edition of the *Financial Stability Report (FSR)*, covering the period January 2009 to June 2010. Thereafter, the *Report* will be published bi-annually.

**Sanusi Lamido Sanusi**
***Governor***

# Executive Summary

The global financial crisis of 2007-2009 created a paradigm shift in the manner in which global economies are run. The experience has revealed that macroeconomic stability is vulnerable in the face of financial instability. In realisation of this, financial stability is now accorded prominence in the global arena, giving rise to the establishment of Financial Stability Boards by the leaders of developing nations (G20) to, among other things, co-ordinate the work of national financial authorities and international standard-setting bodies in order to develop and promote the implementation of effective regulatory, supervisory and other sector policies.

Most monetary authorities across the globe are taking bold steps to blend monetary policy with elements of financial stability, in addition to promoting resilience through collaboration and advocacy, with periodic reviews of environmental circumstances and attendant risks. This *Financial Stability Report (FSR)* is an instrument for stimulating such review and, hence, an indispensable policy driver.

In Nigeria, the financial system has witnessed rapid growth, occasioned by the bank consolidation exercise of 2005. However, poor governance and a lax risk management culture, exacerbated by the adverse impact of the global financial and economic meltdown, have brought about distress in a number of Nigerian banks. This development prompted the Central Bank of Nigeria (CBN), in collaboration with the Nigeria Deposit Insurance Corporation (NDIC), to conduct a special examination of all the banks to ascertain the health of the banking sector. The examination revealed serious shortcomings, including poor corporate governance and inadequate risk management practices, which portended systemic risk, necessitating the intervention of the CBN since August 2009. Additional measures were subsequently implemented to effectively contain the distress in the system.

*The Financial Stability Report (FSR)*, which will be issued bi-annually henceforth, is intended to provide regular updates on developments in the Nigerian financial sector, as well as analyses of their impact on the economy. This maiden edition of the *FSR*, provides an insight into the structure of the Nigerian financial system and domestic and global macroeconomic developments, and highlights the major prudential, developmental and payments system initiatives which were undertaken to strengthen the resilience and integrity of the financial system. The publication is intended to promote a clearer understanding of the issues impacting on the stability of the Nigerian financial system and the corresponding policy responses.

## GLOBAL MACROECONOMIC AND FINANCIAL DEVELOPMENTS

### Output

The global economy began a gradual recovery in the second half of 2009, after the deep recession triggered by the subprime mortgage crisis in the United States of America (USA) and subsequent global financial and economic crises. In response to the various fiscal and monetary stimulus packages adopted by various countries in 2008 and 2009, global economic activity further improved in the first quarter of 2010, as evidenced by growing world trade, and improved industrial production and retail sales which boosted confidence in markets.

Output growth in emerging and developing economies is expected to rebound to over 6.3 per cent during 2010 and 6.5 per cent in 2011, following a modest 2.4 per cent growth in 2009. Growth in Sub-Saharan Africa is projected to improve from 2.1 per cent in 2009 to 4.7 per cent in 2010 and further to 5.9 per cent in 2011. Similarly, the health of the international banking system is generally improving alongside global economic recovery. The IMF estimates of bank write-downs since the start of the crises through 2010 have been reduced to $2.3 trillion from $2.8 trillion in October 2009. The recoveries in real and financial activities were mutually supportive, but access to credit remained tight for some sectors. Money markets were stabilizing, while corporate bonds and equity markets were recovering. In most developed markets, credit to the private sector had eased, while many emerging and developing economies were showing signs of gradual improvement. In a few advanced economies, however, rising fiscal deficits and public debts have contributed to the sharp increase in sovereign risk premium, thereby posing new risks to the recovery.

### Inflation

Global consumer prices moderated for most of 2009, as inflationary pressures remained subdued. This was attributed to weak global demand. For example, inflation in advanced economies is projected to moderate from 1.5 per cent in 2010 to 1.4 per cent in 2011, compared with that of emerging and developing economies where inflation is expected to decline from 6.2 per cent in 2010 to 4.7 per cent in 2011. Overall, inflation is likely to fluctuate during the recovery period as consumer prices remain sensitive to commodity prices. Modest increases are expected in oil prices, which are expected to reach about $78.25 per barrel (pbl) on the average by end 2010, from the $61.78 pbl level in 2009.

### Interest Rates

Monetary policy had been largely expansionary for most part of 2009. This was driven by the use of unconventional liquidity measures (quantitative easing) and low monetary policy rates (close to zero) adopted in many developed economies. For most of 2009, for example, the Bank of Japan kept its policy rate at 0.1 per cent; the Federal Reserve System of the USA at 0.25 per cent; the Bank of England at between 0.5 and 1.5 per cent; while the Reserve Bank of South Africa and the CBN kept their rates at around 6 per cent. High capacity utilisation in some sectors, coupled with deteriorating credit quality, accounted for the credit squeeze in a number of emerging economies thereby driving up rates.

### Exchange Rates

The global financial crisis and fragile economic recovery continued to dominate the major international currency markets in the second half of 2009. Following concerns over the high US budget deficits and the sustainability of its economic recovery, most international currencies appreciated against the US Dollar during the period. For example, in the first quarter of 2010, the Canadian Dollar and the Mexican Peso appreciated against the US Dollar by 3.62 and 5.80 per cent, respectively. In Europe, the British Pound and the Euro depreciated against the US Dollar by 6.05 and 5.81 per cent, respectively, while in Africa, the South African Rand and the Egyptian Pound appreciated against the Dollar by 1.75 and 0.01 per cent, respectively. Both the Nigerian Naira and the Kenyan Shilling, however, depreciated against the US Dollar by 0.14 and 1.39 per cent, respectively.

### Stock Markets

The global economic recovery and the associated improvements in financial conditions engendered confidence in international financial markets. As a result of improved overall confidence, equity markets recovered faster than expected and the intense volatility that had characterised major international stock markets until the first half of 2009 abated. Consequently, most global stock indices increased between the fourth quarter of 2009 and March 2010.

In Africa, the Nigerian NSE ASI, the South African JSE All-Share, the Kenyan Nairobi:

NSE 20 and the Egyptian EGX CASE 30 indices increased by 26.8, 3.8, 24.9 and 8.5 per cent, respectively. In North America, the S&P 500, the Canadian S&P/TSX Composite and the Mexican Bolsa indices increased by 5.2, 2.5 and 4.0 per cent, respectively. In South America, the Brazilian Bovespa, Argentine Merval and the Columbian IGBC General indices increased by 2.0, 3.6 and 3.8 per cent, respectively. In Europe, the FTSE 100, the CAC 40, the DAX and the Russian MICEX indices increased by 4.4, 0.3, 2.6 and 6.7 per cent, respectively. In Asia, Japan's Nikkei 225 increased by 4.1 per cent, while China's Shanghai Stock Exchange (A) index decreased by 4.2 per cent. India's BSE Sensex index remained unchanged.

## DOMESTIC MACROECONOMIC AND FINANCIAL DEVELOPMENTS

The macroeconomic outcomes in 2009 and the first half of 2010 were influenced by developments in both the domestic and international economies. Overall, the Nigerian economy was relatively stable, but developments had mixed outcomes. The major challenge to economic and monetary policies since 2009 has remained the management of tight liquidity in the banking system. In particular, the growth in credit to the private sector slowed significantly. Inflation rate (year-on-year) moderated substantially, although it remained at double digit all through 2009 to the first half of 2010. The exchange rate, which was relatively stable during the first and second quarters of 2009, depreciated during the third and fourth quarters and later appreciated in the first quarter of 2010. Interest rates rose in the first half of 2009, influenced by the global financial crisis which precipitated tight liquidity conditions in the banking system, but reversed in the fourth quarter, induced by improvements in liquidity conditions in the money market and the CBN guarantee of all inter-bank transactions. Crude oil production improved in the second half of 2009, following the amnesty programme implemented by the Federal Government in resolving the Niger Delta crisis. Furthermore, oil prices improved in the international oil market in response to economic recovery in most advanced and emerging market economies in the second half of 2009.

### Inflation

Inflationary pressures moderated in 2009 and the first quarter of 2010, as the inflation rate trended downwards. Headline inflation fell from 14.4 per cent at the end of the first quarter of 2009 to 11.8 per cent at end-March 2010, and averaged 12.0 per cent between the first quarters of 2008 and 2010. The relatively high level of inflation reflected the upward movement in food, fuel and housing prices.

## THE FISCAL SECTOR

### Fiscal Operations

The estimated Federal Government-retained revenue and aggregate expenditure stood at ₦2,646.9 billion and ₦3,456.9 billion in 2009, respectively. Consequently, the fiscal operations of the Federal Government resulted in a notional deficit of ₦810.0 billion, compared with the budgeted deficit of ₦836.6 billion for the 2009 fiscal year. The estimated Federal Government-retained revenue and aggregate expenditure in the first quarter of 2010 were ₦468.61 billion and ₦843.81 billion, indicating a decline of 29.34 and 10.14 per cent, respectively, from the levels in the preceding quarter. The fiscal operations of the Federal Government during the first quarter of 2010 resulted in an estimated deficit of ₦375.20 billion, compared with the budgeted deficit of ₦387.70 billion, as against a surplus of ₦32.56 billion in the corresponding period of 2009. The deficit was predominantly financed by FGN Bonds.

## THE FINANCIAL SECTOR

### Monetary and Credit Developments

Provisional data showed that the growth in monetary aggregates was modest in the first four months of 2010. Relative to end-December 2009, the broad measure of money supply (M2), rose by 1.8 per cent to ₦10,959.2 billion at end-April 2010, implying an annualized growth of 5.4 per cent, compared with the respective growth rates of 2.2 per cent and -1.8 per cent at the end of the preceding month and the corresponding period of 2009 and the indicative benchmark growth rate of 29.3 per cent for fiscal 2010. The development was accounted for largely by the increase in net domestic credit and other assets (net) of the banking system.

Aggregate bank credit to the domestic economy (net) rose by 7.7 per cent at the end of April 2010 over the level at end-December 2009. The increase in aggregate credit (net) was due mainly to the increase in credit to the Federal Government which rose by 32.6 per cent. However, on an annualized basis, the increase translates to 23.1 per cent, which is below the indicative target of 55.54 per cent for 2010. Base money, the operating target of monetary policy, at ₦1,497.1 billion at end-April, 2010, was lower than the indicative benchmark of ₦1,872.8 billion programmed for the second quarter of 2010, by 20.1 per cent.

### Interest Rates

The downward trend in interest rates, which began in the second half of 2009, continued in the first four months of 2010. Following the CBN's decision to guarantee inter-bank transactions as well as some improvement in liquidity conditions, both of which helped in the restoration of confidence in the system, interest rates declined. The weighted average inter-bank rate, which was 2.89 per cent as at end-December 2009, declined to 1.27 per cent at end-April 2010. Similarly, the securitized open buy back (OBB) rate declined to 2.46 per cent at end-March 2010, from 2.64 per cent at end-December 2009, and further to 1.11 per cent at end-April, 2010. The average term deposit rate declined by 4.5 percentage points over the level at end-December 2009, to 6.9 per cent at end-March 2010.

The fall in short-term rates impacted marginally on lending rates as prime and maximum lending rates declined by 0.7 and 0.3 percentage points to 18.4 and 23.2 per cent, respectively, at end-March 2010 from their end-December 2009 levels.

### Liquidity Management

Monetary policy was largely influenced by tight liquidity in the domestic economy, induced partly by the distress in some banks and the adverse impact of the global economic and financial crises of 2007/2008. Liquidity management was, therefore, anchored on the need to ensure a well functioning financial market that would foster growth without compromising the objective of monetary and price stability. The CBN made extensive use of open market operations (OMOs), being its primary tool of liquidity management. This was complemented by variation of prudential reserve ratios, tenored repurchase transactions, the sale of treasury instruments at the primary segment of the market, and the use of CBN's standing facility window.

Consequent upon the tight liquidity conditions experienced in the first half of 2009, a number of measures were undertaken by the CBN to achieve optimum liquidity, stability in the foreign exchange markets, and a seamless flow of credit to the real economy. These included the following measures:

- Further liberalisation of the foreign exchange market;
- Downward adjustments of monetary policy rates and other prudential ratios;
- Injection of a stimulus package of ₦620.0 billion to recapitalise ailing banks; and
- Guarantee of inter-bank transactions.

These measures resulted in a number of positive developments in the second half of the year, which manifested in the relative stability in the foreign exchange market and improved liquidity conditions in the inter-bank money market, thus restoring confidence in the system.

## INSTITUTIONAL DEVELOPMENTS IN THE FINANCIAL SECTOR

### The Banking System

The growth of the banking system in the post-consolidation period and the failure of the regulators and supervisors to develop commensurate capabilities to supervise the system, created risks to the system, which posed significant challenges to both regulators and other stakeholders. Furthermore, a number of interdependent factors such as macro-economic instability, major failures in corporate governance at banks, and uneven supervision and enforcement were also identified as being responsible for the ensuing fragile financial system.

The combined effects of these factors rendered the financial system vulnerable and unsupportive of the economy, which informed the CBN's intervention in August 2009. The CBN, thereafter, implemented, among others, the following initiatives to further enhance stability in the system:

- Establishment of the Asset Management Corporation of Nigeria (AMCON);
- Establishment of the Financial Stability Committee (FSC) ;
- Review of supervisory procedures/methodology;
- Adoption of a common year-end for banks;
- Restructuring of the Financial Sector Surveillance Directorate;
- Renewed collaboration with other regulators;
- Review of the Corporate Governance Code for Banks;
- Establishment of a ₦200.0 billion Commercial Agriculture Credit Scheme (CACS) by the CBN, in collaboration with the Federal Ministry of Agriculture and Water Resources (FMA&WR);
- Establishment of a ₦300 billion Power Development Fund in support of Small and Medium Enterprises (SMEs);
- Establishment of a ₦200 billion Small and Medium Enterprises Credit Guarantee Scheme (SMECGS); and
- Establishment of a ₦200 billion refinancing and restructuring of the manufacturing sector loan portfolio.

Other initiatives by the Federal Government that were supportive of financial stability included the following:

- Federal Government's amnesty programme in the Niger Delta region;
- Enactment of Nigerian Oil & Gas Industry Content Development Act 2010 (the "Local Content Act"); and
- Creation of a Ministry for the development of the Niger Delta.

## Key Challenges and Risks in the Financial System

The major challenges in Nigeria's financial system include the following:

- Volatile and reversible capital inflows that characterised bank consolidation exercise of 2005;
- Major weaknesses in the business environment;
- Failures in corporate governance in banks and other financial institutions;
- Inadequate disclosure and transparency in financial reporting;
- Engagement in multiple financial activities that increased the complexity of the operations;
- Uneven supervision and enforcement; and
- Inadequate risk management frameworks for identifying, measuring and controlling the risks associated with the activities of deposit money banks (DMBs).

These factors have combined to destabilise the financial system and constrain growth in 2008 and 2009. However, there was slight recovery in the first half of 2010 as uncertainties about the viability of the world economy, which had been ravaged by the impact of the global financial crisis, eased. Furthermore, the impact of various policy measures adopted by government and regulators to stabilise the system began to yield positive results. The banking system, specifically, has been reasonably stable since the CBN intervention measures were taken in August 2009. It is also pertinent to note that the CBN-induced reforms have been greatly complemented by a relatively conducive macroeconomic environment. Nevertheless, the financial system continues to be exposed to certain inherent risks which include the following:

- Credit risk,
- Liquidity and funding risk,
- Market risk,
- Operational and Reputational risks, and
- Money laundering and terrorist financing risks.

The CBN has, however, implemented a number of measures, including the establishment of AMCON to address these risks.

## REGULATORY REFORMS

The intervention by the CBN in a number of banks revealed certain inadequacies in regulatory procedures, methodology and enforcement. Consequently, the CBN, among other measures, has established a Macro-prudential Division in March 2010 in its Financial Policy and Regulation Department, with a mandate to maintain a banking industry database, and to collate, analyse, review and monitor the banking industry's financial condition. The Bank also reviewed the prudential guidelines for loan classification and margin lending, in line with best practices.

## SUPERVISORY CHALLENGES

In addition to the global financial crisis, the period January 2009 to June 2010 was also characterised by weak governance, inadequate regulation and supervision, data integrity challenges, ineffective consumer protection measures and a weak legal framework.

## THE PAYMENTS SYSTEM

Payments system reforms were rigorously pursued based on the belief that there is a strong link between an efficient payments and settlements system and economic growth and development. The benefits of an efficient payments system include low transaction costs and a predictable and efficient market response to monetary policy, which engender financial system stability. Nigeria's payments and settlements system reforms are intended to promote the use of non-cash mediums, including a robust electronic payment regime that is reliable and accepted throughout the country.

## PRESERVING THE INTEGRITY OF THE FINANCIAL SYSTEM

The preceding review has highlighted various measures taken by the CBN to enhance the stability of the financial system. Additional measures are being taken to further strengthen the system, as the following initiatives suggest:

### i. Review of the Universal Banking Model

The universal banking (UB) model adopted in 2001, allowed banks to diversify into non-bank financial businesses. Following the consolidation programme in 2005, banks became awash with capital funds which were deployed by diversifying into various financial services and the setting up of subsidiaries without adequate capacity to manage the associated risks. Thus, the flexibility and regulatory forbearances provided under the UB model were abused by operators. To address this challenge, the CBN is reviewing the UB model with a view to inducing banks to focus on core banking business. Under the proposed model, banks would not be allowed to invest in or own non-bank subsidiaries, while banks with such investments would be required to either divest or spin off the businesses. The three classes of deposit money banks being proposed would be as follows: International banks, National banks, and Regional banks.

### ii. Establishment of the Asset Management Corporation of Nigeria (AMCON)

The high incidence of non-performing loans in the banking industry and consequent significant erosion of the capital of some banks informed the need to establish AMCON to free such banks of the burden of toxic assets. AMCON is an interventionist initiative with a life span of ten years and an authorised capital of ₦10 billion which would be subscribed to by the CBN and the Ministry of Finance.

### iii. Adoption of the International Financial Reporting Standards (IFRS) in the Nigerian Banking System

The CBN has taken steps to expose the banking system to global best practices in financial reporting and disclosure. In this respect, the CBN has been proactive in promoting initiatives to improve disclosure and reporting practices in banks. The provision of adequate information by banks would enhance market discipline, promote transparency and facilitate the management of systemic risks. It would also foster safe and sound banking practices which would enhance financial stability.

### iv. Promoting Consumer Protection in the Nigerian Banking Industry

To further engender public confidence in the banking system and enhance consumer protection, the CBN has established the Consumer and Financial Protection Division to provide a platform through which consumers can seek redress.

The CBN recognises that financial stability is fostered by public confidence which is facilitated by an arrangement whereby consumers are educated and enlightened on their rights and responsibilities. Consequently, the Consumer and Financial Protection Division would embark on a programme of consumer education and enlightenment for all categories of bank customers throughout the country. The details are in the process of being worked out and would be disseminated to the Nigerian banking public in due course.

The CBN is also collaborating with the Consumer Protection Council on the review of the *Consumer Protection Council Act No. 66 of 1992* to further empower the regulators to enforce discipline in the market.

### v. Enhancement of the Credit Risk Management System (CRMS)

The CBN has expanded the operations of its CRMS by licensing some private credit bureaux to complement the efforts of the CBN bureau. The private credit bureaux are mandated to cover all sectors of the economy with a view to providing credit reports on all individuals and corporate bodies that intend to enjoy, or are enjoying, any type of financial facility in the country.

# 1.0 OVERVIEW

The global economy experienced gradual recovery beginning in the second half of 2009. This was driven largely by the unprecedented amount of monetary and fiscal stimulus packages introduced in both developed and emerging market economies in the wake of the global financial and economic crises. The recovery was evidenced by growing world trade, improved industrial production and retail sales. Consumer prices also moderated for most of 2009, as inflationary pressures remained low.

In Nigeria, the financial system witnessed rapid growth, occasioned by the bank consolidation exercise of 2005. However, poor governance and lax risk management, exacerbated by the adverse impact of the global financial and economic meltdown, brought about distress in a number of Nigerian banks. This prompted the Central Bank of Nigeria (CBN), in collaboration with the Nigeria Deposit Insurance Corporation, to conduct a special examination of all the banks to ascertain the health of the banking sector. The examination revealed some serious shortcomings in corporate governance and risk management practices, among others. These posed significant regulatory challenges and a threat to the entire system, necessitating the intervention of the Central Bank of Nigeria (CBN). In addition, various monetary and fiscal policy measures were adopted to address these challenges.

The *Financial Stability Report (FSR)*, which shall henceforth be issued bi-annually, is intended to provide regular update on developments in the Nigerian financial sector and their impact on the economy. This maiden edition of *FSR* highlights the major prudential, developmental and payments system initiatives undertaken to strengthen the resilience and integrity of the financial system. The publication is intended to enhance understanding of the issues affecting stability in the Nigerian financial system and the corresponding policy responses. It provides an assessment of the downside risks to the Nigerian financial system and would thereby assist the authorities and other market participants in mitigating those risks.

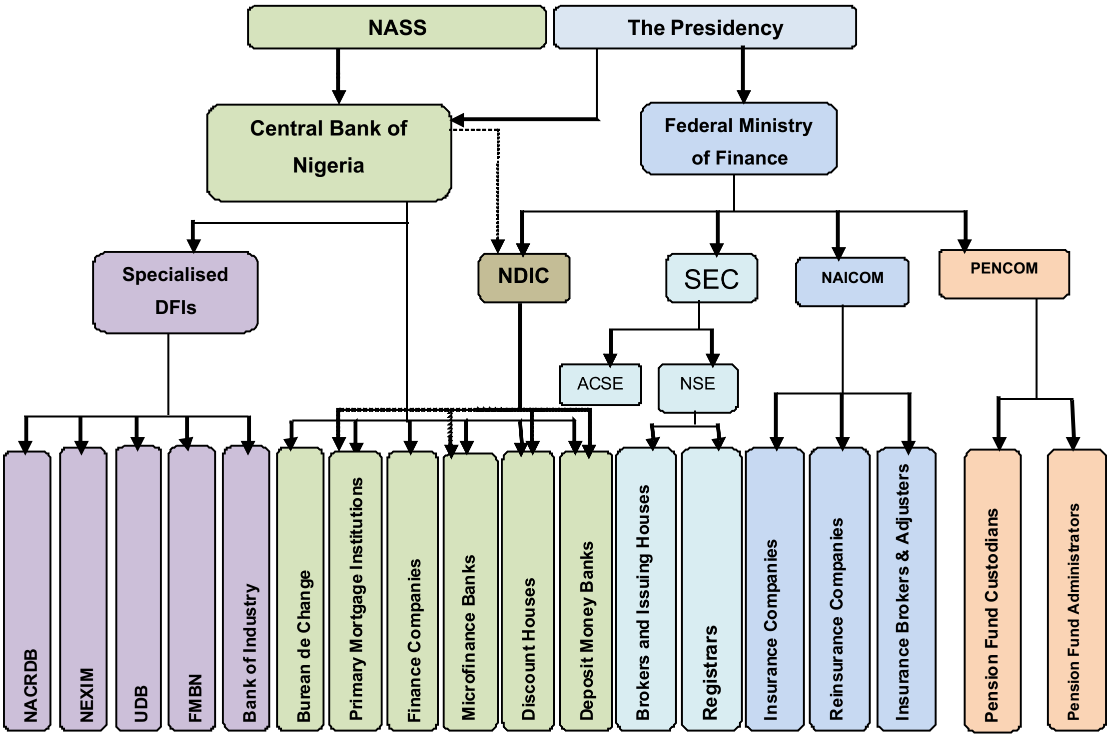
This *Report* is structured into seven sections. Section 1 is an overview of the *Report* while Section 2 presents the structure of the Nigerian financial system. Section 3 unveils the global and domestic macroeconomic and financial environment and assesses inherent risks in the financial system, followed by highlights of developments in the financial sector in Section 4. In Section 5 the prudential supervisory and regulatory framework in Nigeria is discussed. Section 6 reviews developments in the Payments and Settlements System, Section 7 highlights actions required for preserving the integrity of the Nigerian financial system, while Section 8 concludes the *Report*.

