CENTRAL BANK OF NIGERIA

Keynote Address

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KEYNOTE ADDRESS

Protocols

1.0 I am pleased to be in your midst this morning to present the keynote address at this very important Roundtable Conference on the theme **"Developments, Challenges and Opportunities in the Sub-Saharan Africa Banking Sector"** holding here in Luxembourg. It is equally pleasing to note that the focus of this Conferencecovers such issues as access to finance and financing infrastructural projects. Indeed, the Conference provides a unique opportunity for us, as eminent economists, chief executives of banks, global investors, policymakers and experts in the financial services industry to share views on recent developments, challenges and opportunities relating to the banking sector in the Sub-Saharan Africa and how best to chart the way forward for the Continent.As we are aware, the development of infrastructure remains pivotal to economic growth and development of the continent. I therefore commend the organizers of this event for thinking along this line, as it is not only apt, but very timely, considering the existing huge gaps in financing critical infrastructure in the continent.

2.0 Distinguished ladies and gentlemen, my address would, however, center on **"Developments, Challenges and Opportunities in the Nigerian Banking Sector"** in context of the emerging trends in the global economy. But before then, let me give you some stylized facts about banking reforms in the continent.

3.0 Indeed, African growth challenges remain formidable and require robust financial systems that can mobilize domestic financial resources for productive investments. This is particularly necessary in view of the vast economic potentials of the region which remain untapped. Domestic resource mobilization remains a challenge owing to the narrowness of the money and capital markets and low savings and taxable incomes.The effects of the global financial crisis and the subsequent recession have continued to make access to foreign resources more difficult. Nevertheless, economic growth in the continent remains impressive despite observed challenges. Economic growth rate averaged5.7 per cent prior to the global financial crisis, driven largely by favorable external environment, rich natural resources and domestic factors such as reduced conflict, greater political stability, and prudent macroeconomic policies.

4.0 As we are all aware, the global crisis strained the pre-crisis gains through sharp exchange rate movements that posed challenges, particularly for banks or firms with net open foreign exchange positions, in a few dollarized economies. While the impact of the crisis varied across countries, overall, the African banking system was fairly resilient to the crisis. However, sources of risks that emerged included: increased non-performing loans resulting from the slow-down in economic activity, low commodity prices, currency depreciation, the sharp drop in equity prices, tighter liquidity due to declining trade credit flows and withdrawal of liquidity from local subsidiaries of foreign banks. All of these reflect the fall-out of distress in the banks' home countries, and possible contagion risks from less well-supervised regional banks.

5.0 Let me state that in spite of the euro-zone crisis, financial flows to Africa have continued due to the potential returns on such investments bring. Capital flows such as Foreign Direct Investment (FDI), portfolio equity and loans have registered positive increase over the years. In spite of these developments, Africa's growth is unsustainable and not fully inclusive as it is heavily dependent on commodity prices. Whereas GDP growth and macro-economic equilibrium have reassured and reinvigorated private investors, they still mainly depend on commodity prices, leaving the continent extremely vulnerable to a recession.

6.0 Distinguished guests, the depth of financial markets in Africa has improved in spite of the relatively poor operating environment, though the level of improvement has not been uniform across the continent. In addition, innovative low-cost services provided by financial institutions (banks, insurers etc) and reforms have contributed to the improving financial services landscape. Moreover, the growth in domestic savings; improved efficiency of financial intermediation; and enhanced effectiveness of monetary policy continue to facilitate the achievement of sustainable economic growth. However, Africa's financial markets are yet to be fully integrated with the global system and comprises of a number of different national financial markets characterized by exchange rate risk, divergence of government bond yields in local currencies and differing inflation expectations. Despite the absence of an African inter-bank market or a centralized market for debt or equity, the African financial market has experienced growth driven by reforms undertaken by national regulators.