# 2.0 THE STRUCTURE OF THE NIGERIAN FINANCIAL SYSTEM

The Nigerian financial system comprises both formal and informal sub-sectors. The formal sub-sector is made up of the regulatory authorities, money, capital and foreign exchange markets, insurance companies, brokerage firms, deposit money banks (DMBs), development finance and other financial institutions. As at end-March 2010, there were 24 deposit money banks (DMBs), 5 discount houses (DHs), 941 microfinance banks (MFBs), 107 finance companies (FCs), 101 primary mortgage institutions (PMIs), 13 Pension Fund Administrators (PFAs), 5 Pension Fund Custodians (PFCs), 1 Stock Exchange, 1 Commodity Exchange, 1,621 bureaux-de-change operators (BDCs), 690 securities brokerage firms, 5 development finance institutions (DFIs), and 73 insurance companies. See Figure 1.

The informal sub-sector includes community-based organisations such as financial cooperatives, microfinance institutions, rotatory savings and credit associations (ROSCAS), self-help groups and similar institutions. A major characteristic of the financial system is the weak relationship and integration of the informal sub-sector with the formal sub-sector.

## Figure 1: Structure of the Nigerian Financial System as at June 2010




- ACSE - Abuja Commodity and Securities Exchange
- DFIs - Development Finance Institutions
- FMBN - Federal Mortgage Bank of Nigeria
- NACRDB - Nigeria Agricultural Cooperative and Rural Development Bank
- NAICOM - National Insurance Commission
- NASS - National Assembly
- NDIC - Nigeria Deposit Insurance Corporation
- NEXIM - Nigeria Export-Import Bank
- NSE - Nigerian Stock Exchange
- PENCOM - National Pension Commission
- SEC - Securities and Exchange Commission
- UDB - Urban Development Bank

At the apex of the regulatory system are the Presidency and National Assembly which provide statutory oversight functions on the Federal Ministry of Finance (FMF) and the CBN.

## 2.1 The Central Bank of Nigeria

The CBN's regulatory focus is on deposit money banks (DMBs) and other financial institutions (OFIs), comprising primary mortgage institutions (PMIs), bureaux-de-change (BDCs), microfinance banks (MFBs), finance companies (FCs), discount houses (DHs) and development finance institutions (DFIs).

## 2.2 The Nigeria Deposit Insurance Corporation (NDIC)

The primary responsibility of the NDIC is the insurance of depositors' funds in DMBs and other insured financial institutions. The Corporation is also responsible for the liquidation of distressed banks, and, in conjunction with the CBN, also supervises DMBs and other insured institutions.

## 2.3 The Securities and Exchange Commission (SEC)

The Securities and Exchange Commission is the regulator of the Nigerian capital market.

## 2.4 The Nigeria Stock Exchange (NSE) and the Abuja Commodity and Securities Exchange (ACSE)

These are the two securities exchanges in the Nigerian capital market. The NSE has authority over the securities' trading rules and regulations, while the Abuja Commodity and Securities Exchange superintends commodities trading.

## 2.5 The National Insurance Commission (NAICOM)

NAICOM is responsible for the regulation and supervision of the insurance sub-sector.

## 2.6 The National Pension Commission (PENCOM)

PENCOM is the regulatory agency with oversight responsibility for pension fund custodians as well as pension funds administrators in Nigeria.

## 2.7 Inter-Agency Cooperation

The Financial Services Regulation Coordinating Committee (FSRCC), introduced under the *CBN Act 2007*, serves as a forum for the various financial sector regulators to meet to exchange information on surveillance activities and the health of the financial system. The Governor of the CBN is the Chairman of the FSRCC.

The foregoing agencies, through their activities in the regulation and supervision of financial institutions, engender financial stability.

## 2.8 Other Stakeholders in the Financial System

### 2.8.1 Self-Regulatory Organizations (SROs)

The SROs are professional bodies that prescribe codes of ethics and undertake advocacy for their members. These include: the Chartered Institute of Bankers of Nigeria (CIBN); the various accountancy bodies; the Chartered Institute of Stockbrokers; the Association of Stock Broking Houses of Nigeria; the Association of Issuing Houses of Nigeria; the Association of Capital Market Registrars; the Association of Corporate Trustees; the Financial Market Dealers Association of Nigeria; the Capital Market Solicitors Association; the Association of Bureaux de Change Operators of Nigeria; and the Mortgage Banking Association of Nigeria.

### 2.8.2 The Informal Sub-Sector

The informal financial sub-sector in Nigeria is characterised by small, unit-size, unconventional practices, lack of transparency of operations, a low capital base and limited services. Although their terms of engagement are often more stringent than those of conventional institutions, they are widely patronised because of nearness and availability, promptness of service delivery and the existence of social ties between practitioners and their clients.

Institutions that participate in this sub-sector are the financial cooperatives, self-help groups, the Rotatory Savings and Credit Associations (ROSCAS), money lenders and credit unions. They are predominant in rural settings and, in most cases, outside the formal banking sub-sector. The fact that their activities are not captured in the entire financial aggregates poses concerns and challenges to monetary policy transmission and financial stability.

The CBN has over the years, encouraged their integration with the formal financial system through awareness creation, appropriate policies, capacity building and training. For example, the microfinance policy regulatory and supervisory framework particularly specifies that institutions in this category should aspire to be licensed as microfinance banks where their client base would increase to 2000, or their loan portfolio to a minimum of ₦20 million. The Bank is also enhancing their integration into the formal financial sector through the creation of appropriate linkages, e.g. the self-help linkage groups for agricultural financing.

# 3.0 THE MACROECONOMIC AND FINANCIAL ENVIRONMENT

## 3.1 Global Macroeconomic and Financial Developments

### 3.1.1 Output

The global economy began a gradual recovery in the second half of 2009, after the deep recession triggered by the subprime mortgage crisis in the United States of America (USA) and the subsequent global financial and economic meltdown. In response to the various fiscal and monetary stimulus programmes introduced by various nations in 2008 and 2009, global economic activity further improved in the first quarter of 2010, as evidenced by growing world trade, industrial production, and retail sales which boosted confidence in markets.

World real Gross Domestic Product (GDP) growth reached about 3.3 per cent (on an annualised basis) during the second quarter of 2009 and grew to over 4.5 per cent in the second half of 2009, with commodity prices recording a rebound, in response to the expansion in world economic activity. Output in most regions of the world, however, remained below their pre-crisis levels.

According to the April 2010 edition of the International Monetary Fund's *World Economic Outlook*, global recovery has evolved better than expected, but in many economies the strength of the rebound has been moderate, given the severity of the recession. Economic activity remains dependent on highly accommodating macroeconomic policies and susceptible to downside risks. Therefore, policy makers would need to ensure a smooth transition of demand from government to the private sector, and from economies with huge external deficits to those with surpluses. The IMF's World Economic Outlook envisages further recovery, but at varying speeds across and within regions. Thus, global growth is projected at about 4.2 and 4.3 per cent in 2010 and 2011, respectively. Although advanced economies recorded a decline of more than 3.0 per cent in output in 2009, it is projected that they would expand by 2.3 per cent in 2010 and 2.4 per cent in 2011.

Output growth in emerging and developing economies is projected to rebound to over 6.3 per cent during 2010 and 6.5 per cent in 2011, following a modest 2.4 per cent rebound in 2009. Growth in Sub-Saharan Africa is projected to improve from 2.1 per cent in 2009 to 4.7 per cent in 2010 and further to 5.9 per cent in 2011 (see Table 1).

Similarly, the health of the banking system is generally improving alongside global economic recovery. The IMF's estimates of bank write-downs since the start of the crises through 2010 have been reduced to $2.3 trillion from $2.8 trillion in October 2009. The recoveries in real and financial activities were mutually supportive, but access to credit remained tight for some sectors. Money markets were stabilising, while corporate bonds and equity markets were recovering. In most developed markets, credit to the private sector had eased, while many emerging and developing economies were showing signs of gradual improvement. In a few advanced economies, however, rising fiscal deficits and public debts have contributed to a sharp increase in sovereign risk premium, thereby posing new risks to the recovery.

### Table 1: World Economic Outlook for 2010 and 2011

**Overview of the *World Economic Outlook* Projections for 2010 & 2011**
**(Per cent change, unless otherwise noted)**

| | | | Year over Year Projections | | Difference Jan-10 WEO | | Q4 over Q4 | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | Estimates | Projections | |
| | 2008 | 2009 | 2010 | 2011 | 2010 | 2011 | 2009 | 2010 | 2011 |
| **World output** | **3.0** | **-0.6** | **4.2** | **4.3** | **0.3** | **0.0** | **1.7** | **3.9** | **4.5** |
| **Advanced economies** | **0.5** | **-3.2** | **2.3** | **2.4** | **0.2** | **0.0** | **-0.5** | **2.2** | **2.5** |
| United States | 0.4 | -2.4 | 3.1 | 2.6 | 0.4 | 0.2 | 0.1 | 2.8 | 2.4 |
| Euro area | 0.6 | -4.1 | 1.0 | 1.5 | 0.0 | -0.1 | -2.2 | 1.2 | 1.8 |
| Germany | 1.2 | -5.0 | 1.2 | 1.7 | -0.3 | -0.2 | -2.4 | 1.2 | 2.1 |
| France | 0.3 | -2.2 | 1.5 | 1.8 | 0.1 | 0.1 | -0.3 | 1.5 | 1.9 |
| Italy | -1.3 | -5.0 | 0.8 | 1.2 | -0.2 | -0.1 | -3.0 | 1.4 | 1.3 |
| Japan | -1.2 | -5.2 | 1.9 | 2.0 | 0.2 | -0.2 | -1.4 | 1.6 | 2.3 |
| United Kingdom | 0.5 | -4.9 | 1.3 | 2.5 | 0.0 | -0.2 | -3.1 | 2.3 | 2.6 |
| **Emerging and Developing Economies** | 6.1 | 2.4 | 6.3 | 6.5 | 0.3 | 0.2 | 5.2 | 6.3 | 7.3 |
| Sub-Sahara Africa | 5.5 | 2.1 | 4.7 | 5.9 | 0.4 | 0.4 | NA | NA | NA |
| China | 9.6 | 8.7 | 10.0 | 9.9 | 0.0 | 0.2 | 10.7 | 9.4 | 10.1 |
| India | 7.3 | 5.7 | 8.8 | 8.4 | 1.1 | 0.6 | 6.0 | 10.9 | 8.2 |
| Middle East and North Africa | 5.3 | 2.2 | 4.5 | 4.8 | 0.3 | 0.2 | NA | NA | NA |
| Brazil | 5.1 | -0.2 | 5.5 | 4.1 | 0.8 | 0.4 | 4.3 | 4.2 | 4.2 |
| Mexico | 1.5 | -6.5 | 4.2 | 4.5 | 0.2 | -0.2 | -2.4 | 2.3 | 5.5 |
| **Consumer prices** | | | | | | | | | |
| Advanced economies | 3.4 | 0.1 | 1.5 | 1.4 | 0.2 | -0.1 | 0.8 | 1.3 | 1.6 |
| Emerging and Developing Economies | 9.2 | 5.2 | 6.2 | 4.7 | 0.0 | 0.1 | 4.9 | 5.8 | 4.0 |

*Source: IMF's World Economic Outlook, April 2010*

## 3.1.2 Inflation

Global consumer prices moderated for most of 2009 as inflationary pressures remained subdued. This was attributed to weak global demand. For example, inflation in advanced economies is projected to moderate from 1.5 per cent in 2010 to 1.4 per cent in 2011, compared with that of emerging and developing economies, where inflation is expected to decline from 6.2 per cent in 2010 to 4.7 per cent in 2011. Overall, inflation is likely to fluctuate during the recovery period as consumer prices remain sensitive to commodity prices. Some increases are expected in oil prices, as they are expected to reach $78.25 per barrel (pbl), on the average, by end 2010 from the $61.78 pbl level in 2009.

### 3.1.3 Interest Rates

Monetary policy had been largely expansionary for most of 2009. This was driven by the use of unconventional liquidity measures and low monetary policy rates (close to zero) adopted in many developed economies. For most of 2009, for example, the Bank of Japan kept its policy rate at 0.1 per cent; the Federal Reserve System at 0.25 per cent; the Bank of England at between 0.5 and 1.5 per cent; while the Reserve Bank of South Africa and the Central Bank of Nigeria kept their rates at around 6 per cent (see Table 2). High capacity utilisation in some sectors, coupled with deteriorating credit quality, accounted for the credit squeeze in a number of emerging economies, thereby driving up rates.

**Table 2: Policy Interest Rates of Selected Countries, 2007 - 2010**

| | FED USA | BOJ Japan | ECB EU | BOE UK | SARB South Africa | BOG Ghana | CBN Nigeria |
|---|---|---|---|---|---|---|---|
| 2007 | 4.25 | 0.5 | 4.0 | 5.5 | 11 .0 | 13.5 | 9.0 |
| 2008 | 1.0 | 0.1 | 2.5 | 2.0 | 11.5 | 17.0 | 9.75 |
| 2009 January | 0.25 | 0.1 | 2.0 | 1.5 | 11.5 | 17.0 | 9.75 |
| February | 0.25 | 0.1 | 2.0 | 1.0 | 10.5 | 18.5 | 9.75 |
| March | 0.25 | 0.1 | 1.5 | 0.5 | 9.5 | 18.5 | 9.75 |
| April | 0.25 | 0.1 | 1.25 | 0.5 | 8.5 | 18.5 | 8.0 |
| May | 0.25 | 0.1 | 1.0 | 0.5 | 7.5 | 18.5 | 8.0 |
| June | 0.25 | 0.1 | 1.0 | 0.5 | 7.5 | 18.5 | 8.0 |
| July | 0.25 | 0.1 | 1.0 | 0.5 | 7.5 | 18.5 | 6.0 |
| August | 0.25 | 0.1 | 1.0 | 0.5 | 7.0 | 18.5 | 6.0 |
| September | 0.25 | 0.1 | 1.0 | 0.5 | 7.0 | 18.5 | 6.0 |
| October | 0.25 | 0.1 | 1.0 | 0.5 | 7.0 | 18.5 | 6.0 |
| November | 0.25 | 0.1 | 1.0 | 0.5 | 7.0 | 18.0 | 6.0 |
| December | 0.25 | 0.1 | 1.0 | 0.5 | 7.0 | 18.0 | 6.0 |
| 2010 January | 0.25 | 0.1 | 1.0 | 0.5 | 7.0 | 18.0 | 6.0 |
| February | 0.25 | 0.1 | 1.0 | 0.5 | 7.0 | 16.0 | 6.0 |
| March | 0.25 | 0.1 | 1.0 | 0.5 | 6.5 | 16.0 | 6.0 |
| April | 0.25 | 0.1 | 1.0 | 0.5 | 6.5 | 15.0 | 6.0 |

Sources: FED-US Federal Reserve; BOJ-Bank of Japan; ECB-European Central Bank; BOE-Bank of England; SARB-South African Reserve Bank; BOG-Bank of Ghana; CBN-Central Bank of Nigeria.

### 3.1.4 Exchange Rates

The global financial crisis and fragile economic recovery continued to dominate the major international currency markets in the second half of 2009. Following concerns over the high US budget deficit and the sustainability of its economic recovery, most international currencies appreciated against the US Dollar during the period.

During the first quarter of 2010, the Canadian Dollar and the Mexican Peso appreciated against the US Dollar by 3.62 and 5.80 per cent, respectively. In South America, the Brazilian Real and the Argentine Peso depreciated against the US Dollar by 1.67 and 1.22 per cent, respectively, while the Colombian Peso appreciated against the US Dollar by 6.70 per cent. In Europe, the British Pound and the Euro depreciated against the US Dollar by 6.05 and 5.81 per cent, respectively, while the Russian Rubble appreciated against the US Dollar by 3.45 per cent. In the Asian market, the Japanese Yen depreciated against the US Dollar by 0.51 per cent, whereas the Chinese Yuan and the Indian Rupee appreciated against the US Dollar by 0.42 and 3.57 per cent, respectively.

In Africa, the Nigerian Naira and the Kenyan Shilling depreciated against the US Dollar by 0.14 and 1.39 per cent, respectively, while the South African Rand and Egyptian Pound appreciated against the Dollar by 1.75 and 0.01 per cent, respectively (see Table 3).

### Table 3: Exchange Rates of Some Selected Currencies

**Exchange Rates of Selected Countries: (Value in currency units to US$)**

| | Currency | 31-Dec-08 | 30-Jun-09 | 30-Sep-09 | 31-Dec-09 | 31-Mar-10 | % Change Dec 08 and Mar 10 | % Change Dec 09 and Mar 10 |
|---|---|---|---|---|---|---|---|---|
| **AFRICA** | | | | | | | | |
| Nigeria | Naira | 132.6 | 148.2 | 152.5 | 149.6 | 149.8 | -11.5 | -0.14 |
| South Africa | Rand | 9.3 | 7.7 | 7.5 | 7.4 | 7.3 | 27.6 | 1.75 |
| Kenya | Shilling | 77.7 | 77.2 | 74.9 | 76.3 | 77.4 | 0.4 | -1.39 |
| Egypt | Pound | 5.5 | 5.6 | 5.5 | 5.5 | 5.5 | 0.1 | 0.01 |
| | | | | | | | | |
| **NORTH AMERICA** | | | | | | | | |
| Canada | Dollar | 1.2 | 1.2 | 1.1 | 1.1 | 1.0 | 20.1 | 3.62 |
| Mexico | Peso | 13.8 | 13.2 | 13.4 | 13.1 | 12.4 | 11.8 | 5.80 |
| | | | | | | | | |
| **SOUTH AMERICA** | | | | | | | | |
| Brazil | Real | 2.3 | 1.9 | 1.8 | 1.8 | 1.8 | 29.6 | -1.67 |
| Argentina | Peso | 3.5 | 3.8 | 3.9 | 3.8 | 3.9 | -8.8 | -1.22 |
| Colombia | Peso | 2247.0 | 2144.8 | 1986.9 | 2052.9 | 1923.9 | 16.8 | 6.70 |
| | | | | | | | | |
| **EUROPE** | | | | | | | | |
| UK | Pound | 0.7 | 1.7 | 0.6 | 0.6 | 0.7 | 3.2 | -6.05 |
| Euro Area | Euro | 0.7 | 1.4 | 0.7 | 0.7 | 0.7 | -2.7 | -5.81 |
| Russia | Ruble | 30.5 | 31.0 | 30.2 | 30.5 | 29.5 | 3.7 | 3.45 |
| | | | | | | | | |
| **ASIA** | | | | | | | | |
| Japan | Yen | 90.8 | 96.0 | 91.5 | 93.0 | 93.5 | -2.9 | -0.51 |
| China | Yuan | 6.8 | 6.8 | 6.9 | 6.9 | 6.8 | -0.2 | 0.42 |
| India | Rupee | 48.6 | 47.9 | 48.1 | 46.4 | 44.8 | 8.4 | 3.57 |

Source: www.exchange rates.org
WTW= Week to Week
YTD = Year to Date

### 3.1.5 Stock Markets

The global economic recovery and the associated improvements in financial conditions engendered renewed confidence in international financial markets. As a result of the increased overall confidence, equity markets recovered faster than expected and the intense volatility that had characterised major international stock markets, until the first half of 2009, abated. Consequently, most global stock indices increased between the fourth quarter of 2009 and March 2010.

In Africa, the Nigerian NSE ASI, the South African JSE All-Share, the Kenyan Nairobi: NSE 20 and the Egyptian EGX CASE 30 indices increased by 26.8, 3.8, 24.9 and 8.5 per cent, respectively. In North America, the S&P 500, the Canadian S&P/TSX Composite and the Mexican Bolsa indices increased by 5.2, 2.5 and 4.0 per cent, respectively. In South America, the Brazilian Bovespa, the Argentine Merval and the Columbian IGBC General indices increased by 2.0, 3.6 and 3.8 per cent, respectively. In Europe, the FTSE 100, the CAC 40, the DAX and the Russian MICEX indices increased by 4.4, 0.3, 2.6 and 6.7 per cent, respectively. In Asia, Japan's Nikkei 225 increased by 4.1 per cent, while China's Shanghai Stock Exchange (A) index decreased by 4.2 per cent. India's BSE Sensex index remained unchanged (see Table 4).

**Table 4: International Stock Market Indices**

| Country | Index | 31-Dec-08 | 30-Mar-09 | 30-Jun-09 | 30-Sep-09 | 31-Dec-09 | 31-Mar-10 | % Change Dec 08 - Mar 10 | % Change Dec 09 - Mar 10 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | | | |
| **AFRICA** | | | | | | | | | |
| Nigeria | NSE All-Share Index | 31,450.78 | 19825.08 | 26,861.55 | 22,065.00 | 20,827.17 | 26,411.97 | -16.0 | 26.8 |
| South Africa | JSE All-Share Index | 21,509.19 | 19929.04 | 22,049.42 | 225,066.27 | 27,775.63 | 28,828.17 | 34.0 | 3.8 |
| Kenya | Nairobi NSE 20 Share index | 3,459.97 | 2754.54 | 3,294.56 | 3,005.41 | 3,247.77 | 4,057.63 | 17.3 | 24.9 |
| Egypt | CSE CASE 30 | 4,596.49 | 4247.48 | 5,702.87 | 6,812.40 | 6,272.00 | 6,807.03 | 48.1 | 8.5 |
| | | | | | | | | | |
| **NORTH AMERICA** | | | | | | | | | |
| US | S&P 500 | 903.00 | 784.09 | 919.32 | 1,057.08 | 1,115.10 | 1,173.27 | 29.9 | 5.2 |
| Canada | S&P/TSX Composite | 8,987.70 | 8,465.35 | 10,374.91 | 11,394.96 | 11,746.11 | 12,044.21 | 34.0 | 2.5 |
| Mexico | Bolsa | 22,392.38 | 19,564.23 | 24,368.38 | 29,232.24 | 32,120.47 | 33,399.46 | 49.2 | 4.0 |
| | | | | | | | | | |
| **SOUTH AMERICA** | | | | | | | | | |
| Brazil | Bovespa Stock | 37,060.16 | 40,504.63 | 51,465.46 | 61,517.89 | 68,588.41 | 69,959.58 | 88.8 | 2.0 |
| Argentina | Merval | 1,079.66 | 1,115.53 | 1,587.97 | 2,075.14 | 2,320.73 | 2,404.77 | 122.7 | 3.6 |
| Columbia | IGBC General | 7,560.66 | 7,927.17 | 9,879.73 | 11,257.91 | 11,602.14 | 12,042.19 | 59.3 | 3.8 |
| | | | | | | | | | |
| **EUROPE** | | | | | | | | | |
| UK | FTSE 100 | 4,319.35 | 3,762.91 | 4,249.21 | 5,102.47 | 5,452.35 | 5,693.50 | 31.8 | 4.4 |
| France | CAC 40 | 3,217.13 | 2,719.34 | 3,140.44 | 3,774.96 | 3,982.49 | 3,995.78 | 24.2 | 0.3 |
| Germany | DAX | 4,704.86 | 3,989.23 | 4,808.64 | 5,661.51 | 6,000.75 | 6,157.12 | 30.9 | 2.6 |
| Russia | MICEX | 619.53 | 763.36 | 981.99 | 1,211.30 | 1,370.01 | 1,461.32 | 135.9 | 6.7 |
| | | | | | | | | | |
| **ASIA** | | | | | | | | | |
| Japan | NIKKEI 225 | 8,859.56 | 8,236.08 | 9,939.93 | 9,978.64 | 10,654.79 | 11,089.94 | 25.2 | 4.1 |
| China | Shanghai SE A | 1,911.80 | 2,474.86 | 3,157.77 | 2,916.73 | 3,402.31 | 3,260.00 | 70.5 | -4.2 |
| India | BSE Sensex | 9,716.16 | 9,568.14 | 14,533.58 | 17,134.55 | 17,567.20 | 17,562.15 | 80.8 | 0.0 |

Source: Bloomberg

## 3.2 Domestic Macroeconomic and Financial Developments

The macroeconomic outcomes in 2009 and the first half of 2010 were influenced by developments in both the domestic and international economies. Overall, the Nigerian economy was relatively stable with mixed outcomes. The major challenge to economic and monetary policies, since 2009, has remained the management of tight liquidity in the banking system. In particular, the growth in credit to the private sector slowed significantly. Inflation rate (year-on-year) moderated substantially, although it remained at double digit all through 2009 to the first half of 2010. The exchange rate, which was relatively stable during the first and second quarters of 2009, depreciated marginally during the third and fourth quarters and later appreciated marginally in the first quarter of 2010. Interest rates rose in the first half of 2009, influenced by the global financial crisis which precipitated tight liquidity conditions in the banking system, but reversed in the last quarter, reflecting improvements in the liquidity conditions in the money market, as well as the CBN guarantee of all inter-bank transactions. Crude oil production improved in the second half of 2009 following the amnesty programme implemented by the Federal Government towards resolving the Niger Delta crisis. In addition, oil prices improved in the international oil market, in response to reported economic recovery in most advanced and emerging market economies in the second half of 2009.

### 3.2.1 The Real Sector

#### 3.2.1.1 Output

Real Gross Domestic Product (GDP) recorded a growth of 7.4 per cent in the fourth quarter of 2009 and 7.8 per cent in the first quarter of 2010, compared with 7.1 per cent and 4.5 per cent in the fourth quarter of 2008 and first quarter of 2009, respectively. The outcome was driven mainly by the non-oil sector, particularly agriculture, which constituted 35.9 per cent of GDP and grew by 5.5 percentage points in the first quarter of 2010, compared with 5.4 per cent in the corresponding period of 2009. A GDP growth rate of 7.8 per cent is envisaged for 2010.

Nigeria's crude oil output declined in the first half of 2009, with an estimated total average production of 1.76 million barrels per day (mbd), but increased to 1.94 and 1.99 mbd in the fourth quarter of 2009 and first quarter of 2010, respectively. The improved output was attributable to the relative calm in the Niger Delta Region, following the Federal Government's amnesty programme.

As in the preceding years, allocation of crude oil for domestic consumption remained at 0.445 mbd for 2009 and the first half of 2010. The average spot price of Nigeria's reference crude oil, the Bonny light ($37^0$ API), stood at US$62.1 per barrel at end-December 2009 and rose to US$79.1 per barrel in the first quarter of 2010 (see Figures 2 and 3).

**Figure 2: Growth in Oil and Non-Oil GDP**

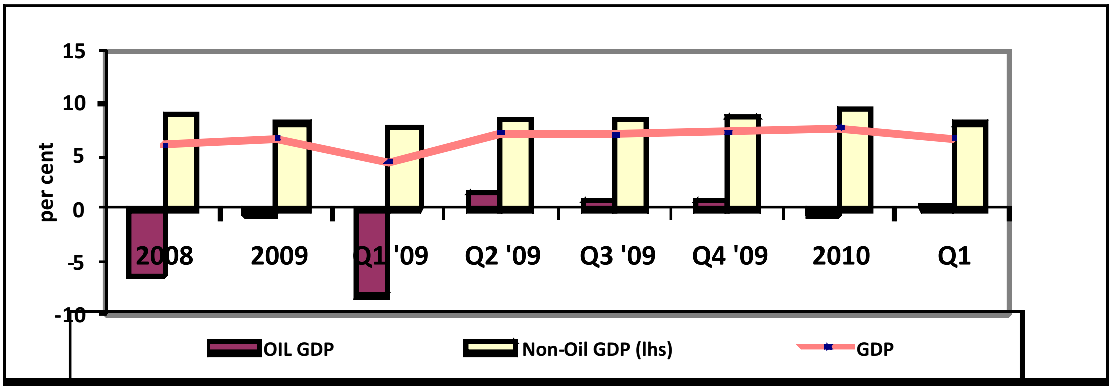
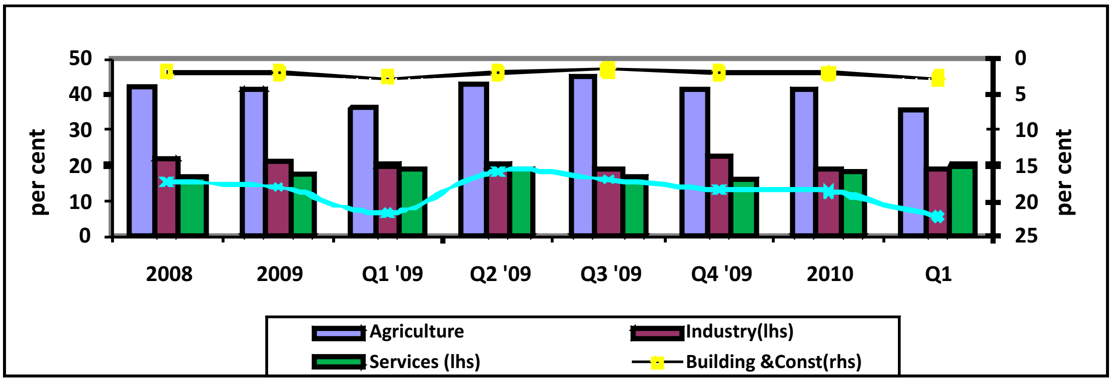


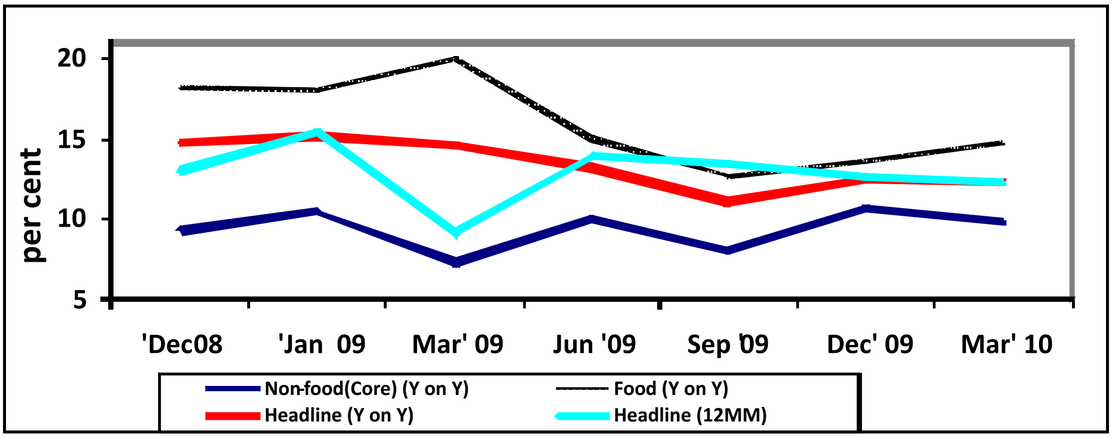

**Figure 3: Contribution to Non-oil GDP**




### 3.2.1.2 Inflation

Inflationary pressures moderated in 2009 and the first quarter of 2010, as the inflation rate trended downwards. Headline inflation fell from 14.6 per cent at the end of the first quarter of 2009 to 11.8 per cent at end-March 2010 and averaged 12.0 per cent between the first quarters of 2008 and 2010. The relatively high level of inflation reflected the upward movement in food, fuel and housing prices.

Figure 4: Inflation Trend




## 3.2.2 The Fiscal Sector

### 3.2.2.1 Fiscal Operations

The estimated Federal Government-retained revenue and aggregate expenditure stood at ₦2,646.9 billion and ₦3,456.9 billion in 2009, respectively. Consequently, the fiscal operations of the Federal Government resulted in an estimated deficit of ₦810.0 billion, compared with the budgeted deficit of ₦836.6 billion for the 2009 fiscal year. The estimated Federal Government-retained revenue and aggregate expenditure in the first quarter of 2010 were ₦468.61 billion and ₦843.81 billion respectively, indicating a decline of 29.34 and 10.14 per cent, respectively, from the levels in the preceding quarter. The fiscal operations of the Federal Government during the first quarter of 2010 resulted in an estimated deficit of ₦375.20 billion, compared with the budgeted deficit of ₦387.70 billion, as against a surplus of ₦32.56 billion in the corresponding period of 2009. The deficit was predominantly financed by FGN Bonds.

Figure 5: Government Expenditure and Revenue (Q1 2009 - Q1 2010)

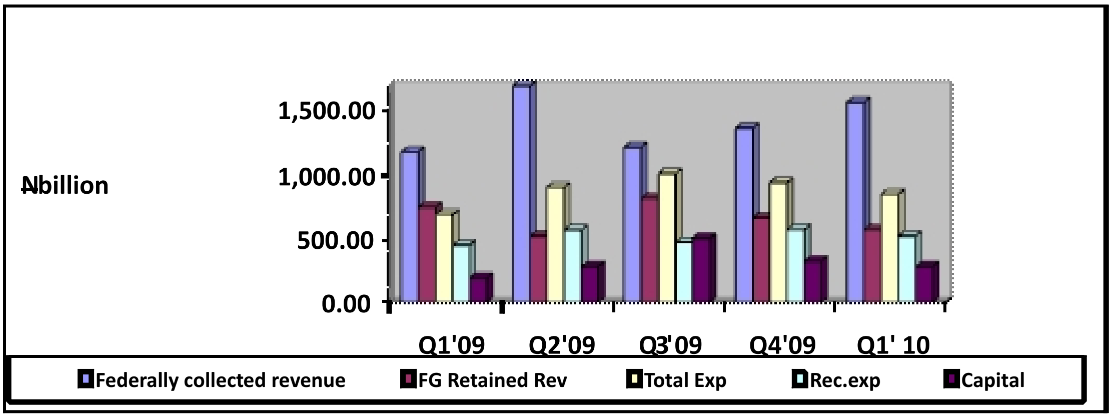


**Figure 6: Fiscal Balance and Quarterly Budget (Q1 2009 - Q1 2010)**

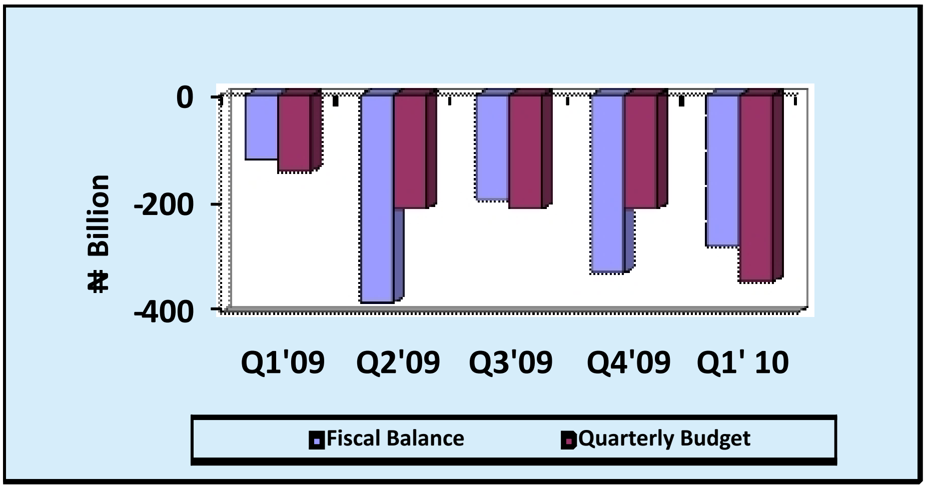
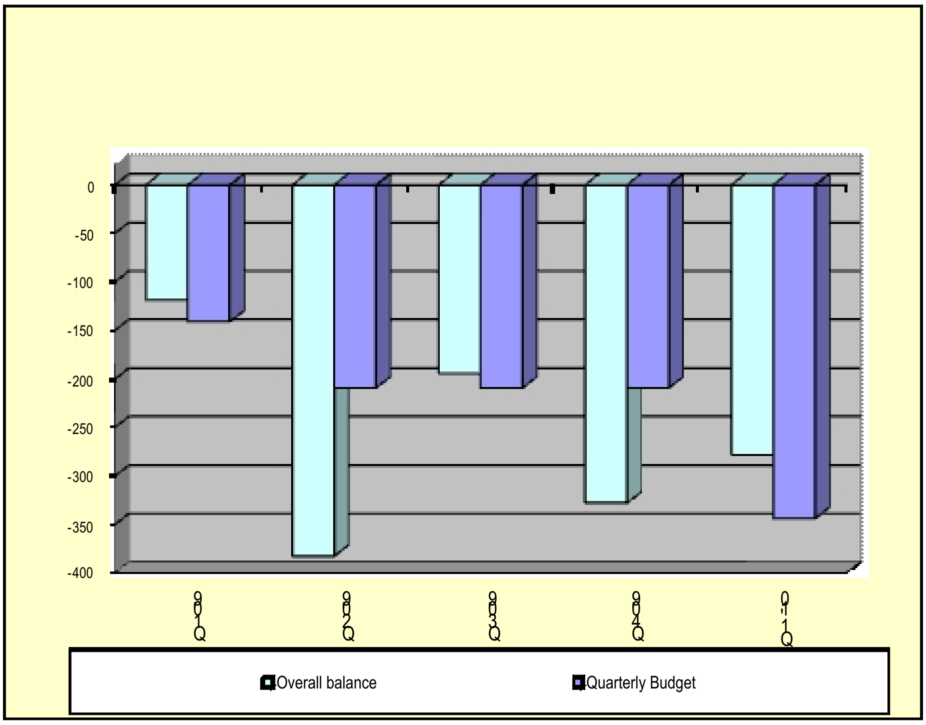



**Figure 7: Overall Fiscal Balance and Quarterly Budget (₦'billion)**




### 3.2.3 The Financial Sector

#### 3.2.3.1 Monetary and Credit Developments

Provisional data showed that the growth in monetary aggregates was modest in the first four months of 2010. Relative to end-December 2009, the broad measure of money supply (M2), rose by 1.8 per cent to ₦10,959.2 billion at end-April 2010, implying an annualised growth of 5.4 per cent, compared with the respective growth rates of 2.2 per cent and -1.8 per cent at the end of the preceding month and the corresponding period of

2009, and the indicative benchmark growth of 29.3 per cent for fiscal year 2010. The development was accounted for, largely, by the increase in net domestic credit and other assets (net) of the banking system.

Aggregate bank credit to the domestic economy (net) rose by 7.7 per cent at the end of April 2010 over the level at end-December 2009. The increase in aggregate credit (net) was due mainly to the increase in credit to the Federal Government, which rose by 32.6 per cent. However, on an annualised basis, the increase translates to 23.1 per cent, which was below the indicative target of 55.54 per cent set for 2010.

Base money, the operating target of monetary policy, which stood at ₦1,497.1 billion at end-April, 2010, was lower than the indicative benchmark of ₦1,872.8 billion programmed for the second quarter of 2010 by 20.1 per cent. See Figures 8 and 9.

**Figure 8: Trends in Major Monetary Aggregates**

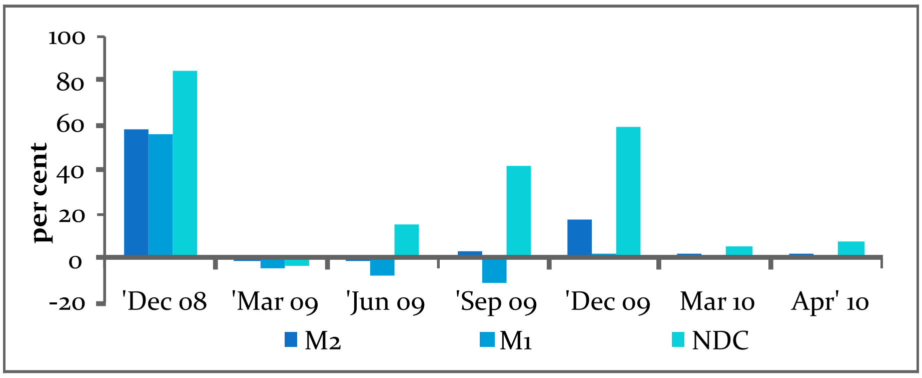
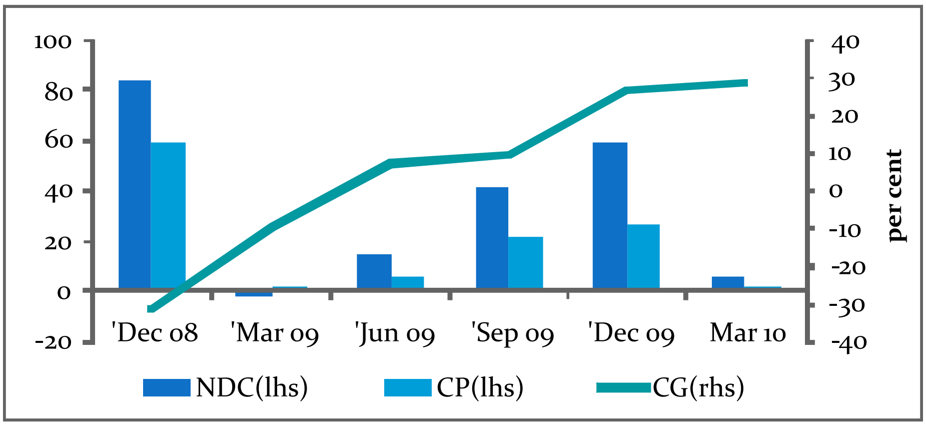



**Figure 9: Trends in Net Domestic Credit**



### 3.2.3.2 Interest Rates

The downward trend in interest rates, which began in the second half of 2009, continued in the first four months of 2010. Following CBN's decision to guarantee inter-bank transactions as well as some improvement in liquidity conditions which helped to restore confidence in the system, the rates declined. The weighted average inter-bank rate, which was 2.89 per cent as at end- December 2009, declined to 1.27 per cent at end-April 2010. Similarly, the securitised open buy back (OBB) rate declined to 2.46 per cent at end-March 2010, from 2.64 per cent at end-December 2009, and further to 1.11 per cent at end-April 2010. Average term-deposit rate declined by 3.95 percentage points to 5.54 per cent at end-March 2010, from the level at end-December 2009.

The fall in short-term rates impacted marginally on lending rates as prime and maximum lending rates declined by 0.7 and 0.3 percentage points to 18.4 and 23.2 per cent, respectively, at end-March 2010, from their end-December 2009 levels. Despite the declining rates, the spread between the average term-deposit and the maximum lending rates widened to 18.09 percentage points in March 2010, from 11.72 percentage points in December 2008 (see Figures 10 and 11).