7.0 Many sub-Saharan African countries, have at one time or the other in the last three decades, implemented financial sector reforms, particularly financial liberalization as a component of structural adjustment programme (SAP) to improve macroeconomic conditions. Generally, banking sector reforms were undertaken in these countries against the backdrop of severe macroeconomic imbalances and financial distress. For instance, banking reforms had been carried out in Ghana, Nigeria, Sierra Leone and Kenya in recent years.

8.0 In Ghana, notable aspects of the banking reforms were decisive steps to improve Ghana's regulatory and supervisory responsibilities to ensure that only strong and well-managed banks operated in the country. Other measures included the reconstitution and strengthening of banks' Board of Directors, closure of unprofitable branches, reduction of operating costs through retrenchment of staff; cleaning of balance sheets by off-loading non-performing loans to state-owned enterprises, guaranteeing loans by the government of Ghana, and non-performing loans granted to the private sector. Following the reform measures, Ghana's financial sector development recorded a notable impact on growth, which rose to 6.3 percent in 2007 from 4.5 percent in 2002 prior to the onset of reforms. Other positive outcomes included the doubling of the ratio of money (M2) to GDP (43.0 percent) in 2007 with much of the increase funded by the rise in demand and savings deposits. The banking system also grew rapidly, with banks now accounting for about 70.0 percent of the financial sector (Mohamadu and Onwusu, 2008).

9.0 In Kenya, before the banking reforms, the performance of financial institutions was weak as a result of several factors, including ineffective board and management malpractices, high non-performing loans, unsecured insider lending, undercapitalization and violations of the provisions of the Banking Act and Prudential Regulations, leading to banking failures between 1984 and 2005. To enhance the stability and soundness of the banking sector through improved corporate performance, the Central Bank of Kenya (CBK) initiated a number of corporate governance reforms. These included: establishment of audit committees, emphasis on majority non-executive directors on bank boards, trilateral meetings between the CBK, external auditors and financial institutions, among others. In addition, changes were proposed to the Banking Act with a view to defining, vetting and certifying banks' significant shareholders (Baroko, 2007).

10.0 On its part, Sierra Leone undertook pragmatic measures to reposition the banking sector through a Financial Sector Development Plan which placed emphasis on eight major issues. These included: building commercial banking sector capacity; increasing access to finance; improving mobilization and investment of long-term funds; strengthening banking supervision and regulation; improving the macroeconomic environment; modernizing the payments system; strengthening of financial markets and monetary policy and the central bank infrastructure. These measures largely sanitized the country's banking sector (Central Bank of Sierra Leone, 2009).

The Nigerian Experience

The Early Reform Measures

11.0 In Nigeria, the government had since 1986 embraced banking sector reforms as part of its structural adjustment programme. The reforms had evolved in response to the challenges posed by developments in both the domestic and international financial landscape, including globalization and technological innovation, among others. Through the reform programme, the government intended to mitigate the country's vulnerability to systemic distress and macroeconomic instability, liberalize the financial sector and strengthen market mechanisms and ethical standards.

12.0 The financial environment that emerged from the paradigm shift (particularly the deregulation of interest and exchange rates) was unstable, inefficient, risky, illiquid and generated lower return on assets relative to the pre-reform period. The incidences of fraud and non-performing loans also increased as revealed by a Central Bank Nigeria/Nigeria Deposit Insurance Corporation study of distress in the financial system (1995). The industry was heavily concentrated, with the 10 largest banks out of the over 100 banks in operation, controlling 50.0 per cent of the assets and deposits in the banking system.

Moreover, most of the banks were poorly capitalized while poor corporate governance was pervasive in the industry.