**Figure 10: Money Market Rates between December 2008 and March 2010**

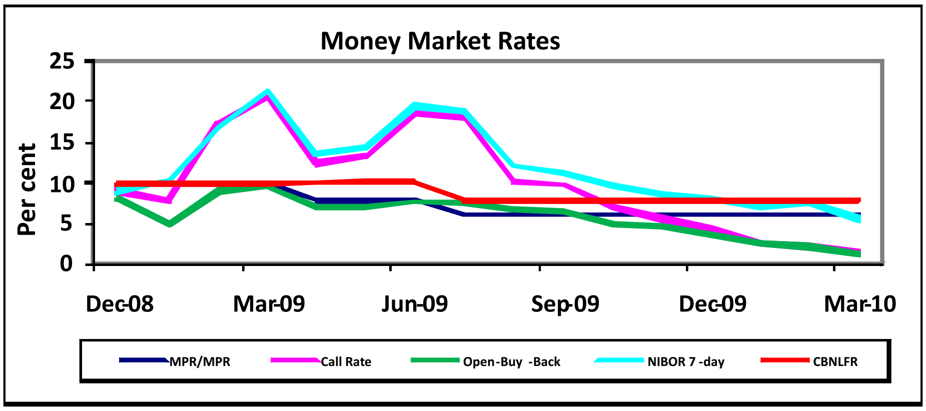
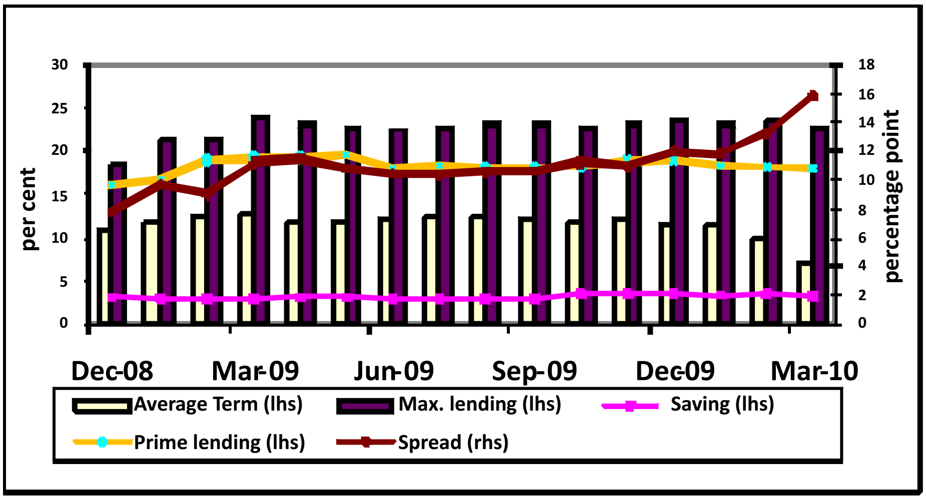


**Figure 11: Lending Rates**




### 3.2.3.3 Liquidity Management

Monetary policy was largely influenced by tight liquidity conditions in the domestic economy, induced partly by the distress in some local banks and the global economic and financial crises of 2007/2008. Liquidity management was, therefore, anchored on the need to ensure a well functioning financial market that would foster growth without compromising the objective of monetary and price stability. The CBN made extensive use of open market operations (OMOs), being its primary tool of liquidity management. This was complemented by prudential reserve ratios, tenored repurchase transactions, the sale of treasury instruments at the primary segment of the market, and the used of CBN's standing facility window.

Consequent upon the tight liquidity conditions experienced in the first half of 2009, a number of measures were taken by the CBN to achieve optimum liquidity, stability in the foreign exchange markets, and a seamless flow of credit to the real economy. The measures included the following:

- Further liberalisation of the foreign exchange market;
- Downward adjustment of monetary policy rates and other prudential ratios;
- Injection of a stimulus package of ₦620.0 billion to recapitalise some ailing banks; and
- Guarantee of inter-bank transactions.

These measures resulted in a number of positive developments in the second half of the year as manifested in the relative stability of the foreign exchange market and improved liquidity conditions in the inter-bank money market.

### 3.2.3.4 Capital Market Developments

The improved performance recorded in the capital market between 2006 and the early part of 2008 was driven by the recapitalisation and consolidation of the banking industry and the huge inflows from pension funds. Consequently, the market recorded phenomenal increases in all the indices, especially the All-Share-Index (ASI) and market capitalisation. Market capitalisation grew from a very low level of ₦500 billion in 2000 to ₦5.1 trillion and ₦13.3 trillion in 2005 and 2007, respectively.

However, the global financial crisis adversely affected the Nigerian capital market in 2008, as activities were generally bearish. Share prices of quoted companies crashed and market capitalisation declined to ₦9.5 trillion. Also, internal market shortcomings, including poor corporate governance, insider dealings, weak risk management practices and share price manipulation, contributed to loss of confidence in the market.

In 2009, the major market indicators further trended downwards, as the aggregate volume and value of traded securities declined substantially by 46.8 and 71.4 per cent, respectively. Also, aggregate market capitalisation of the 266 listed securities declined by 26.3 per cent to close at ₦7.0 trillion, from ₦9.6 trillion recorded in 2008. The market capitalisation of the 216 listed equities dropped from ₦7.0 trillion in 2008 to close at ₦5.0 trillion. These developments were due largely to the price depreciation recorded by the equities, the delisting of 11 companies and the maturing of 53 fixed income securities. Market capitalisation as a percentage of GDP was 28.5 per cent in 2009, compared with 39.7 per cent in 2008. The ratio of the value of stocks traded to GDP stood at 10.0 per cent, same as in 2008, while the turnover value as a percentage of market capitalisation was 9.8 per cent, compared with 25.2 per cent in 2008. The annual turnover value (measured as the ratio of the total value of stocks traded to the total value of stocks listed on the domestic market) declined by 71.4 per cent, compared with a decline of only 14.3 per cent in 2008.

In the first quarter of 2010, developments in the capital market were mixed. The volume of traded securities declined by 1.4 per cent to 27.2 billion shares, while the value increased by 9.5 per cent to N193.8 billion in 621,662 deals, compared with 27.6 billion shares and ₦177.0 billion in 368,980 deals in the preceding quarter. The market capitalisation of the 262 listed securities rose by 20.0 per cent to ₦8.4 trillion over the preceding quarter's level. The All-Share Index, which opened at 20,827.17 at the beginning of the quarter, closed at 25,966.25, implying an increase of 24.7 per cent over the level in the preceding quarter. The development was attributed to the price gains recorded by the highly capitalised stocks and listing of new securities on the Exchange during the period under review.

### 3.2.3.5 Institutional Developments in the Financial Sector

#### The Banking System

Following the consolidation exercise in 2005, the banking sector witnessed dramatic growth. However, neither the banks nor the regulators were sufficiently prepared to sustain and monitor the explosive growth. Furthermore, the concomitant build-up of risks in the system posed serious challenges to the regulators and other stakeholders. The interdependent factors that were identified as being responsible for the ensuing fragile financial system included corporate governance failures at banks, inadequate disclosure and transparency, inadequate legal and regulatory framework, poor risk management practices, etc.

The combined effects of these factors rendered the financial system vulnerable and incapable of supporting the economy adequately. Furthermore, there were doubts and concerns about the true financial conditions of some banks, thereby eroding public confidence in the system. In the circumstances, the CBN had to conduct a diagnostic review of the industry to establish its true health and to enable it effectively intervene to remedy the situation. The result of the exercise revealed that the factors listed above, which were exacerbated by the adverse impact of the global financial crisis, threatened the safety and soundness of the financial system.

The exercise also revealed that some banks that were exposed to the capital market, in the form of margin trading facilities, experienced liquidity problems. Furthermore, the pressure to earn a high return on the huge capital increased the risk appetite of many banks, resulting in huge exposures in highly risky areas, such as oil and gas.

Specifically, the diagnostic review revealed the following shortcomings:

- A high percentage of non-performing loans in some banks, which exceeded by far the industry average. The poor asset quality was attributed to poor corporate governance practices, weak risk management practices, lax credit administration processes and non-adherence to the banks' credit risk management policies;

- The poor asset quality impacted negatively on the earnings and capital of some banks thereby threatening their going concern status;

- Huge exposure to the Capital Market and Oil and the Gas sector. Consequently, some banks were required to increase their provision for loan losses, which impacted negatively on their profitability and shareholders' funds;

- Some banks were significantly undercapitalised for their levels of operation and needed to urgently inject fresh funds, ranging from about ₦5.8bn to ₦109.23bn;

- The capital adequacy ratios recorded in some banks were below the prescribed minimum threshold of 10 per cent, which implied that the capital of such banks was inadequate to support their levels of operation;

- The affected banks did not meet the minimum liquidity ratio of 25 per cent set for banks and could also not meet their maturing obligations without resorting to the CBN discount window, thereby providing proof of their illiquid status; and

- Pervasive poor corporate governance practices, especially in the areas of disclosure and financial reporting.

Given the above aggravated state of affairs and other challenges posed to the system, the CBN implemented a number of initiatives, not only to rescue the ailing banks in the interest of depositors, but also to safeguard the stability and soundness of the system. The initiatives are summarised in the following paragraphs.

- **Intervention and Restructuring**: The CBN intervened in eight banks by removing executive management teams and the board of directors and appointing new executive management teams to run the affairs of the affected banks. It also injected ₦620 billion in the form of Tier 2 Capital (seven-year convertible bond) into the banks. The capital injection was to be repaid from the proceeds of re-capitalisation of the banks. Subsequently, the process of strengthening the banks in which the CBN had intervened was initiated to make them attractive to both local and foreign investors.

- **Establishment of the Asset Management Corporation of Nigeria (AMCON):** The need for a special purpose vehicle (SPV) to free banks of their toxic asset burden led to the promotion of AMCON by the CBN, in conjunction with the Federal Ministry of Finance. It is believed that the establishment of AMCON constitutes the first critical step towards the resolution of the non-performing loan problem in banks a process that would eventually facilitate further consolidation of Nigerian banks.

- **Establishment of the Financial Stability Committee (FSC):** The Committee was established to strengthen systemic stability in the financial system, through the formulation of monetary policy and macro-prudential rules. The FSC and the Monetary Policy Committee would be at the core of the new macro-prudential framework, working together to ensure that monetary policy is shaped by systemic risk trends and consistent with the expanded goals for asset price stability.

- **Review of Supervisory Procedures & Methodology:** Implementation of risk-based and consolidated supervision commenced with a pilot run of two deposit money banks and is being vigorously pursued.

- **Adoption of a Common Year-End for Banks:** A common accounting year-end for banks in Nigeria with effect from December 31, 2009 was introduced. Furthermore, a road map was provided for the implementation of the International Financial Reporting Standards (IFRS) by December 2012.

- **Restructuring of the Financial Sector Surveillance Directorate:** The CBN streamlined its organisational structure to ensure better supervision and regulation of the industry. Thus, with effect from March 2010, the CBN has restructured its Financial Sector Surveillance Directorate by creating the Financial Policy and Regulation Department to, among other things, enhance regulatory effectiveness. The Directorate is now named Financial System Stability Directorate, made up of four departments, namely, Banking Supervision, Financial Policy and Regulation, Development Finance, and Other Financial Institutions Supervision Departments. Also, as part of the restructuring of the CBN, new departments Financial

Markets, Banking and Payments System, and Risk Management Departments have been created to enhance financial stability.

- **Collaboration with Other Regulators:** The CBN has intensified efforts, through the Financial Services Regulation Coordinating Committee (FSRCC), to foster closer collaboration and the harmonisation of its policies with those of other regulatory agencies, such as SEC, NAICOM, PENCOM, etc, for better supervisory impact.

- **Corporate Governance:** The CBN has strengthened corporate governance in banks by limiting the tenure of managing directors to a maximum of ten years. Also, the former top management of the CBN and the NDIC are no longer eligible to hold offices in Nigerian banks, including their subsidiaries, for a minimum period of five years after their exit from service.

**The other reforms implemented were as follows**:
- Licensing of private credit bureaux,
- Establishment of a Small and Medium Enterprise Credit Guarantee Scheme (SMECGS),
- Establishment of Infrastructure Finance Office,
- An Export Financing Initiative,
- A Warehouse Receipt Financing Initiative,
- Establishment of the Commercial Agriculture Credit Scheme, and
- A certification programme for Microfinance Banks.

## The Capital Market
In an effort to strengthen the Nigerian Stock Exchange (NSE), a new organisational structure was approved for the Exchange in 2009 to enable it effectively deliver on its mandate. The Exchange introduced a new NSE-30 and four sectoral indices, covering Food and Beverage, Banking, Insurance, and Oil and Gas.

Furthermore, the Exchange concluded arrangements with Thomson Reuters and Bloomberg for the dissemination of real-time market data to the global investment community. The Exchange also commissioned two (2) new trading floors in Owerri and Bauchi, bringing the number of trading floors to thirteen (13).

In the first quarter of 2010, a review of capital market rules was undertaken. The key provisions of the new rules include the following:

- Prior approval of the Securities and Exchange Commission (SEC) for appointments into the top management of market operators must be obtained;
- Listed companies are required to submit their year-end accounts to the SEC, not later than 9 months after their financial year ends, while government and supranational bodies must submit not later than 12 months;
- The underwriting of issues is no longer mandatory: where an issue is underwritten, the underwriting commitment by a single underwriter shall not be more than 3 times its shareholders' fund for equity offering and 4 times for fixed income securities;
- Issuers are now required to list their securities not later than 30 days after the allotment clearance (where the issuer had stated in its prospectus that the securities would be listed); and
- Public companies are now required to make additional financial reporting, such as quarterly reports, half-yearly reports and to file annual reports with the Commission, in accordance with the requirements of *sections 60  65* of the *Investment and Securities Act (ISA), 2007*.

A list of the practices considered by the SEC as substantially preventing or reducing competition in a company's line of business, was also provided.

## The Real Sector

For sustainable growth and development in any economy, developments in the real and financial sectors should move in the same direction. However, in Nigeria, the experience of the immediate past has shown a marked disconnect between the two sectors. This was because the phenomenal growth in the financial sector did not translate to enhanced real sector financing.

To address this challenge and boost economic growth, several measures have been initiated over the past eighteen (18) months, including the following:

### i. Agriculture:

a. Guaranteed Minimum Price (GMP) Scheme to serve as an incentive for farmers to expand the cultivated areas in the country;

b. Construction of additional 19 silos, with a view to attaining the national target of 1 million tonnes storage capacity, in line with the Food and Agriculture Organization (FAO) recommendation;

c. Establishment of 37 buying points and 36 markets for livestock, fisheries and fruit and vegetables to improve the market infrastructure and access to these basic commodities; and

d. Establishment of a ₦200.0 billion Commercial Agriculture Credit Scheme (CACS) by the CBN, in collaboration with the Federal Ministry of Agriculture and Water Resources (FMA&WR).

**ii. Manufacturing and SMEs:**

- Establishment of a ₦300 billion Power Development Fund in support of SMEs;
- Establishment of a ₦200 billion Small and Medium Enterprises Credit Guarantee Scheme (SMECGS); and
- Establishment of a ₦200 billion fund for the refinancing and restructuring of the manufacturing sector loan portfolio.

**iii. Oil & Gas:**

- The Federal Government's amnesty programme in the Niger Delta region.
- The enactment of the Nigerian Oil & Gas Industry Content Development Act, 2010 (the "Local Content Act"); and
- The creation of a separate Ministry for the development of the Niger Delta.

**iv. Transportation:**

- Commencement of the dredging of the River Niger;
- Establishment of maritime institutes in five river ports at Warri, Onitsha, Idah, Lokoja and Baro;
- Introduction of various models of Public-Private-Partnership (PPP) initiatives, such as the Build Operate and Transfer (BOT), the Build Operate and Own (BOO), etc, in some key areas, such as roads, airports, and rail transport. Examples in this regard include:
    - The construction of rail lines to seaports at Tin Can, Onne, Calabar, Koko, Warri and various river ports; and

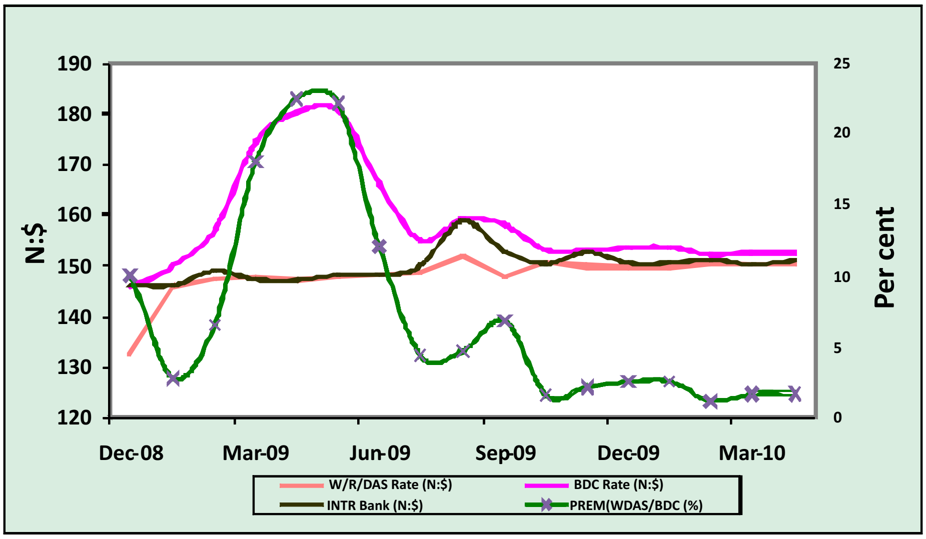
- The construction of rail lines to six identified Inland Container Depots (ICDs), the expansion of some existing ICDs, and the rehabilitation of Idogo and Baro lines for use as ICDs.

### 3.2.4 The External Sector

The external sector recorded a modest improvement during the review period. Total exports, free-on-board (FOB), decreased by 31.7 per cent to ₦6,771.6 billion (US$20.12 billion) by end-December 2009, compared with the level in the corresponding period of 2008. The development reflected the downward movement in crude oil prices in the international market, relative to the preceding year. The overall balance of payments position stood at ₦1,508.40 billion at end-December 2009, compared with N196.4 billion at the corresponding period of 2008, reflecting the changes in the external reserves. The overall deficit was equivalent of 63 per cent of GDP and contrasted with the modest surplus of 0.8 per cent recorded in 2008.

The exchange rate remained relatively stable in the first four months of 2010. The weighted average exchange rate of the Naira against the US Dollar, under the WDAS, depreciated by 1.7 per cent to ₦149.92 per US Dollar, from ₦147.36 per US Dollar recorded at the end of the corresponding quarter of 2009. In the bureaux-de-change (BDCs) segment of the market, the Naira traded at an average rate of ₦152.45 per US Dollar, compared with ₦160.97 per US Dollar in the corresponding quarter of 2009, reflecting a 5.3 per cent appreciation. The admission of the BDCs to the CBN foreign exchange window was responsible for the appreciation and the convergence of rates (see Figure 12).

**Figure 12: Exchange rates From December 2008 to March 2010**



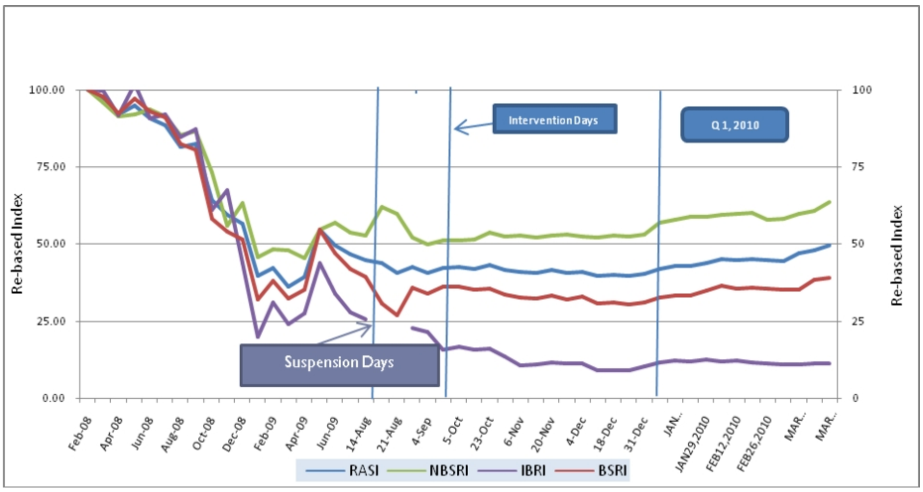
### 3.3 Key Risks in the Financial System

After the 2005 bank consolidation programme, some interrelated negative factors, which have been accentuated by the global financial and economic crises, began to surface and resulted in a fragile financial system on the verge of collapse. The factors included volatile capital flows, major weaknesses in the business environment, failures in corporate governance in banks and other financial institutions, inadequate disclosure and transparency, engagement in multiple financial activities, and uneven supervision and enforcement. In addition, DMBs did not have adequate risk management frameworks for identifying, managing and controlling the risks associated with their businesses.

In the first half of 2010, the financial sector was reasonably stable. The uncertainty in some quarters over the viability of the financial system, which had been precipitated by the adverse impact of the global financial and economic crises on the sector, had eased. This positive development arose from the impact of various policy measures adopted by government and the regulatory authorities to stabilise the system. Specifically, the banking system had been relatively stable since the intervention by the CBN and the measures taken since August 2009 to safeguard depositors' funds and engender financial stability. It is also pertinent to note that the reforms have been greatly complemented by a conducive macroeconomic environment.

Consequently, the CBN, as part of the initiatives taken under the banking reforms programme, established the Risk Management Department to facilitate the institutionalisation of a comprehensive risk management framework in the Nigerian financial system. It is envisaged that this initiative would engender financial stability.

**Figure 13: Measuring Stock Market Confidence, February 2008 March 2010**



The financial system continues to be exposed to certain risks which the CBN is taking steps to manage (see Figure 13). The key risks include the following:

- Credit risk,
- Liquidity and funding risk,
- Market risk,
- Operational and Reputational risks, and
- Money laundering and terrorist financing risks.

### 3.3.1 Credit Risk

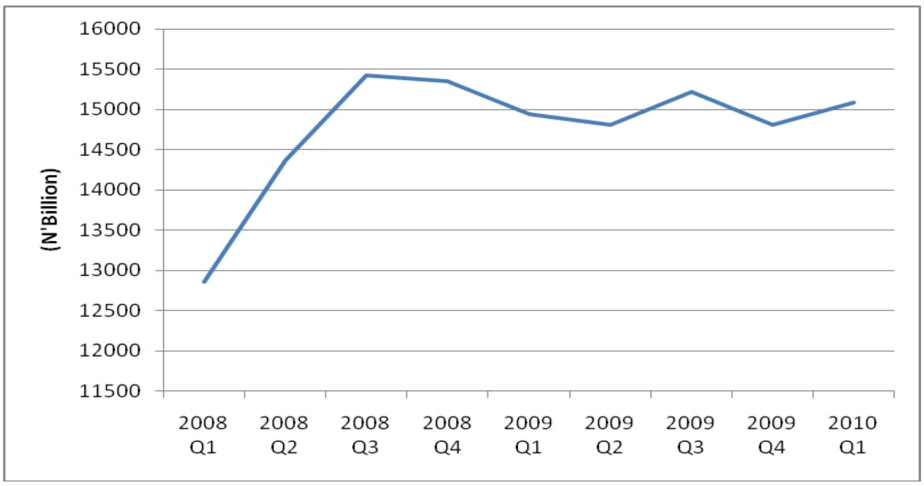
Credit exposure continues to constitute the main source of risk to the financial system. The major risks in this area that warrant close attention include the credit exposure of DMBs to the more volatile sectors of the economy such as general commerce and oil and gas. The threat to financial stability from the risk perspective is evidenced from:

- Rapid growth in total assets;
- The lack of diversification in the credit portfolio of DMBs; and
- The deteriorating asset quality of banks.

### a. Total Assets

The total assets of the 24 DMBs in the Nigerian banking system stood at ₦15,056 billion at end-April 2010. Between 2007 and end-March 2010, total banking system assets grew by 41.39 per cent, indicating an average annual growth rate of 13.80 per cent. The growth in banking system assets was boosted by the rise in Government Securities and Investments which grew by 48.93 and 58.23 per cent, respectively. The financing of the growth in total assets of DMBs during the period was traced to increased deposit liabilities and money at call, which grew by 21.24 and 60.04 per cent, respectively (see Figure 14).

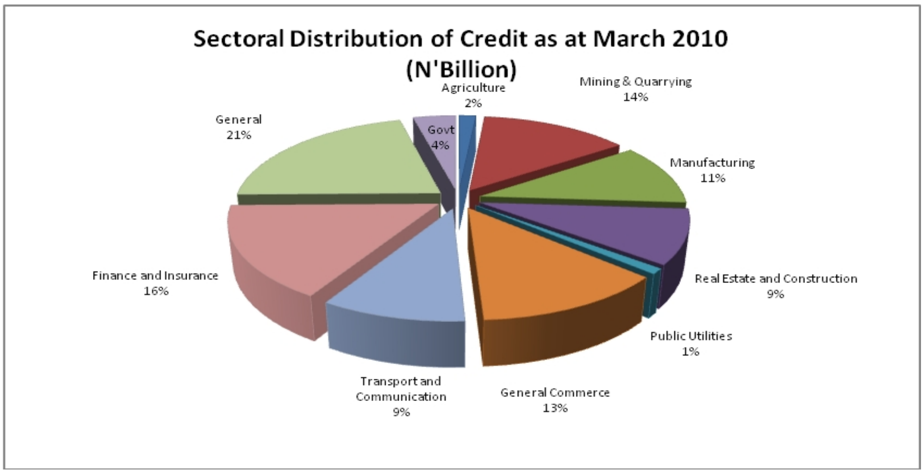
**Figure 14: The Total Assets of DMBs**



## b. Credit Portfolio of DMBs

The gross credits of DMBs grew from ₦4,607 billion as at end-December 2007 to ₦8,950 billion as at end-December 2009, and further to ₦11,071.1 billion as at end-March 2010. However, the reluctance of DMBs to lend to the real sector of the economy has persisted as banks have remained averse to extending new loans and advances to the real sector. The reluctance of DMBs to grant credit to the real sector constitutes a challenge in fostering economic growth and in generating employment opportunities.

**Figure 15: Sectoral Distribution of Credits as at End-March 2010**




The distribution of outstanding bank credit, which is skewed in favour of less-preferred sectors, has long-term implications for growth and financial stability (see Figure 15 and Table 5). High levels of credit concentration in the Oil and Gas, Real Estate, and Stock Market segments, as was the case in 2009, remain a major concern to the authorities in view of the prevailing volatile nature of developments in these sectors. Inadequate or absence of basic economic and social infrastructure remains a major factor determining the sectoral distribution of credit. There is a need to expedite the proposed reforms in some key sectors of the economy, notably power and oil/gas sectors, to attract the much-needed investment which should stimulate credit to the more preferred sectors of the economy. The resumption of credit to the key productive sectors of the economy is critical because of the obvious medium to long-term benefits for the real economy.

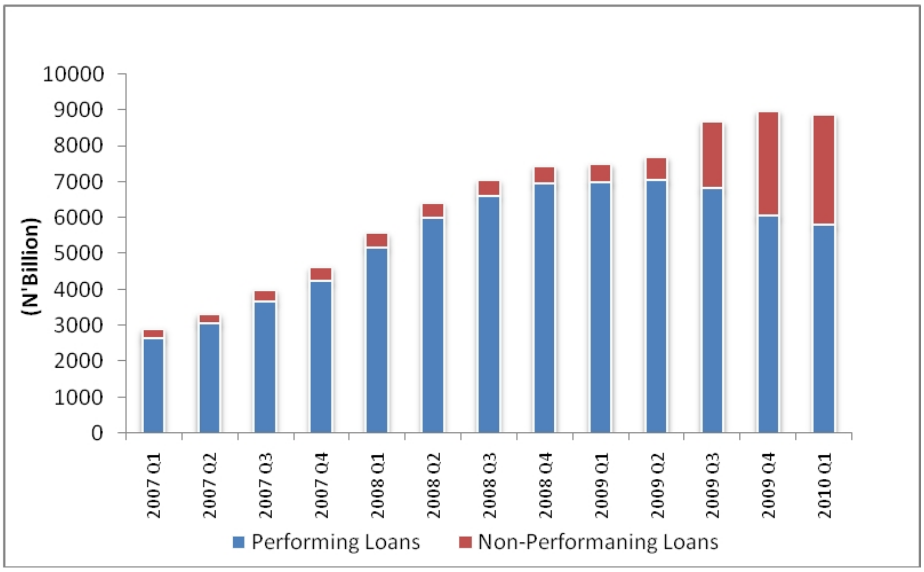
### Table 5: Sectoral Distribution of Credit

| | Dec - 09 | Jan -10 | Feb -10 | Mar -10 | Mar -10 |
|---|---|---|---|---|---|
| | N'b | N'b | N'b | N'b | % |
| Agriculture | 136 | 113 | 136 | 137 | 1.55 |
| Mining & Quarrying | 1,191 | 1,052 | 1,060 | 1,217 | 13.75 |
| Manufacturing | 993 | 1,030 | 1,003 | 954 | 10.78 |
| Real Estate and Construction | 778 | 765 | 822 | 842 | 9.51 |
| Public Utilities | 75 | 38 | 33 | 85 | 0.96 |
| General Commerce | 1,245 | 1,112 | 954 | 1,116 | 12.61 |
| Transport and Communication | 777 | 784 | 826 | 833 | 9.41 |
| Finance and Insurance | 1,231 | 1,132 | 1,306 | 1,435 | 16.21 |
| General | 2,172 | 2,485 | 2,440 | 1,882 | 21.26 |
| Govt | 352 | 315 | 319 | 352 | 3.98 |
| Total Credit (Gross) | 8,950 | 8,825 | 8,900 | 8,853 | 100 |

## c. Asset Quality of Banks

In aggregate terms, Nigerian banks' non-performing assets have increased, reflecting, largely, the ongoing reclassification of bank assets. As at March 2010, 34.8 per cent of on-balance sheet assets were classified as non-performing. Of these non-performing assets, 20.4 per cent were not covered by the value of collateral (see Figure 16). The remainder of these assets were in arrears, but were well covered by collateral. Most of the non-performing loans (NPLs) were, as earlier noted, as a result of margin lending and huge exposures to the oil and gas sector.

### Figure 16: Trend in the Growth of Gross Loans and Non-performing Loans



### CBN Initiatives to Mitigate Credit Risk

The credit risk within the Nigerian banking sector between 2008 and 2009 has posed a major challenge to the continued viability of the financial system. In order to mitigate the risks, the CBN has taken the following initiatives:

i. The establishment of private credit bureaux to complement the Credit Risk Management System (CRMS) of the CBN, in order to improve the credit appraisal procedures of DMBs, so as to strengthen their credit risk management processes. Three credit bureaux have been licensed as at June 2010;

ii. The establishment of the Asset Management Corporation of Nigeria (AMCON), as a critical part of ongoing initiatives by the CBN of mitigating credit risks in the banking system by freeing banks of their toxic assets and injecting liquidity into the system;

iii. Promoting self-discipline by banks in the management of their risks. In this regard, the DMBs are being encouraged to implement the *Code of Corporate Governance for Banks in Nigeria,* and put in place risk management frameworks, in line with the existing *Guidelines for Development of Risk Management Framework by Banks,* issued by the CBN;

iv. The adoption of Basel II in Nigeria by 2012;

v. The issuance of new *Prudential Guidelines, Guidelines on Margin Lending,* circulars on the use of *Bankers Acceptances and Commercial Paper,* and of *Minimum Information Disclosure Requirements in Financial Statements;*

vi. Continued advocacy for the establishment of special courts for the speedy resolution of commercial cases; and

vii. The adoption of the IFRS by Nigerian banks by 2012, at the latest.

### 3.3.2 Liquidity and Funding Risks

Nigerian banks experienced severe liquidity challenges from 2007 to July 2009, which were caused mainly by the following factors:

- Huge non-performing loans, particularly margin loans and Oil & Gas-relates exposures;
- Recall of foreign credit lines by correspondent banks;
- Withdrawal of foreign portfolio investments from the system; and
- Absence of a robust liquidity risk management framework.

The CBN has taken the following measures to contain the liquidity crisis:

- Expansion of the CBN Discount Window in October 2008;
- Reduction of the liquidity ratio from 30.0 per cent to 25.0 per cent and the Cash Reserve Requirement from 2.0 per cent to 1.0 per cent, with effect from April 2009;
- Removal of the executive management of eight (8) banks adjudged to have engaged in unsafe and unsound banking practices which were the root cause of their liquidity problems;
- Injection of ₦620 billion into the eight (8) banks as Tier 2 capital;
- The CBN guarantee of all foreign credit lines to banks; and
- The CBN guarantee of inter-bank market transactions.

It is noteworthy that the various measures taken have significantly restored confidence in the market and resulted in a more stable financial system.

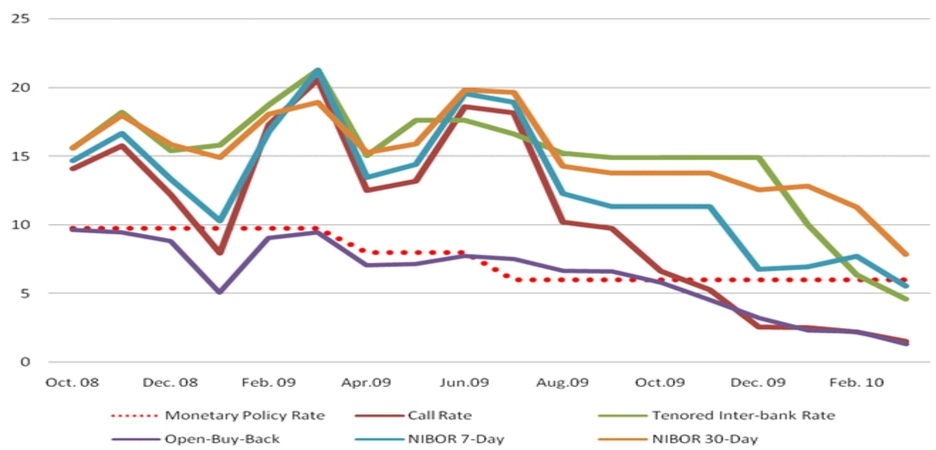
### 3.3.3 Market Risk

#### Interest and Foreign Exchange Rates

During the first quarter of 2010, yields on the Federal Government of Nigeria (FGN) bond market did not reflect economic fundamentals. For instance, yields on 10-20 year FGN bonds were around 6-8 per cent, whilst the rate of headline inflation was estimated at 12.5 per cent. Thus, real interest rates on those bonds were negative, a situation which is not sustainable in the medium or long term. The situation is more likely to be corrected by an increase in nominal interest rates, rather than a substantial decline in the rate of inflation. As DMBs hold over 60 per cent of outstanding FGN bonds, such a correction could result in huge capital losses to the DMBs. This situation would also apply to other institutional investors, such as pension fund administrators who hold 10 per cent of FGN bonds. This could lead to erosion of banks' capital, and would have a negative impact on financial system stability.

The CBN has succeeded in reducing the level of volatility of money market rates in the past one year. Accordingly, the Monetary Policy Rate (MPR) was reduced from 9.75 per cent to 8.50 per cent and further to 6.00 per cent in July 2009. The weighted average inter-bank rate and other key money market rates had fallen below the end-December 2008 level by end-August 2009, after the sharp increase recorded between January and July 2009. The downward trend is partly attributed to the CBN guarantee on inter-bank transactions which has increased confidence in the market. Despite the low money market rates, retail lending rates have not decreased correspondingly (see Figure 17). Policy would continue to be geared towards reducing the high lending rates in the face of low money market rates.

**Figure 17: The Money Market and Monetary Policy Rates**




The foreign exchange market remained fairly stable over the review period, with the Naira/US Dollar exchange rate at ₦149/USD1, as at end-April 2010. However, as inflows into the economy increase, there would be a need to monitor and establish the nature of the inflows in order to ensure that as events unfold in the international economic arena, the impact of capital reversals on the domestic economy would be minimised. FDI inflows were ₦102.42 billion in 2009 and are likely to improve in 2010, given the fact that FDI inflows stood at ₦84.78 billion in Q1 2010. The flows spread across share equities - banking, telecom, manufacturing and oil and gas sectors. In addition, Nigerian banks have been receiving increased levels of foreign credit lines into the economy.

### 3.3.4 Operational and Reputational Risks

#### Operational Risk

Some of the operational risks faced by Nigerian financial institutions in the past eighteen months include ATM frauds, armed robberies, identity theft, fraud and break-down of information technology (IT) systems. These risks arising from failure in the people, processes and systems of financial institutions or from external events have implications for confidence in the system as unexpected and uncontrolled operational risk can present a major threat to a financial institution and by extension to the financial system. The occurrence of an operational risk event can pose a threat to a financial institution either directly or by aggravating other risk types. The threat to confidence in the financial system, in itself portends crisis and instability, if it occurs for a sustained period.

Towards ensuring a safe and sound banking system, therefore the CBN has taken several steps to encourage effective risk management in banks and discount houses. Some specific steps taken to ensure that operational risk is effectively managed by financial institutions include:

- The directive by the CBN to DMBs and discount houses to develop Enterprise Risk Management Frameworks (ERMF), which are expected to cover operational risk management, among others;

- Carrying out regular examination of the financial institutions during which the adequacy and effectiveness of their internal control processes are evaluated;

- Commencement of RBS with pilot examination of two banks, and later other DMBs, which involved assessment of the adequacy and effectiveness of risk management, and covered operational risk, among other risk types;

- Training of bank directors on their role in risk management including operational risk ;

- Adoption of Basel II, which prescribes various safety and soundness standards for operational risk management for banks and other financial institutions; and

- Commencement of macro-prudential management by the CBN, which is expected to help monitor risks trends and the economic big picture and map interconnections between financial institutions especially with regards to risks which may pose a threat to the stability of the system.

It is believed that the various initiatives will have the desired effect and reduce the risk to the system arising from operational risk.

Confidence in a nation's financial system is eroded by money laundering of criminal proceeds, widespread financial fraud, insider-trading of securities, embezzlement, breach of laid-down procedures, the threat of instability or failure of financial institutions, etc. The negative and undesirable reputation from such activities would undermine the economic growth and development of any country, with far-reaching implications for the country.

### Reputational Risk

Once a country's financial system's reputation has been damaged, repairing it could be very difficult as significant government resources may be required to rectify a problem that could have been prevented by putting in place an adequate legal and regulatory framework.

In the light of the possibility of such undesirable developments in Nigeria, the CBN has embarked on a number of initiatives to mitigate the risk to the reputation of Nigeria's financial system, including the following:

i. Issued the *AML/CFT Regulation 2009* to ensure compliance with FATF Recommendations;

ii. Established a 'Chief Risk Officers Forum' to promote strong risk appreciation among risk managers and encourage them to share information on areas of common interest;

iii. Collaborated with other regulators, through the institution of the FSRCC for the purpose improving supervisory impact;

iv. Issued circulars on banks' handling of the receipt of proceeds of international money transfers;

v. Commenced review of the banking model to ring-fence banking operations; and

vi. Established the Financial Stability Committee (FSC) to strengthen systemic stability through the formulation of monetary policy and micro-prudential rules.

These efforts have, so far, shown that public confidence in the system is being restored and that interest in the financial system is on the upswing.

### 3.3.5 Money Laundering and Terrorist Financing Risk

Money Laundering (ML) and terrorist financing have negative effects on the economy as they are inextricably linked to the underlying criminal activities. Financial institutions whose platforms are used for any of these purposes run the risk of being associated with the underlying crime.

Where funds from a particular criminal activity are processed through a particular financial institution, the latter could be construed as being in active complicity with criminals, and may be considered part of the criminal network. Evidence of complicity could have a damaging effect on the attitude of other financial intermediaries, regulatory authorities and customers of such institution.

In order to underscore these grave concerns, the CBN has put in place appropriate measures aimed at controlling the activities of money launderers within the institutions under its regulatory purview. Some of such measures taken during the review period include the following:

- *The AML/CFT Regulation*, which was gazetted in December 2009, in line with the FATF Recommendations;

- The establishment of the AML/CFT Office, with responsibility for policy formulation and ensuring compliance with the AML/CFT best practices; and

- Reform of the Payments System to discourage cash transactions, and encourage electronic payments which could be more easily traced and documented.

# 4.0 INITIATIVES IN THE FINANCIAL SECTOR

The focus of the CBN in 2010 is to enhance the safety and soundness of the financial system through appropriate banking reforms and achieve improved access to financing, institutional capacity building, and entrenchment of good corporate governance practices, thereby stimulating economic development.

## 4.1 Promoting Financial Stability

One of the core functions of the CBN, as provided for in Section 2 of the CBN Act of 2007, is promoting financial stability. The importance of this function became more apparent during the global economic crisis of 2008 and its effect on the Nigerian economy. The global crisis affected the Nigerian economy in two significant ways:

- The exit of portfolio investors from the Nigerian stock market; and
- A significant reduction in government revenues

The impact was compounded by a sharp decline in capital inflows, which put considerable pressure on foreign reserves. The resultant liquidity shock necessitated the intervention of the CBN to restore financial stability.

**Box 1: The Intervention Measures**

- Reduction in the Monetary Policy Rate (MPR) from 10.25 per cent to 9.75 to 8 and further to 6 per cent;
- Reduction in the Cash Reserve Ratio from 4.0 per cent to 2.0 per cent and then 1.0 per cent;
- Reduction of the Liquidity Ratio from 40 per cent to 30 per cent and then to 25 per cent;
- A directive to banks to restructure margin loans in 2009;
- The expansion of the Discount Window to allow additional eligible instruments and allow banks to borrow for up to 360 days (currently suspended);
- The stoppage of liquidity mop–up since September 2008;
- Greater emphasis on enforcing the *CBN Code of Corporate Governance* to promote transparency and accountability in banks;
- A review of *the Contingency Planning Framework for Systemic Distress in Banks*; and
- CBN's Guarantee of inter-bank market transactions.

## Banking Reforms

The 2005 bank consolidation programme significantly transformed the Nigeria banking system. The number of banks decreased from 89 to 25, and subsequently to 24, following the post-consolidation merger of two banks. The exercise brought about a substantial growth in capital and led to the expansion of banks' internal and external operations. Banks embarked on an aggressive expansion of their branch networks in the West African sub-region and beyond including the addition of several local subsidiaries. Thus, the number of bank branches increased from 2,900, at pre-consolidation, to 5,565 by end-2009. Aggressive credit expansion ensued. Consequently, banks were under pressure to report high returns on their expanded activities without adequate risk management practices to mitigate the risks inherent in their operations.

Regulatory concerns about poor corporate governance practices, system-wide risk arising from persistent abuse of the Expanded Discount Window (EDW) and distress borrowing from the inter-bank market by some banks, etc, informed a special examination of the banking system by the CBN in 2009. The special examination report revealed that 10 out of the 24 banks were in weak financial conditions, prompting the following remedial actions by the CBN:

- The removal of the executive management of 8 of the 10 banks;
- The appointment of new management teams for the affected banks; and
- The injection of ₦620 billion into the affected banks as tier 2 capital. The capital is to be repaid from the proceeds of future recapitalisation by the banks.

The intervention substantially stabilised the Nigerian banking system. The CBN further introduced a four-pillar reform programme to boost confidence in the financial system, by;

i. Enhancing the quality of banks,
ii. Establishing financial stability,
iii. Enabling the evolution of a healthy financial sector, and
iv. Ensuring that the financial sector contributes to the real sector of the economy.

The CBN is committed to conducting regular and effective surveillance of the financial system to promote safe and sound banking system that supports the economic growth and development of Nigeria.

## 4.2 Institutional Capacity Building

The rapid expansion of the Nigerian banking industry has presented a serious challenge of inadequate institutional capacity to manage the growth. The dearth of management skills in banks, coupled with an inadequate regulatory/supervisory capacity has exacerbated the negative impact of the global financial crisis on the Nigerian economy.

There are two major institutions responsible for training at all levels for the banking industry: the Chartered Institute of Bankers of Nigeria (CIBN), which is statutorily charged with the responsibility for banking education in Nigeria and the Financial Institutions Training Centre (FITC), which conducts short courses for middle and top-level bankers to enhance their competence. In addition, the West African Institute for Economic and Financial Management also engages in the training of regulators in various areas of public finance and economic management. Capacity building for bank supervisors received much deserved attention during the review period. Several local and foreign training programmes were executed, covering a wide area of interest. The major areas were non-interest banking, risk management, credit bureaux operations, consolidated supervision, Basel II, corporate governance, anti-money laundering, financial markets/products and bank examiners' courses.

Also, the CBN took the following steps to build capacity in the industry:

- A certification programme for boards and top management staff of microfinance banks;
- Fostering closer collaboration among regulators on new developments in the industry; and
- Training of bank directors, in conjunction with the FITC, on risk management and corporate governance.

## 4.3 International Economic Relations and Cooperation

The successful completion of the banking and insurance sector consolidation has provided an opportunity for the Nigerian financial system to further integrate into the global economy. The exercise has facilitated the flow of trade and investment, deepened the financial market, created employment opportunities, and enhanced the development of new financial products and services.

In the process of banks complying with the minimum capital requirement, the economy has recorded substantial inflow of Foreign Direct Investment (FDI). The policy on external reserve management has also encouraged collaboration between local banks and external fund managers. Furthermore, the desire to foster financial integration and support infrastructure development in Africa has informed the Nigerian initiative for establishment of the African Finance Corporation (AFC).

In line with Nigeria's goal to become one of the top 20 economies in the world by the year 2020, the CBN has initiated a *Financial System Strategy 2020 (FSS 2020)* to transform Nigeria into an international financial centre and provide one of the safest and fastest growing financial systems amongst emerging economies. The focus of the strategy includes the strengthening of domestic financial markets, enhancing integration with external financial markets, and building an international financial centre.

As part of its reform process, the CBN has continued to support monetary and financial integration within the Economic Community of West African States (ECOWAS) sub-region. So far, the West Africa Monetary Agency (WAMA), the West Africa Monetary Zone (WAMZ), and the West African Monetary Institute (WAMI) have been established to promote financial integration and stability in the sub-region.

The strengthening of international linkages has exposed the country to a number of challenges, especially on the supervision of Nigerian banks with offshore operations. Accordingly, a number of Memoranda of Understanding (MOUs) have been signed with some countries to facilitate information exchange and supervisory collaboration.

The Nigerian financial system, as a result of its increasing international linkages, is gradually becoming an active player in the world financial system. It is envisaged that with sustained efforts, the aggressive implementation of the *FSS 2020 Initiative* would improve the international competitiveness of the Nigerian economy.