13.0 Consequently, a number of far-reaching policy reform measures were adopted, such as the enactment of the Failed Banks (Recovery of Debts) and Financial Malpractices Act of 1994 under which a number of bank executives and directors were prosecuted for their roles in the failure of their respective institutions. Furthermore, the Bank introduced universal banking scheme in 2001 to create a level-playing field for financial sector operators, encouraged greater efficiency through economies of scale and foster competition by opening up various lines of business to banks. In addition, in 1991, the government promulgated the Bank and Other Financial Institutions Decree (No. 24) and the Central Bank of Nigeria Decree (No.25) which spelt out comprehensive guidelines for bank regulation, supervision and liquidation. The supervisory role of the CBN, aimed at promoting sound banking and financial system, was also statutorily expanded to cover non-bank financial institutions. Consequently, activities of all the regulatory and supervisory authorities in the Nigerian financial services sector were brought under the coordination of the Financial Sector Regulation and Coordinating Committee (FSRCC), under the chairmanship of the Governor of the Central Bank of Nigeria. The monetary authority also adopted the Code of Good Practice in Monetary and Financial Policies, the International Accounting and Auditing Standards and initiated a private sector-funded "lifeboat" facility accessible to all DMBs to tackle temporary liquidity problems. Again, in line with international best practice, the CBN adopted the Core Principles of the Basel Committee on Banking Supervision, including the prudential guidelines for licensed banks to promote banking soundness and financial sector stability.

14.0 In spite of these efforts, there was an over-dependence of many Nigerian banks on public sector deposits and government revenue collection. Although the distribution among banks was not uniform, the dependency ratios of some banks were in excess of 70 per cent as at June 2004. The implication was that the resource base of such banks was weak and volatile, rendering their operations highly vulnerable to swings in government revenue. Many banks had abandoned their traditional intermediation role of mobilizing savings and inculcating banking habit at the household and micro enterprise levels.

15.0 A surveillance report by the CBN as at end-March 2004 indicated that 62 banks out of the 89 in operation as at that time, were classified as sound/ satisfactory, 14 as marginal, while the position of unsound banks had deteriorated from 9 as at end-December 2003 to 11. The report further indicated that the industry was dominated by the top 20 – 30 banks, with 69 banks out of the 89 licensed banks operating as marginal players, while about 60 – 70 per cent of total deposits were short-term (30 – 90 days), and this accounted for why banks were not lending to the real sector.

16.0 A significant number of the banks exhibited other weaknesses, such as weak corporate governance, evidenced by high turnover in the Board and management staff, inaccurate reporting and non-compliance with regulatory requirements, falling ethics and de-marketing of peers in the industry; gross insider abuses, resulting in huge non-performing insider-related credits. Other indicators were late or non-publication of annual accounts that obviates the impact of market discipline in ensuring banking soundness; insolvency, as evidenced by negative capital adequacy ratios and complete erosion of shareholders' funds by operating losses; over-dependence on public sector deposits, and neglect of small and medium class savers.

The Bank Consolidation Exercise

17.0 Against the backdrop of the aforementioned examination report, the supervisory authorities in 2004-2005 adopted the bank consolidation programme as a resolution option. The bank consolidation programme sought, among other things, to strengthen and improve the operational efficiency of the Nigerian banks. The major elements of the reform agenda were: the requirement for banks to increase their minimum shareholders' funds to N25 billion (US$173 million) from N2 billion (US$14 million); phased withdrawal of public sector funds from banks; consolidation of banking institutions through mergers and acquisitions; adoption of a risk focused and rule-based regulatory framework; and adoption of zero tolerance in the regulatory framework, among others. Specifically, the clear intention of the policy was to consolidate the existing banks into fewer, larger and financially-stronger banks that could compete internationally.

Outcomes of Consolidation

18.0 One of the positive outcomes of the consolidation exercise was the emergence of 24 banks from 89 with increased capital and asset base, which gave them the capacity to undertake bigger ticket transactions. The increased size and complexity of operations of these emergent banks also engendered greater competition in the industry and product innovations which exposed them to the risks associated with such scale of operations to which they were unfamiliar with and ill-equipped to handle.