## 4.4 Access to Finance

Access to finance in most developing economies is facilitated essentially through two channels: direct credit extension and indirect extension, through the provision of appropriate incentives and fiscal policy.

### 4.4.1 Direct Real Sector Interventions

In order to effectively channel financial resources to the real sector of the economy in the period under review, assist government in the realisation of its *Vision 2020* objectives, provide the required policy support and improve access to financial services by the otherwise excluded segment of the economy, the CBN has sustained the following initiatives, schemes and programmes:

#### 4.4.1.1 The Agricultural Credit Guarantee Scheme Fund (ACGSF)

The ACGSF was established by the Federal Government and the CBN to induce banks to channel credit to the agricultural sector, with the CBN exercising oversight responsibility. During the period under review, the Scheme provided 75 per cent guarantee in respect of loans granted by banks for agricultural purposes. By end-April 2010, the sum of ₦35.45 billion had been guaranteed under the Scheme in respect of 652,549 bank loans granted to farmers as individuals, cooperative societies and corporate bodies.

#### 4.4.1.2 The Agricultural Credit Support Scheme (ACSS)

In furtherance of its developmental role and to reduce the cost of agricultural production, increase output, generate exportable surplus, and provide inputs for the manufacturing sector, the ACSS, which had been introduced earlier in 2006 as a Presidential Initiative by the Federal Government, was deepened by the CBN during the period under review. Under the Scheme, loans are granted to benefitting farmers at 14 per cent, but the farmers pay a concessionary rate of 8 per cent while the CBN bears the remaining 6 per cent. By end-April, 2010 the sum of ₦17.32 billion had been disbursed by banks to promoters of 101 large scale farm projects. The CBN has, so far, honoured its 6.0 per cent interest rebate obligation as it paid up the sum ₦323.18 million to the financing banks with respect to 34 large scale commercial agricultural projects.

#### 4.4.1.3 The Commercial Agricultural Credit Scheme (CACS)

The ₦200 billion CACS was also introduced in 2009 by the CBN, in collaboration with the Federal Government, to mitigate the effects of the global food and financial crisis. As a response mechanism, CACS was established to finance the development of large scale commercial agriculture, value chain and shore up the level of aggregate food supply. Other objectives of the Scheme are to increase foreign exchange earnings, generate employment, diversify the country's revenue base, and provide the raw materials required by the manufacturing sector of the economy on a sustainable basis. By end-April 2010, a total of ₦48.24 billion had been released by the CBN to four banks in respect of 4 state government projects valued ₦4.0 billion and 45 private projects valued ₦44.24 billion.

### 4.4.1.4 The N300 Billion Power Infrastructure Fund

The ₦300 billion Power Infrastructure Fund was introduced in April 2010 by the CBN to provide long-term support to finance power-chain projects and SME clusters. The Fund is a 15-year debenture investment in the Bank of Industry (BOI) for on-lending to all eligible DMBs and Development Finance Institutions (DFIs) at 1 per cent. The DMBs and DFIs would, in turn, lend to promoters of appropriate projects at a maximum rate of 7.0 per cent (all in cost).

### 4.4.1.5 The N200 Billion Refinancing/Restructuring of SME/Manufacturing Fund

The CBN introduced the ₦200 Billion Refinancing/Restructuring of SME/Manufacturing Fund in April 2010 to enable banks refinance and restructure their existing loan portfolio to SMEs and manufacturing. The 15-year facility has a 3-year moratorium, with loan amounts ranging from ₦5 million (minimum) to ₦1 billion (maximum) to a single obligor at an interest rate of 7.0 per cent annually, repayable quarterly.

### 4.4.1.6 The SME Credit Guarantee Scheme (SMECGS)

The SME Credit Guarantee Scheme (SMECGS) was established during the period under review by the CBN to provide a credit enhancement window to manufacturing SMEs, agriculture value chain, and educational facilities. The intervention is targeted at creating more jobs. The Scheme allows a maximum tenor of 7 years and provides an 80 per cent guarantee. All DMBs and development banks are eligible to participate in the new Scheme.

### 4.4.2 Indirect Interventions

In response to the effects of the global financial crisis, additional policy measures were introduced to further improve access to credit to the real sector. These measures include the following:

- Reduction in the Cash Reserve Requirement and Liquidity Ratio;
- Extension of guarantee to all lenders in the inter-bank market;
- Further liberalisation of the foreign exchange market by creating a window for BDCs to enable them service small businesses that require foreign exchange; and
- Enhancing the life-cycle of money market instruments by extending their tenor to a maximum of 364 days.

It is expected that these measures would further encourage banks to lend to the real sector of the economy, especially agriculture, SMEs, and infrastructure projects.

### 4.5 Non-Interest Banking

In recognition of the potential benefits of non-interest banking to the economy, the CBN is finalising the regulatory and supervisory framework for Islamic banking in Nigeria. Towards the full implementation of non-interest banking in Nigeria, the following milestones have been achieved as at end-June 2010:

- Admission of the CBN as a full member of the Islamic Financial Services Board (IFSB) based in Malaysia. IFSB is a standard-setting institution, made up of regulatory and supervisory bodies;

- The formation of an inter-agency committee comprising the CBN, Federal Inland Revenue Service (FIRS), the Nigeria Accounting Standards Board (NASB), PENCOM, the SEC and the NDIC to define the role each would play under the new concept; and

- Receipt of a technical grant from the Islamic Development Bank (IDB) Jeddah through the Federal Ministry of Finance, to support the CBN in developing the regulatory and supervisory framework, building the capacity of supervisors, and conducting an international conference to create needed awareness.

### 4.6 Anti-Money Laundering Measures and Combating the Financing of Terrorism (AML/CFT)

In recognition of the negative effects of economic crimes and money laundering on the stability of the financial system, the Nigerian Federal Government took a number of measures to strengthen the hitherto weak institutional framework for AML/CFT. The efforts have led to increased compliance with the *Financial Action Task Force (FATF) 40+9 Recommendations*.

#### 4.6.1 Major Developments

#### *i. The AML/CFT Compliance Examination/Inspection*

The supervision of anti-money laundering activities in the financial system was conducted by the various regulatory bodies for institutions under their authority. The CBN and NFIU have carried out joint AML/CFT examinations/inspections of 24 banks during the period. Several other financial institutions have been slated for inspection in the remaining part of 2010. Similarly, the SEC and NAICOM have inspected several institutions under their supervision and regulation, while the examination of Designated Non-Financial Businesses and Professions (DNFBPs) was carried out by the Federal Ministry of Commerce (FMC). The FMC has also produced guidelines and *Know-Your-Customer (KYC)* manuals for DNFBPs and ran AML/CFT training programmes for both the regulators and operators. Also all stakeholders in the project work in collaboration with the Nigerian Financial Intelligence Unit (NFIU).

### *ii. Financing of Terrorism and Terrorist Activities*

The Nigerian Federal Government has made vigorous efforts to collaborate and cooperate regionally and globally with key AML/CFT stakeholders to strengthen the fight against terrorism and has ratified all the relevant United Nations universal instruments against terrorism.

The CBN has circulated to financial institutions under its regulatory purview, for appropriate action, the United Nations list of persons suspected to be involved in terrorism financing or terrorist activities. The same list was circulated by the Ministry of Foreign Affairs to other relevant agencies involved in the fight against terrorism and terrorist financing.

The UN Security Council Monitoring Team on Terrorism (UNSCMTT), in October 2009, evaluated Nigeria's level of compliance with the extant UN resolutions with respect to terrorism and terrorism financing. The assessment-visit paid particular attention to issues pertaining to asset freezing, arms embargo and travel ban. The Team acknowledged Nigeria's progress and commendable level of compliance in the implementation of the relevant United Nations Security Council resolutions.

### *iii. Capacity Building*

The CBN and other stakeholders have continued to build capacity, through training programmes that cut across critical areas of AML/CFT awareness, skills and compliance, with participants being drawn from regulatory/supervisory bodies and reporting entities. The Inter-Governmental Action Group Against Money Laundering in West Africa (GIABA) provided and supported capacity building programmes on AML/CFT in Nigeria and the West African sub-region. Other entities, including the West African Institute for Financial and Economic Management (WAIFEM) have also been prominent in the building of capacity in this area.

### *iv. Co-operation among Stakeholders*

Cooperation amongst domestic stakeholders has witnessed a significant improvement as they have exchanged information sharing, conducted joint investigations/operations, and organized joint training programmes. Similarly, on the international scene, relevant national agencies have strengthened their relationships and have interfaced with their overseas counterparts. In order to ensure full cooperation with other countries in the fight against money laundering and terrorism financing, the NFIU has signed a number of Memoranda of Understanding (MOUs) with many countries on behalf of Nigeria. Other agencies, including the Independent Corrupt Practices Commission (ICPC), the EFCC and the NDLEA have also been working directly with their counterparts in several countries to investigate cases of corruption, drug trafficking and money laundering. The Nigerian Customs Service has also collaborated with the United States Customs in the area of bulk cash smuggling.

## 4.6.2 Other Developments

### 4.6.2.1 *The Creation of an AML/CFT Office at CBN*

As part of ongoing efforts to interface more efficiently with NFIU and other stakeholders on AML/CFT matters, the CBN, in March 2010, established an AML/CFT office in the Financial Policy and Regulation Department. The main objective is to ensure that AML/CFT enforcement efforts in the CBN are properly coordinated, that sound AML/CFT policies are formulated, and that the financial institutions are compliant with FATF/GIABA's requirements.

### 4.6.2.2 *The Constitution of Presidential Inter-Ministerial Committee on FATF*

In 2009, the FATF subjected Nigeria to a targeted review on account of the size of her financial system being in excess of US$ 5 billion, as well as poor ratings on 13 of the 16 key/core Recommendations in the Mutual Evaluation Report (MER) of GIABA. In response, the Nigerian authorities constituted a high-level Presidential Inter-Ministerial/Agency Committee on FATF in June 2009 to engage the FATF's International Cooperation Review Group (ICRG) on Africa/Middle-East and address the concerns cited in the 2007 MER, as well as ensure full compliance with FATF Recommendations.

During the period, Nigeria held two face-to-face meetings and provided progress reports and responses to the Regional Review Group (RRG) and ICRG. Since the commencement of the targeted review of Nigeria in September, 2009, the country has:

i) Worked closely with the RRG and reported on the progress made since the Mutual Evaluation of 2007;

ii) Produced and submitted a comprehensive Action Plan and a Time-table on Nigeria's Strategic Action Plan to address FATF's concerns;

iii) Re-presented the Anti-Terrorism Bill (ATB) as an Executive Bill to the National Assembly (NASS). The ATB is set for passage in 2010;

iv) Made a proposal, in the form of an executive bill, to the National Assembly, for the amendment of the Money Laundering (Prohibition) Act (MLPA); and

v) Gazetted the *AML/CFT Regulation* in December 2009, thereby making it a Statutory Instrument (SI) which has the full effect of a law of parliament.

In September and December 2009, Nigeria participated in the RRG's meetings in Bahrain which discussed the *Report* of the Africa/Middle East Countries. She also participated in GIABA's 13th Technical Commission/Plenary Meeting held in Praia, Cape Verde between 2nd and 4th, May, 2010.

On the whole, Nigeria has demonstrated a strong commitment to combating money laundering and terrorism financing.

## 4.7 Other Strategies for Dealing with Risks in the Banking System

### i. *Chief Risk Officers (CROs) Forum*

The CBN, in recognition of the potential role of risk officers in improving risk management practices in banks, has established a Chief Risk Officers' (CROs) Forum. The Forum seeks to achieve the following objectives:

- Promote strong risk appreciation/expertise and corporate governance across the sector;
- Provide early warning signals on systemic risk issues;
- Provide feedback on the impact of CBN's existing (or planned changes to) policies, directives, circulars, and guidelines;
- Serve as the industry's risk management think tank; and

- Enhance collaboration and capacity building, through sharing of best practices.

### *ii. Contingency Plan for Systemic Distress*

The limitations in the existing contingency plan for managing systemic crisis in the Nigerian financial system have necessitated a review of the framework. The revised contingency plan would strengthen CBN's early warning system to facilitate effective action to detect and deal with systemic distress in the industry.

### iii. *Capital Adequacy*

Nigerian banks have shown considerable resilience, despite experiencing huge capital erosion and risk of insolvency, as a result of huge provisioning and decline in asset quality. The average capital adequacy ratio (CAR) for DMBs has grown from 18.1 per cent in 2004 to 21.9 per cent in 2008, but declined to 3.65 per cent in 2009 after some DMBs made full loan loss provisions for their non-performing loans. By end-December 2009, the average CARs of 14 DMBs controlling 45.2 per cent of total deposits were still above both the Basel Capital Accord benchmark and the CBN regulatory threshold of 10 per cent, while 10 DMBs controlling 46.5 per cent of total deposits, had their CARs below the prescribed requirement.

The CAR of the banking system is expected to improve as the new AMCON becomes operational and buys up the non-performing loans of banks.

## 4.8 Macroeconomic Outlook

In the global economy, more countries have shown signs of rising output, moderating inflation, rising stock market indices and moderating exchange rate depreciation. Although the outlook appears bright, the challenges and concerns with regards to sovereign default risk in Europe and increasing fiscal deficits in most advanced economies remain and constitute serious potential dangers to full recovery.

At the domestic front, macroeconomic outcomes have been mixed in the first half of 2010. Money supply expanded moderately and inflationary pressure is projected to increase in the second half of 2010. The gross official reserves declined marginally during the review period. The exchange rate depreciated at both the official and inter-bank market, but appreciated slightly at the BDCs segment. If the current policy stance of liberalising the foreign exchange market subsists, the exchange rate is likely to remain stable in the near term. In the money market, most deposit and lending rates fell.

There is need for caution as the current price of oil may not be sustained, especially if the value of the US Dollar appreciates and global recovery is not sustained. The remainder of 2010 may witness relatively substantial growth in money supply, given the anticipated pre-election spending, the planned deregulation of the downstream petroleum sector, and possible additional liquidity injection into the troubled banks from the purchase of toxic assets by AMCON. The likely expansion in money supply would constitute a potential threat of inflationary pressures. However, monthly forecasts indicate that reserve money would continue below the provisional indicative benchmarks for the second half of 2010, indicating that the quantitative easing measures currently being deployed to boost liquidity in the system should not be quickly withdrawn.

Given the reforms in various sectors of the economy and the sustained implementation of the Federal Government's amnesty programme in the Niger Delta region, it is expected that growth in GDP would improve in 2010.

# 5.0 THE PRUDENTIAL REGULATION AND SUPERVISORY FRAMEWORK

## 5.1 Regulatory Reforms

### 5.1.1 The Establishment of the Macro-Prudential Analysis Division

Experience has shown that there are strong linkages between financial institutions and that the failure of one systemically important institution could affect other institutions. This experience has been reinforced by the global financial crisis. Consequently, it has become increasingly imperative to evaluate the soundness and vulnerability of the entire financial system. Pursuant to this, the CBN has established a Macro-prudential Division in March 2010 in its Financial Policy and Regulation Department to:

- Provide early warning signals that would protect the entire financial system from distress, rather than focusing only on individual institutions in the system;
- Avoid large and burdensome costs to the economy, by adopting more cost-effective distress resolution mechanisms;
- Identify the collective risks faced by the banking system rather than those faced by individual banks; and
- Examine risks that may arise from contagion as a result of the interaction of banks as part of the financial system, rather than only on a bank-by-bank basis.

Accordingly the Division now performs the following functions:

- Maintaining a banking industry database;
- Collating, analysing, reviewing and monitoring the banking industry's financial condition (that is, the preparation of periodic financial soundness indicators);
- Preparing periodic management reports (banking industry updates and developments); and
- Managing the Credit Risk Management System (CRMS).

The Division also provides information, including early warning signals, to CBN's Management on the condition of the financial system.

### 5.1.2 Review of Prudential Guidelines and Related Matters

This was another key measure initiated by the CBN to strengthen its regulatory/supervisory framework. The decision of the CBN to review and enhance the *1990 Prudential Guidelines* was informed by the need for adequate supervision to promote the safety and soundness of the banking system, in particular, and the financial system as a whole. The *Revised Prudential Guidelines* address some critical aspects of the operations of banks, such as risk management, corporate governance, single obligor limits, anti-money laundering compliance, loan loss provisioning, etc. The Guidelines also address the peculiarities of different loan types and financing to different sectors of the economy.

*The 1990 Prudential Guidelines* were deficient in the following areas:

- They did not cover certain sector-specific credits, such as project financing, agricultural financing and SMEs financing, owing to the long gestation periods of such credits;
- They were silent on the need for a moratorium (grace period) associated with maturities in credits to sectors requiring long gestation periods;
- They were pro-cyclical;
- They did not address the need to specify a collateral value; and
- There was ample room for subjectivity and management intervention that tended to compromise credibility.

The Revised Prudential Guidelines provide appropriate guidance on the recognition and measurement of loans, the establishment of loan loss allowances, credit risk disclosure, sound loan provisioning, and related matters. Some of the key objectives of the *Revised Prudential Guidelines* are as follows:

- Enhance provisioning policies and practices for Nigerian banks consistent with sound risk management practices ;
- Align provisioning guidelines with the life-cycle and gestation periods of specific industry loan types;
- Provide a framework for ensuring that provisioning guidelines are counter-cyclical (dynamic); and
- Put in place a framework that recognises credit risk mitigation through “haircuts” adjustment for lost facilities.

The key features of the Revised Prudential Guidelines include the following:

- Provision of a credit Portfolio Classification system for facilities defined as "Specific Loan Types" and facilities defined as "Other than Specific Loan Types";
- Provision of a dynamic provisioning regime intended to overcome the challenge of pro-cyclicality which is a major drawback of the old Prudential Guidelines; and
- Discontinuation of general provisioning.

### 5.1.3 Guidelines on Margin Lending

Following the recent crash of the Nigerian stock market, arising from the twin-effects of the global financial crisis and margin loan abuse by some Nigerian banks, the FSRCC in December 2009, set up a committee to develop appropriate guidelines on margin lending.

The objectives of the guidelines are as follows:

- Serve as a guide to market operators;
- Enhance the oversight functions of the regulatory agencies;
- Limit the risks inherent in margin lending;
- Stem the tide of insider and corporate governance abuses; and
- Improve the current level of reporting and disclosure by market operators.

Features of the guidelines include the following:

- Provides for the contents of a margin agreement;
- Specifies the categories of margin accounts, which are of two types, that is: Bank Margin account and Brokerage Margin account;
- Spells out the rules for establishing/opening and maintaining margin accounts;
- Stipulates the margin maintenance requirements for a broker or dealer, and the bank requirements for margin accounts;
- Specifies marginable Securities.
- Makes provision for the certification of capital market operators by the CBN and the SEC; and
- Makes margin transaction reporting to both the CBN and the SEC on a periodic basis mandatory.

## 5.2 The Supervisory Framework

### 5.2.1 Adoption of Risk-based Supervision of Banks and Other Financial Institutions

During the period under review, the CBN commenced the implementation of risk-based supervision (RBS) of banks and discount houses in Nigeria, in the context of the ongoing reforms in the industry. The implementation of RBS was one of the key supervisory deliverables of 2009 to enhance financial stability.

The key objectives of RBS are to:

- Prioritise supervisory resources;
- Enable supervisors to focus on what matters;
- Encourage sound risk management practices; and
- Focus on the significant activities of banks and the control structures.

A supervisory framework and supporting guidelines for the implementation of RBS were developed. The supervisory guidelines included the following:

- A set of Assessment Criteria for evaluating the effectiveness of an institution's risk management control functions;
- Section Notes, covering the generic activities that banks undertake;
- Supervisory Guidelines for the development of the Risk Assessment Summary (RAS), Knowledge of Business (KOB), Management Reporting, Supervisory Strategy Formulation and Supervisory Documentation, as well as the identification and assessment of the Inherent Risks in an institution's significant activities; and
- Frequently Asked Questions (FAQs) issued as part of a discussion series to facilitate a better understanding of the Supervisory Framework among examiners.

Implementation of risk-based and consolidated supervision commenced with a pilot run of two DMBs and is being rigorously pursued.

### 5.2.2 Consolidated and Cross-border Supervision

The banking sector consolidation of 2005 has provided huge capital funds for Nigerian banks and the funds have enabled them to engage in rapid expansion, domestically and internationally. The expansion in banks' operations, products and services development, and the emergence of large complex banking organizations (LCBOs) beyond national borders, have brought about challenges which have rendered the current supervisory approach inadequate. In response, the CBN has initiated a framework for consolidated and cross-border supervision of banks.

The key objectives of CBN's consolidated and cross-border supervision include the following:

- Adoption of appropriate risk-weighting in capital adequacy calculations and the prevention of double-leveraging (multiple gearing of capital/buffer);
- Support for the principle that no banking operations, wherever located, should escape supervision;
- Ensuring that all the risks incurred by a banking group, regardless of where they are booked, would be evaluated and controlled on a global basis;
- Evaluation of the strength of a group to which a licensed bank belongs, in order to assess the potential impact of other members of the group on the licensed bank. It may be conducted on either a quantitative or a qualitative basis, or on the basis of a combination of both;
- Consolidation of the financial returns, i.e., consolidation of accounts of the licensed entity using the quantitative approach, while ensuring that the qualitative approach evaluates the material risks; and
- Elimination of regulatory arbitrage.

The key issues in the adoption of Consolidated and Cross-border Supervision are as follows:

- Containing the financial instability associated with cross-border activities (risk of contagion);
- Harmonisation of accounting standards, regulatory and legal frameworks;
- Reduction of information gap between home and host regulators/supervisors; and
- The resolution of cross border crises.

The CBN response to the challenges above is summarised in the following action:

- Reaed the Financial Services Regulation Coordinating Committee (FSRCC) to improve information sharing among regulators; and
- Signed “Memoranda of Understanding” with a number of jurisdictions where Nigerian banctivatks are operating.

### 5.2.3 The Financial Services Regulation Coordinating Committee (FSRCC)

The FSRCC is a forum established by the *CBN Act of 2007* for the purpose of exchanging information on surveillance activities on the condition of the financial system among regulators of the financial sector. It provides a platform for the coordination of regulatory efforts to minimise regulatory arbitrage. The Governor of the CBN is the Chairman of the FSRCC, while other members are as follows:

- Managing Director, Nigeria Deposit Insurance Corporation,
- Director-General, Securities and Exchange Commission,
- Commissioner for Insurance,
- Registrar-General, Corporate Affairs Commission, and
- A representative of the Federal Ministry of Finance, not below the rank of Director.

The objectives of the Committee are to:

- Coordinate the supervision of institutions that provide financial services.
- Reduce regulatory arbitrage.
- Cooperate and share information/experience among members.
- Articulate strategies for the promotion of safe, sound and efficient financial system.

### 5.2.4 Memoranda of Understanding (MOUs)

As at end-June 2010, 12 Nigerian banks were operating offshore, while four (4) foreign banks were licensed to operate in Nigeria. In the spirit of cross-border supervision and cooperation with other regulators, a number of MOUs have been signed between Nigeria and some of these regulators. The MOUs seek to achieve the following objectives:

- Enhance the stability of the financial system in each country and prepare the supervisory authorities for the management of any crisis with cross-border implications;
- Improve the effectiveness and efficiency of supervisory measures;
- Facilitate the exchange of information, views and assessments among banking supervisors and promote a better understanding of each other's methods and approaches, with the aim of encouraging the convergence of supervisory practices;
- Identify significant differences in national laws and regulations that might imperil the convergence process and take necessary steps to ensure a clear understanding of such differences among the parties, as well as, their

possible influence on the convergence process, and address issues concerning the stability of national financial systems that may have potential contagion and spill-over effects in the collaborating countries; and

- Enable supervisors to develop a common understanding of the risk profile of large cross-border banking groups in the collaborating countries; and develop a common understanding of the risk profile of a banking group as a starting point for risk-based supervision, at both group and individual levels.

### 5.2.5 Proposed Amendment to the Banks and Other Financial Institutions Act (BOFIA)

The impact of the recent global financial and economic crises has varied from country to country. Furthermore, the rate of recovery of each country from the crises has tended to depend greatly on the robustness of the enabling laws and the powers of the apex regulator to take prompt regulatory action.

The adequacy of *BOFIA, 1991* (as amended), the principal banking legislation enacted to provide an effective and efficient legal framework for the supervision of banks and other financial institutions in Nigeria, has been a matter for concern among bankers over the years. In recognition of this fact, amendment of BOFIA has become imperative. Some of the proposed amendments would empower the CBN to:

- Prohibit the operation of shell banks;
- Restructure, reorganise, merge and dispose of banks without recourse to the SEC or the provisions of the *Investments and Securities Act*; and
- Inject funds into a failing institution under CBN's jurisdiction by way of equity participation, up to a level that guarantees control by the CBN.

## 5.3 Supervisory Challenges

The period, January 2009 June 2010 has been undoubtedly challenging for financial institutions' supervisors across the globe. While some of the challenges were similar, the CBN, in addition, had to contend with issues peculiar to its domestic environment. Some of the challenges and the remedial action taken by the Bank are highlighted in the following sub-sections of the *Report*.

### 5.3.1 The Impact of Global Financial and Economic Crises

The effects of the recent global financial and economic crises on the Nigerian financial system were at their peak in 2009. The effects include the following:

- Recall of foreign credit lines;
- A precipitous decline in the price of crude oil, occasioned by weak global demand;
- Huge non-performing loans to the Capital Market and the Oil & Gas Sectors; and
- A sharp decline in portfolio investment and inflows from the Diaspora.

In order to mitigate the effects of these negative developments, supervision of financial institutions became more intrusive, thereby stretching already thin supervisory resources.

### 5.3.2 Weak Corporate Governance Culture/Practices

The predominance and overbearing influence of some members of bank Boards and their management inhibited the entrenchment and institutionalisation of good corporate governance practices and a healthy culture in many financial institutions. The introduction of a tenure limit for members of boards and executive management, as well as external auditors of banks, was one of the measures taken during the period to tackle this development.

### 5.3.3 An Inadequate Legal Framework

The changing dynamics of bank supervision require that most of the provisions of the *BOFI Act* be amended from time to time. Therefore, the passage of the proposed amendments to the *Act* by the National Assembly is essential for laying a robust legal framework for the supervision of banks and other financial institutions in the country.

### 5.3.4 Data Integrity

The unreliable call reports prepared by banks have remained the bane of appropriate and timely supervisory intervention by the CBN and other regulatory authorities. This fact has prompted some supervisory responses, including the following:

- Upgrading the Electronic Financial Analysis Surveillance System (e-FASS) infrastructure for online reporting between banks and the CBN;
- Adopting a zero tolerance policy for financial misreporting; and.
- The adoption of a common financial year-end of December 31 for all banks and their subsidiaries, effective December 31, 2009.

### 5.3.5 Addressing Inadequate Supervisory Capacity/Arrangements

Skills gaps have hampered the successful implementation of a number of supervisory/regulatory initiatives, such as the IFRS, risk-based supervision and the effective supervision of complex e-products. The challenge is being addressed through structured training for supervisors, and stronger collaboration with the relevant institutions.

### 5.3.6 Consumer Protection

There have been increasing complaints by bank customers. The complaints relate to excessive charges, breach of contract, and e-products fraud. In response to the complaints, the CBN has established a Consumer Protection Office, which collaborates with the Nigerian Consumer Protection Council, to ensure that consumers would always be adequately protected. The Nigerian banking public would be given details of CBN's specific guidelines in this regard, as soon as they have been finalised.

## 5.4 Focus of Surveillance in 2010/2011

Building on the remedial measures already taken to address the weaknesses revealed by the Special Examination of Banks in 2009 in order to ensure a stable financial system, the CBN has initiated a Four-pillar Reform Programme with the following features:

- Enhancing the quality of banks;
- Establishing financial stability;
- Enabling the evolution of a healthy financial sector; and
- Ensuring that the financial sector contributes to the real sector of the economy.

Towards this end, CBN's surveillance activities in 2010/11 would focus on strengthening supervisory standards at both the micro and macro levels. Specifically, supervision would be proactive by focusing on the full implementation of risk-based and consolidated supervision.

Furthermore, the implementation of the *New Prudential Guidelines* and the *Revised Banking Model* would come into effect before year end-2010.

The CBN is committed, through the FSRCC, to championing the harmonisation of regulatory standards, as well as collaborating and sharing information among financial system regulators.

As Nigerian banks move towards the adoption of IFRS by 2012 in order to enhance transparency, surveillance activities would focus on capacity building for supervisory staff to ensure a seamless transition from the Nigerian Generally Accepted Accounting Principles (NGAAP) to the IFRS.

Supervision would also focus on the activities of the recently licensed private credit bureaux to enhance access to credit in Nigeria. The establishment of a FSC would further enhance the stability of the financial system.

# 6.0 THE PAYMENTS AND SETTLEMENTS SYSTEM

Empirical evidence suggests a positive correlation between an efficient payments and settlements system on one hand, and economic growth and development on the other. The benefits of an efficient payments system include low transaction costs and a predictable and efficient market response to monetary policy, both of which engender financial system stability. In realisation of these benefits and in line with the *Financial System Strategy (FSS 2020)* target on payments system, the CBN has initiated the *Payments System Vision 2020 (PSV 2020)*.

## 6.1 The Payments System Vision 2020 (PSV 2020)

The thrust of PSV 2020 is to develop a payments system that would be nationally utilised and internationally recognised.

Specifically, the PSV 2020 initiative was designed to achieve the following objectives:

- Migrate from a cash-based to an e-payment system for transactions settlement;
- Develop national mobile and electronic cards payments infrastructure;
- Replace the current RTGS with a modern, world class system;
- Ensure the interoperability and interconnectivity of e-payment service providers;
- Develop an effective framework for consumer protection and dispute resolution;
- Develop a policy and oversight mechanism for the payments system;
- Ensure that the Nigerian Payments System complies with the West African Monetary Zone (WAMZ) standards; and
- Ensure appropriate legal backing for the National Payments System.

The Nigerian payments system has witnessed significant improvements over the years, moving from a rudimentary level during its early years of banking business to the current level of sophistication. The high dependence on cash for settlements has, however, resulted in the inefficient allocation of resources and a low depth of financial intermediation, with adverse repercussions on monetary policy implementation. In addition, it has discouraged the use of specific banking services, resulting in the high operational costs for the CBN and DMBs.

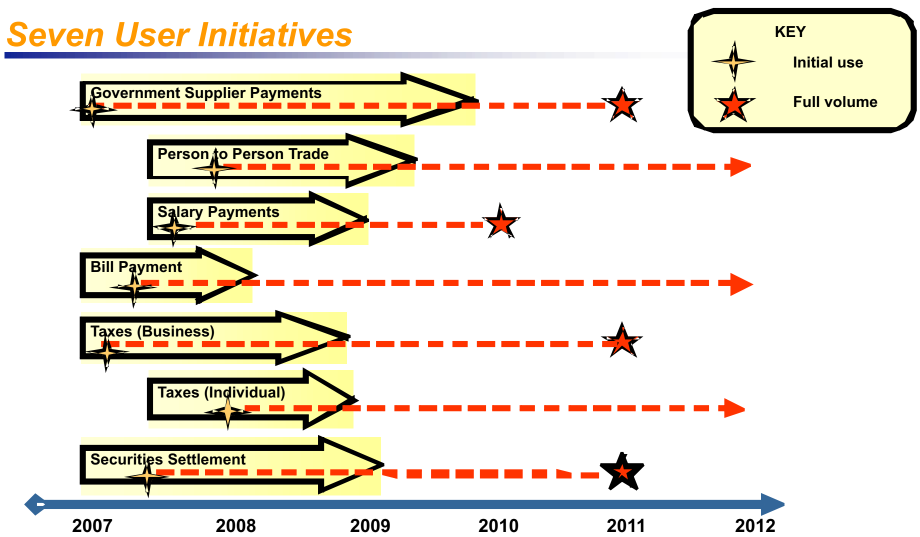
In order to reverse this trend, the CBN has initiated the PSV 2020 project, which is aimed at improving the efficiency of the payments system, through the adoption of electronic payments. The e-payments initiative provides a road map for the required infrastructure in the context of the expectations of end-users, service providers, the CBN, other regulators and the international community.

The seven key features of the PSV 2020 initiative are as follows:

- Government Supplier Payment,
- Person-to-person payment,
- Salary Payment,
- Bill Payment,
- Tax Payment (Business),
- Tax Payment (Individuals), and
- Securities Settlement.

Figure 18 presents the timelines for initial use and full volume operation.

**Figure 18: Timelines for the Implementation of the PSV 2020 User Initiatives**




## 6.2 Developments in the Payments System

The Bank sustained the implementation of the *Payments System Vision 2020* initiative during the last eighteen months. The Nigeria Automated Clearing System (NACS) has been deployed in Kano, Ibadan and Benin Clearing Zones, thereby, bringing the total number of automated clearing houses to five (5). Further measures taken to facilitate the efficiency of the payments system included the following:

- Issuance of operational rules and guidelines for the Nigeria Central Switch to connect all existing switches for the inter-operability and inter-connectivity of the different card schemes;
- Restriction on the deployment of Automated Teller Machines (ATMs) by banks to their premises only, while three ATM Consortia have been licensed to undertake off-site installations of ATMs;
- Application of e-payment by Federal Government Ministries, Departments and Agencies (MDAs), in line with the Presidential directive prohibiting the use of cheques for transactions by the Federal Government;
- Appointment of payments system Project Management Team to fast track the implementation of the *PSV 2020* initiative;
- Reviews of the following guidelines, which have reached various stages of completion: Nigeria Bankers Clearing House Rules, Nigeria Uniform Bank Account Number, and the e-payment of taxes/salary/pension;
- The creation of a Payments System Policy and Oversight Office in the CBN to:
  - Ensure compliance, monitoring, and enforcement of PSV 2020 policies and guidelines; and
  - Enlighten and sensitise the public on PSV 2020 activities;
- Issuance of operational rules and guidelines for ATMs;
- Migration from magnetic stripe cards to chip and pin cards;
- Introduction of two clearing sessions per day to improve efficiency;
- Issuance of a regulatory framework for mobile payment services; and
- A cap of N10 million for cheque payments to encourage e-payment.

### 6.2.1 *Real-time Gross Settlement (RTGS)*

The volume of inter-bank transfers increased from 220,586 in 2008 to 289,535 in 2009, implying a growth of 31.3 per cent, while the value decreased by 12.1 per cent, from ₦73,227 billion to ₦64,351 billion in the same period (see Figures 19 and 20).

**Figure 19: Volume of Inter-bank Funds Transfers Between 2007 and 2009**

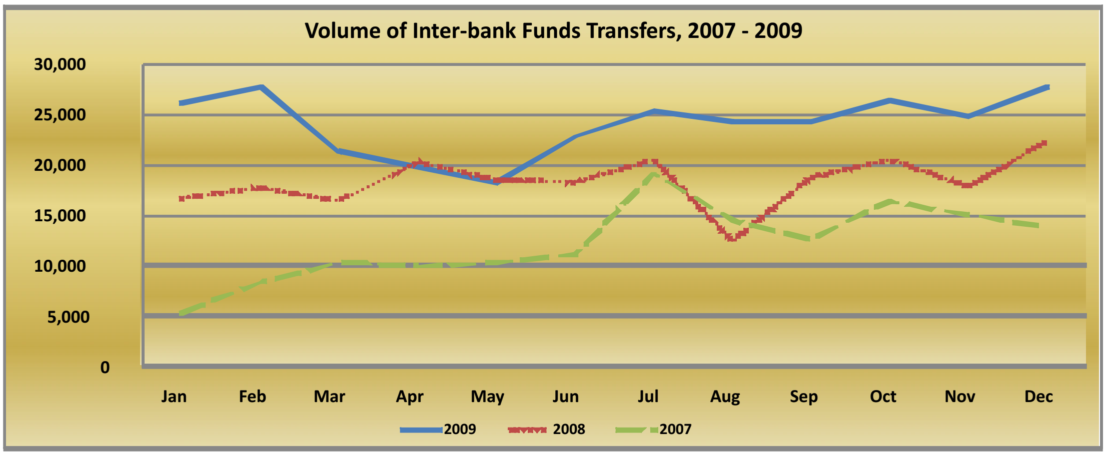
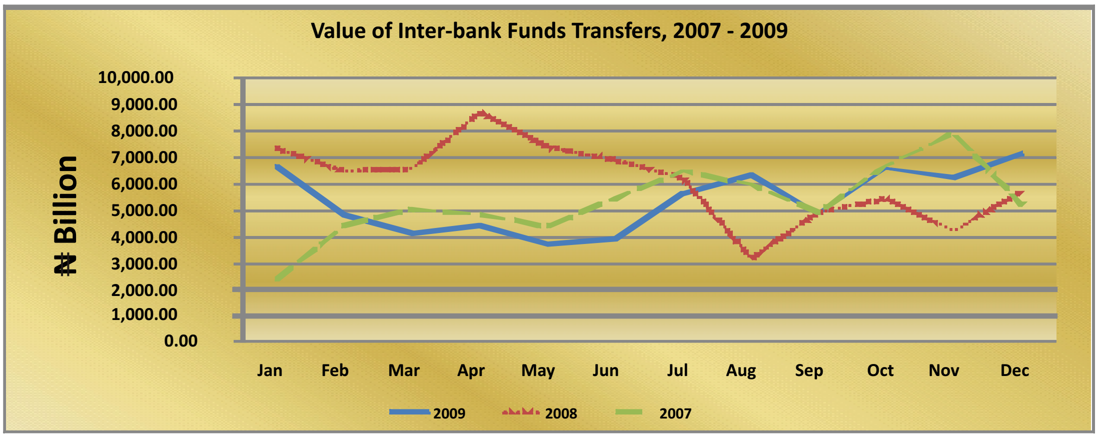



**Figure 20: Value of Inter-bank Funds Transfers Between 2007 and 2009**




### 6.2.2 *Clearing of Cheques*

During the period covered by the *Report*, the clearing days for up-country cheques (T+5) and local cheques (T+3) were unified to T+3. This was subsequently reduced to T+2. Other developments in the period include the following:

- Review of the Clearing House Rules,
- Implementation of a Cheques Standard, and
- Issuance of Cheques and Automated Clearing House (ACH) regulatory guidelines.

The volume of cheques cleared decreased from 30,172,925 in 2008 to 29,159,780 in 2009, a decline of 3.5 per cent. The gradual adoption of the e-payment system accounted for the decline in the volume of cheques cleared, an indication that the objectives of the adoption of e-payment were being achieved.

### 6.2.3 *e-Cards*

The volume and value of e-card transactions increased from 66,108,388 and ₦441.6 billion in 2008 to 114,592,669 and ₦645.0 billion in 2009, reflecting increases of 73.34 and 46.1 per cent, respectively (see figures 21 and 22).

**Figure 21: Volume of Electronic Card Transactions, 2007 - 2009**

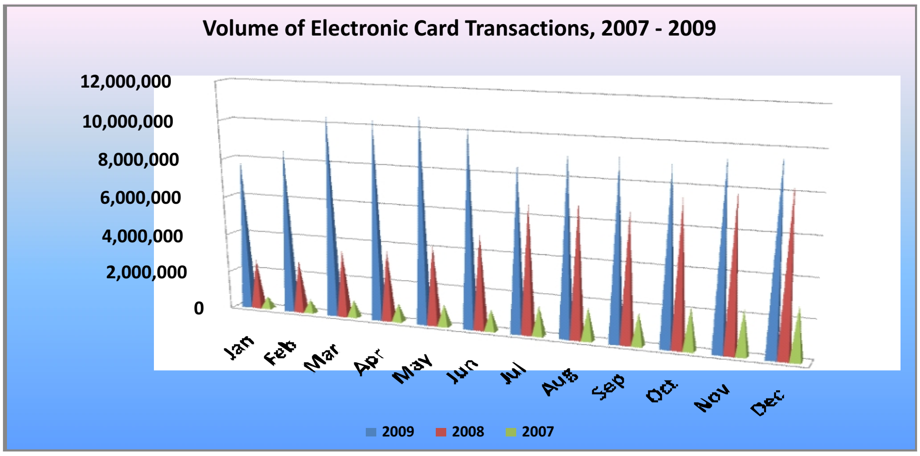
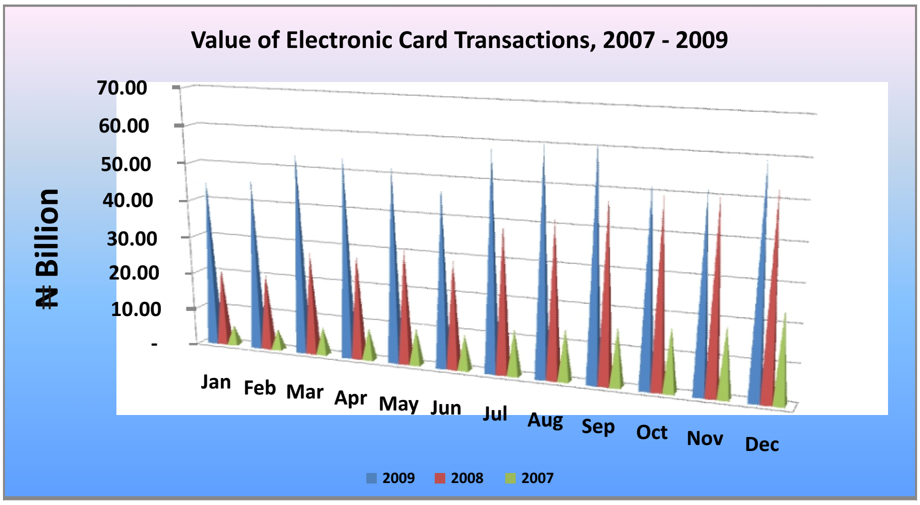



**Figure 22: Value of Electronic Card Transactions, 2007 - 2009**



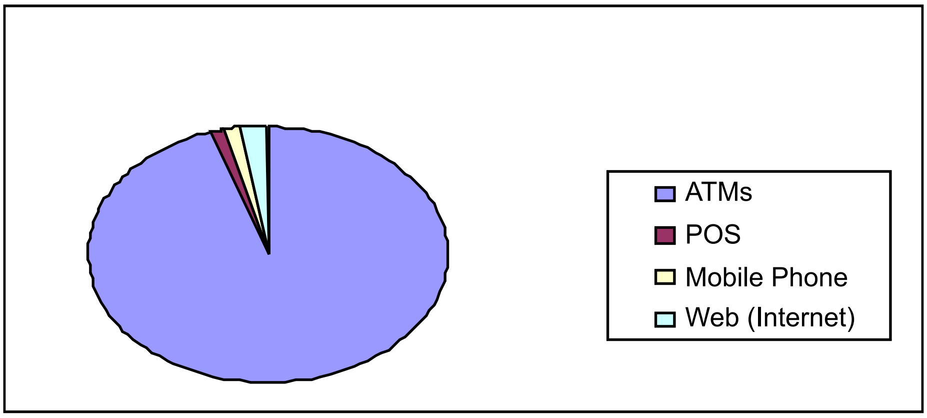

### 6.2.4 *Automated Teller Machines*

Given the high dependency on cash in Nigeria, it is no surprise that Automated Teller Machine (ATM) transactions are widely used by individuals, particularly in the urban areas. Lack of relevant ATM infrastructure in rural areas is a key challenge to the wider usage of bank accounts since it is the primary method of accessing accounts for many individuals. Available data on various e-payment channels for the period under review indicated that ATMs remained the most patronised channel, accounting for over 80 per cent of the total e-payment transactions, while the Point-of-Sale (POS) terminal was the least, with less than 1.0 per cent usage. The details are as follows:

**Volume terms**

| | % |
|---|---|
| ATMs | 95.26 |
| POS | 0.80 |
| Mobile Phone | 1.58 |
| Web (Internet) | 2.36 |

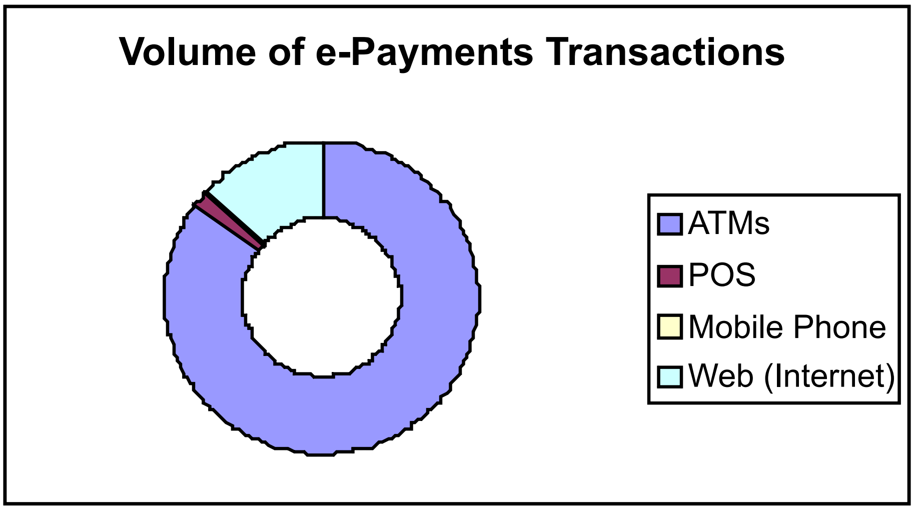
**Figure 23: Volume of e-Payment Transactions**




**Value terms**

| | % |
|---|---|
| ATMs | 85.05 |
| POS | 1.71 |
| Mobile Phone | 0.19 |
| Web (Internet) | 13.05 |

**Figure 24: Value of e-Payment Transactions**




The upsurge in the use of ATMs continued during the review period, with the volume and value standing at 109,592,646 and ₦548.60 billion, respectively, as at end-December, 2009. This reflected increases of 81.5 per cent and 37.3 per cent in the volume and value of over 60,133,610 and ₦399.71 billion, respectively, recorded in the corresponding period of 2008. The increase in the use of ATMs was attributable to a number of factors, such as the increased number of ATMs in the country and convenience of usage.

### 6.2.5 *Mobile Payments*

The use of mobile payments is still at its infancy as the regulatory framework was only recently approved, while the process of licensing the payment service providers is still in progress.

## 6.3 Challenges of the Payments and Settlements System

Notwithstanding the progress made so far, the Nigerian payments and settlements system is faced with the following constraints:

- A weak infrastructure,
- High transaction costs,
- High dependence on cash transactions,
- A high incidence of poverty and ignorance,
- A high level of illiteracy,
- A low level of Internet access,
- Inadequate inter-operability and inter-connectivity,
- The high cost of deploying and maintaining of the payments infrastructure,

- A low level of public awareness of the existence of some non-cash payment products, resulting in under utilisation of e-payments solutions, and
- The concentration of e-payment facilities in urban centres.

It is, however, expected that full implementation of the PSV 2020 project would address these challenges.

# 7.0 PRESERVING THE INTEGRITY OF THE FINANCIAL SYSTEM

The preceding review has highlighted various measures taken by the CBN to enhance the stability of the financial system. Additional efforts, as discussed below, are being made to further strengthen the system.

## 7.1 Review of the Universal Banking Model

The universal banking (UB) model adopted in 2001 has allowed banks to diversify into non-bank financial businesses. Following the bank consolidation programme in 2005, banks became awash with capital, which was deployed in a variety of financial services and the setting up of subsidiaries. Soon, a number of weaknesses began to surface, such as the following:

- Inadequate skills and poor risk management practices;
- Poor corporate governance practices;
- The structural operations of the subsidiaries allowed banks to play multiple roles, as operating entities, holding companies to their subsidiaries, and also holding direct and indirect investments in non-financial services entities such as real estate firms, security outfits, and facilities management undertakings, thereby increasing contagion risks;
- Minimal distinction between the banks and their subsidiaries in the areas of management and operations. Consequently, instances of improper allocation of depositors' funds to high risk businesses were rampant;
- The inability of regulators of the financial sector to keep pace with the developments and growth in the sector facilitated a high incidence of regulatory arbitrage; and
- The underlying short-term profit objectives negated the developmental role of the banking system. Consequently, the real economy suffered from neglect and also bore the excruciating burden of high interest rates on loans and advances.

In effect, the laudable objectives of the UB model were vitiated by operators, with banks operating as financial supermarkets, to the detriment of core banking practices. In order to address this challenge, the CBN is reviewing the UB model with a view to inducing banks to focus on core banking business. Under the new model, banks would not be allowed to invest in non-bank subsidiaries. Banks which currently hold such investments would be required to either divest or spin off the businesses The three classes of deposit money banks being proposed are International banks, National banks, and Regional banks.

## 7.2 The Establishment of the Asset Management Corporation of Nigeria (AMCON)

The high incidence of non-performing loans in the banking industry and the consequent erosion of the capital of many banks informed the need to establish AMCON designed to free the banks of the burden of toxic assets.

AMCON is an interventionist initiative with an authorised capital to be subscribed by the CBN and the Ministry of Finance.

The objectives of the Corporation include the following:

- Assist eligible financial institutions to efficiently dispose of eligible bank assets;
- Efficiently manage and dispose of the eligible bank assets acquired by the Corporation; and
- Obtain the best achievable financial returns on eligible bank assets, or other assets, acquired by it having regard to:
  - the need to protect or otherwise enhance the long-term economic value of those assets; and
  - any other factor which the Corporation considers relevant to the achievement of its objectives.

The use of asset management companies in the management of NPLs has proved to be a potent tool in a number of jurisdictions. However, its effectiveness would depend on such variables as type, legal framework, ownership structure, level of economic development of the country, and political independence of the agencies, among other variables.

## 7.3 Adoption of the IFRS in the Nigerian Banking System

In order to achieve financial stability, the CBN has taken steps to expose the banking system to the global best practices in financial reporting and disclosure. The provision of adequate information by banks would enhance market discipline and reduce uncertainties, thereby reducing the risk of contagion. Besides promoting the adoption of

IFRS in the Nigerian banking industry by end-2012, the Bank has:

- Issued a refined reporting templates that would allow for the capture of standardized sectoral and/or other information;
- Introduced a common accounting year-end for all banks, with effect from end-December 2009, aimed at improving data integrity and comparability; and
- Issued a comprehensive minimum disclosure guideline for banks and discount houses with effect from December 2009 accounts.

The CBN is also closely collaborating with other stakeholders, such as the NASB, the FMF, the NDIC, the SEC, NAICOM, PENCOM, the FIRS, and ICAN amongst others, to ensure a seamless adoption of IFRS in the Nigerian banking sector by 2012. These efforts are being pursued under the aegis of the Roadmap Committee of Stakeholders on the Adoption of IFRS in Nigeria, which was inaugurated in 2009 by the NASB and facilitated by the World Bank.

The adoption of IFRS would bring about significant benefits, but not without its potential challenges as well.

## 7.4 Promoting Consumer Protection in the Nigerian Banking Industry

In order to further engender public confidence in the banking system and enhance customer protection, the CBN has established a Consumer and Financial Protection Division to provide a platform through which consumers can seek redress.

In the first three months of the Division's operation, about 600 consumer complaints were received a clear manifestation of the absence of an effective complaints resolution mechanism in banks. In order to further address this challenge, the CBN has issued a directive to banks to establish Customer Help Desks at their head offices and branches. Also, the CBN has commenced a comprehensive review of the *Guide to Bank Charges*, with a view to making the charges realistic and consumer-friendly.

Furthermore, it is important that bank consumers are properly educated and enlightened on their rights and responsibilities. Consequently, the Consumer and Financial Protection Division would commence a programme of consumer education and enlightenment very shortly. The details are being worked out and would be made public as soon as they are ready.

The CBN is also collaborating with the Consumer Protection Council on the review of the *Consumer Protection Council Act No. 66 of 1992* to further empower the regulators to enforce discipline in the market.

## 7.5 Enhancement of the Credit Risk Management System

The concern of the CBN over bank failures resulting from bad loans, coupled with the need to strengthen the risk management processes in the financial system, has become paramount leading to the establishment, in 1990, of a public credit bureau, known as the Credit Risk Management System (CRMS) and the licensing of private credit bureaux in 2009.

### *i. CBN CRMS*

The CRMS was given legal backing by the *CBN Act No. 24 of 1991* [sections 28 and 52] as amended. The *Act* empowers the CBN to obtain from all banks, returns on all credits with a minimum outstanding balance of ₦100,000.00; now ₦1million and above (principal and interest), for compilation and dissemination by way of status reports to authorized institutions which are mainly financial institutions and regulators. However, it was not until 1997 that the CBN, by its circular No. BSD/PA/7/97, dated 31/12/97, formally informed the banks of the commencement of operations of the CRMS, with effect from 1st January, 1998. The circular compulsorily requires all banks to:

[a] Obtain, from the Credit Bureau, a CRMS borrower's code number in respect of all customers enjoying any form of credit facilities of ₦1 million and above;

[b] Render monthly Credit Returns to the Credit Bureau on all customers with facilities of ₦1 million and above;

[c] Ensure that before a credit of ₦1 million or above is granted to any customer, or an additional credit that would increase the outstanding exposure to ₦1 million or above, the lending bank should obtain a credit report from the Credit Bureau on such customer; and

[d] Ensure that credits are only granted to borrowers on whom favourable credit reports have been obtained from the CRMS.

The circular also specifies the penalties to be imposed on banks that violate the provisions of the enabling *Act* or circular.

The CRMS was initially designed to capture credits of ₦100,000 and above, but was later reviewed upwards to ₦1 million and above to enable it focus on large credits. The CBN Credit Bureau operations are limited to banks which are mandatorily required to render monthly returns on the details of all credits of ₦1 million and above. Other financial institutions are expected to be incorporated at a later date. Also, it is mandatory for all banks to request from the CBN Credit Bureau a credit report in respect of any customer to whom a credit facility of ₦1 million and above is being contemplated. The aim of the CRMS is to strengthen the appraisal procedures of banks, through the identification of delinquent borrowers, checking of over-lending, and ensuring the consistent classification of credits.

As at end December 2009, the CBN CRMS had in its database records of 63,451 borrowers with an outstanding indebtedness of ₦4.0 trillion from 36,768 different credit facilities, including fixed term loans, overdrafts, leases, CP/BAs, etc.

The CBN CRMS would continue to play its regulatory role, by operating as a public credit registry and sharing information with the private credit bureaux. In this regard, banks and other financial institutions shall continue to render returns to the CBN and comply with all relevant circulars and guidelines.

### *ii. Establishment of Private Credit Bureaux*

The operations of the CRMS as a public credit bureau are limited when compared to a normal credit bureau which provides credit information on all persons and sectors of the economy. Also the CRMS only captures credits of ₦1 million and above, as against the best practice which places no limits on the amount to be captured.

These limitations, together with the reforms in the financial services sector, especially in the provision of access to credit at the micro level, informed the establishment of credit bureaux that would meet international best practices in Nigeria. Consequently, the *CBN Act, 2007* has been amended to empower the CBN to license and regulate private credit bureau operations in Nigeria.

The private credit bureaux are mandated to cover all sectors of the economy, with a view to providing credit reports on all individuals and corporate bodies that intend to enjoy, or are enjoying, any type of facilities in the country. In order to streamline the operations of the bureaux, guidelines covering their licensing as well as their operational and regulatory requirements, were issued in October 2008. In doing so, full account was taken of the best practices in credit bureau operations as well as Nigeria's environmental peculiarities. Inputs from various stakeholders, including the World Bank's MSME project, the IFC, individuals and corporate organizations, were taken into consideration.

### *a. Operational Challenges in the Credit Bureaux (CBs)*

The challenges that are unfolding, consequent upon the commencement of operations by the private credit bureaux, are the following:

- Lack of public awareness of the relevance and operational modalities of CBs;
- Lack of an acceptable unique identifier in Nigeria (as a result of the failure of the National Identity card); and
- Absence of reliable and regular data collection and dissemination mechanism.

### *b. The Outlook for Credit Bureaux in 2010*

In 2010 the CBN would embark on the following measures aimed at addressing the identified challenges of this sub-sector of the financial system:

i. Liaison with National Identity Management Commission (NIMC), with a view to enhancing the National Identity Card project;

ii. Whenever the National Identity scheme takes off, circulars would be issued to ensure that no new credit shall be extended to anybody unless the person has a national identity card;

iii. Conduct a nationwide awareness programme on credit bureau operations, in order to get the buy-in of other stakeholders, especially the non-financial sectors;

iv. Offer technical assistance by organising capacity building programmes for the personnel of the licensed credit bureaux;

v. Issue a circular directing banks and other financial institutions to sign data exchange agreements with at least two licensed credit bureaux from which they would be required to obtain credit reports on current and intending borrowers;

vi. Develop an appropriate reporting format for lending institutions and bureaux for ease of regulation and monitoring by the CBN; and

vii. Ensure that risk management and corporate governance tenets would be properly entrenched in the operations of licensed credit bureaux.

As at end-June 2010, three credit bureaux had been licensed by the CBN to operate in Nigeria, while one has been granted an Approval-in-Principle. They have since commenced operations.

### Box 2: Financial Stability Going Forward

The CBN is making strenuous efforts to strengthen the framework for financial stability in Nigeria going forward. In particular, the following steps are being taken:

- Adoption of the macro prudential regulation/supervision approach;
- Review of the UB model;
- Adoption of risk-based and consolidated supervision;
- Establishment of the Asset Management Corporation of Nigeria (AMCON);
- Strengthening the Financial Services Regulation Coordinating Committee (FSRCC);
- Ensuring transparency in the banking system by enforcing mandatory additional disclosure requirements by banks;
- Adoption of Nigerian GAAP-plus in the interim, and full adoption of IFRS by 2012;
- Phased implementation of Basel II in preparation for full adoption by 2012;
- Establishment of a Micro Small and Medium Enterprises (MSMEs) Fund;
- Mortgage/Housing Finance Policy reform that would restructure the PMI sub-sector;
- Establishment of a Housing Sector Support Fund;
- Sanitisation of the finance company sub-sector;
- Decentralisation of OFISD by the establishment of five zonal offices across the nation;
- Full implementation of the PSV 2020 Project; and
- Review of the microfinance policy framework and operating guidelines for MFBs.

# 8.0 CONCLUDING REMARKS

The principal mandate of the CBN, as encapsulated in its enabling *Act*, includes the promotion of a sound financial system and ensuring monetary and price stability in Nigeria. Thus, the issue of stability in the financial system has been central to the functioning of the CBN since its inception. This responsibility has, however, attained added importance in recent times as a result of events in the financial system, especially the crises that have affected the Nigerian banking system between 2007 and 2009. Following the rapid financial sector liberalisation in the 1990s and the consolidation programme embarked upon in 2005, the financial system has witnessed a rapid growth that has not been supported by appropriate measures designed to encourage prudent risk management practices. This fact, taken along with other issues, such as corporate governance failures, the absence of investor and consumer sophistication, inadequate disclosure and transparency, critical gaps in the regulatory framework and regulation, uneven supervision and enforcement by regulators, as well as macro-economic instability that was caused by large and sudden capital inflows, among others, has precipitated the crises that have negatively impacted the financial system.

In realization of the fact that the financial crises were caused by a myriad of issues and that no single policy solution for dealing with them would suffice, the CBN aims to introduce and implement various policies to address the causes of the crises, taking into account the peculiarities of the domestic environment. In this regard, the CBN, as part of its ongoing efforts to attain and promote financial stability, has recently articulated various policies aimed at addressing any likely constraint to the stability of the financial system. Consequently, a four-pillar reform programme aimed at correcting the anomalies that have hampered the effective functioning of the financial system was introduced and is being vigorously implemented.

The reform programme, as well as other policy measures by the CBN to promote financial stability, constitutes the bedrock of this *Report*. It is pertinent to state that the decision to publish this *Report* at this time when the risk to financial stability in Nigeria is still high, is quite courageous in the light of the reasoning that such report could precipitate the very crisis that we seek to mitigate. However, the need to demonstrate our commitment to the efforts being implemented to address the challenges in our financial system has swayed our decision in favour of the publication of this *Report*. It is hoped that the publication would provide a clearer understanding of the issues affecting financial stability in the Nigerian financial system and the efforts that are being made to address them.

# LIST OF ABBREVIATIONS AND ACRONYMS

| | | |
|---|---|---|
| ACH | - | Automated Clearing House |
| ACGSF | - | Agricultural Credit Guarantee Scheme Fund |
| ACSE | - | Abuja Commodity and Securities Exchange |
| ACSS | - | Agricultural Credit Support Scheme |
| AfDB | - | African Development Bank |
| AFC | - | African Finance Corporation |
| AIP | - | Approval-in-Principle |
| AMCON | - | Asset Management Corporation of Nigeria |
| AML/CFT | - | Anti-Money Laundering/Combating the Financing of Terrorism |
| ASI | - | All Share Index |
| ATB | - | Anti-Terrorism Bill |
| ATMs | - | Automated Teller Machines |
| BAs | - | Bankers Acceptances |
| BDC | - | Bureaux-de-Change |
| BOO | - | Build Operate and Own |
| BOFIA | - | Banks and Other Financial Institutions Act |
| BOI | - | Bank of Industry |
| BOT | - | Build Operate and Transfer |
| CAC | - | Corporate Affairs Commission |
| CACS | - | Commercial Agriculture Credit Scheme |
| CAR | - | Capital Adequacy Ratio |
| CB | - | Credit Bureaux |
| CBN | - | Central Bank of Nigeria |
| CEO | - | Chief Executive Officer |
| CIBN | - | Chartered Institute of Bankers of Nigeria |
| CP | - | Commercial Paper |
| CRMS | - | Credit Risk Management System |
| CRO | - | Chief Risk Officer |
| CRR | - | Cash Reserve Requirement |
| CTR | - | Currency Transaction Reports |
| DFI | - | Development Finance Institution |
| DH | - | Discount House |
| DMB | - | Deposit Money Bank |

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| ECOWAS | - | Economic Community of West African States |
| EDW | - | Expanded Discount Window |
| eFASS | - | electronic Financial Analysis and Surveillance System |
| EFCC | - | Economic and Financial Crimes Commission |
| FATF | - | Financial Action Task Force |
| FAQ | - | Frequently Asked Question |
| FBN | - | First Bank of Nigeria |
| FC | - | Finance Companies |
| FDI | - | Foreign Direct Investment |
| FGN | - | Federal Government of Nigeria |
| FHAN | - | Finance Houses Association of Nigeria |
| FIRS | - | Federal Inland Revenue Service |
| FITC | - | Financial Institutions Training Centre |
| FMAWR | - | Federal Ministry of Agriculture and Water Resources |
| FMBN | - | Federal Mortgage Bank of Nigeria |
| FMC | - | Federal Ministry of Commerce |
| FMF | - | Federal Ministry of finance |
| FOB | - | Free On Board |
| FSA | - | Financial Services Authority |
| FSC | - | Financial Stability Committee |
| FSRCC | - | Financial Services Regulation Co-ordinating Committee |
| FSS | - | Financial System Strategy |
| GDP | - | Gross Domestic Product |
| GIABA | - | Inter-Governmental Action Group Against Money Laundering in West Africa |
| GMP | - | Guaranteed Minimum Price |
| ICAN | - | Institute of Chartered Accountants of Nigeria |
| ICD | - | Inland Container Depots |
| ICPC | - | Independent Corrupt Practices and related offences Commission |
| ICRG | - | International Cooperation Review Group |
| ICT | - | Information Communication Technology |
| IDB | - | Islamic Development Bank |
| IDC | - | Industrial Development Corporation |
| IFC | - | International Finance Corporation |
| IFEM | - | Inter-bank Foreign Exchange Market |
| IFRS | - | International Financial Reporting Standards |

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| IFSB | - | Islamic Financial Services Board |
| IMF | - | International Monetary Fund |
| ISA | - | Investment and Securities Act |
| IT | - | Information Technology |
| KOB | - | Knowledge of Business |
| KYC | - | Know Your Customer |
| LCBO | - | Large Complex Banking Organization |
| MDA | - | Ministries, Departments and Agencies |
| MER | - | Mutual Evaluation Report |
| MFB | - | Microfinance Bank |
| MFI | - | Microfinance Institutions |
| ML | - | Money Laundering |
| MLPA | - | Money Laundering (Prohibition) Act |
| MOFI | - | Ministry of Finance Incorporated |
| MOU | - | Memorandum of Understanding |
| MPD | - | Monetary Policy Department |
| MPR | - | Monetary Policy Rate |
| MRR | - | Minimum Rediscount Rate |
| MSME | - | Micro, Small and Medium Enterprise |
| NACOB | - | National Association of Community Banks |
| NACRDB | - | Nigeria Agricultural Co-operative and Rural Development Bank |
| NACS | - | Nigeria Automated Clearing System |
| NAICOM | - | National Insurance Commission |
| NASB | - | Nigeria Accounting Standards Board |
| NASS | - | National Assembly |
| NCCT | - | Non Co-operative Countries and Territories |
| NDIC | - | Nigeria Deposit Insurance Corporation |
| NDLEA | - | National Drug Law Enforcement Agency |
| NEXIM | - | Nigeria Export Import Bank |
| NFIU | - | Nigeria Financial Intelligent Unit |
| NGAAP | - | Nigerian Generally Accepted Accounting Principles |
| NGO-MFI | - | Non-governmental Organisation-Microfinance Institution |
| NHF | - | National Housing Fund |
| NIBSS | - | Nigerian Inter Bank Settlement System |
| NIMC | - | National Identity Management Commission |
| NIPOST | - | Nigerian Postal Service |

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| NPL | - | Non-Performing Loan |
| NSE | - | Nigerian Stock Exchange |
| OBB | - | Open Buy back |
| OECD | - | Organisation for Economic Co-operation and Development |
| OFI | - | Other Financial Institutions |
| OFID | - | Other Financial Institutions Department |
| OFISD | - | Other Financial Institutions Supervision Department |
| OMO | - | Open Market Operations |
| OSFI | - | Office of the Superintendent of Financial Institution |
| P&A | - | Purchase and Assumption |
| P&L | - | Profit and Loss |
| PBT | - | Profit before Tax |
| PENCOM | - | National Pension Commission |
| PEP | - | Politically Exposed Person |
| PFA | - | Pension Fund Administrator |
| PFC | - | Pension Fund Custodian |
| PLC | - | Public Liability Company |
| PMI | - | Primary Mortgage Institutions |
| PN | - | Promissory Note |
| POS | - | Point of Sale |
| PPP | - | Public Private Partnership |
| PSV | - | Payment System Vision |
| RBS | - | Risk Based Supervision |
| RI | - | Reporting Institution |
| RMP | - | Risk Mitigation Programme |
| ROA | - | Return on Assets |
| ROE | - | Return on Equity |
| ROSCAS | - | Rotary Savings and Credit Association |
| RRG | - | Regional Review Group |
| RTGS | - | Real Time Gross Settlement |
| SEC | - | Securities and Exchange Commission |
| SI | - | Stability Instrument |
| SME | - | Small and Medium Enterprises |
| SMECGS | - | Small and Medium Enterprises Credit Guarantee Scheme |
| SMEEIS | - | Small and Medium Enterprises Equity Investment Scheme |
| SMIEIS | | Small and Medium Industries Equity Investment Scheme |

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| STR | - | Suspicious Transaction Report |
| UB | - | Universal Banking |
| UDB | - | Urban Development Bank |
| UN | - | United Nations |
| UNSCMTT | - | United Nations Security Council Monitoring Team on Terrorism |
| WAFSA | - | West African Financial Supervisory Authority |
| WAIFEM | - | West African Institute for Financial and Economic Management |
| WAMA | - | West Africa Monetary Agency |
| WAMI | - | West African Monetary Institute |
| WAMU | - | West African Monetary Unit |
| WAMZ | - | West African Monetary Zone |
| WDAS | - | Wholesale Dutch Auction System |