The Post-Consolidation Issues/Weaknesses in the System

19.0 But the 2007/2009 global financial crisis strained the gains made in the Nigerian banking sector from the consolidation exercise. Following the impact of the global financial crisis, a section of the banking industry was badly affected as some banks were in grave condition and faced liquidity problems, owing to their significant exposure to the capital market in the form of margin lending. Furthermore, in the wake of high oil prices in the international oil market, a section of the industry had extended huge facilities to the operators in the oil and gas sectors, particularly those operating at the downstream segment. As crude oil prices tumbled during the crisis, most of these facilities became non-performing and banks that were significantly exposed to the sector were badly affected.

20.0 The excessive exposures resulted in the weaknesses (liquidity problems) exhibited by some of the banks towards the end of 2008. As part of its liquidity support, the CBN Discount Window was expanded in October 2008 to accommodate money market instruments such as Bankers' Acceptances and Commercial Papers in order to avert a liquidity crisis. With the expanded Discount Window in place, banks took advantage of this facility and increased their commitment. It turned out that a significant number of them became totally dependent on it for survival. When the CBN closed down the EDW and, in its place, guaranteed inter-bank placements, it was observed that the same number of banks were the main net-takers under the guarantee arrangement, indicating that they had a deep-rooted liquidity problem.

21.0 In addition, some other internally interdependent factors that led to the crisis experienced in the banking sector in the post-consolidation era included: inadequate regulatory framework and regulations, inadequate disclosure and lack of transparency among operators, instability in macro-economic variables, lack of investor and consumer education, weak corporate governance, weak supervision and enforcement and poor business environment.

22.0 In order to address these issues and ensure financial stability in the system, the CBN decided to ascertain the true state of the health of the banks by first carrying out a joint special examination (CBN/NDIC) of all the banks in June 2009 to review, evaluate and determine the quality of the banks portfolios. The findings of the special examination revealed several infractions including: substantial non-performing loans; poor corporate governance, weaknesses in governance and management; weaknesses in capital adequacy; and illiquidity problem. These problems necessitated the 2009 banking reforms initiated by the CBN.

Current Reform Initiatives and Objectives

23.0 Thus, the CBN moved decisively to strengthen the industry, protect depositors and creditors, and restore public confidence and safeguard the integrity of the Nigerian banking industry by replacing the chief executives/executive directors of eight (8) out of the ten (10) banks that were identified as the source of instability in the industry. The CBN injected the sum of N620.0 billion into the affected banks in the form of Tier II capital in an effort to prevent a systemic banking crisis. The liquidity injection was structured as a 7-year convertible long-term loan, initially at 11.0 per cent interest rate, but later reduced to 8.0 per cent in December 2009, callable on the 5th anniversary of the loans. The Boards of two (2) of the banks were directed to recapitalize by June 30, 2010 as they were adjudged to have insufficient capital for their levels of operation. Arrangements were also made to recover non-performing loans from the banks' debtors while guaranteeing all foreign credits and correspondent banking commitments of the affected banks.

24.0 As additional measure to strengthen the reform process, the CBN further articulated a blueprint for reforming the Nigerian financial system in general and the banking sector in particular in the next ten years. The blueprint code-named "The Project Alpha", is built on 4 pillars of: enhancing the quality of banks, establishing financial stability, enabling healthy financial sector evolution and ensuring that the financial sector contributes to the real economy.

The Journey So Far

25.0 Based on the last pillar, the Bank is collaborating with the fiscal authorities to improve the macroeconomic environment so as to achieve robust monetary and financial policies in particular and, the overall macroeconomic objectives of the government, in general. Under this, the reform has a direct bearing on the development of the real sector as it seeks to position the banking system to contribute to the growth and development of the various sectors of the economy. The spirit of this pillar is anchored on the fact that real economic growth must be supported by actual rise in physical goods and services. This segment of the reform has sought to break from the classical orthodoxy of leaving the allocation of financial resources to market forces. Rather, the reform has identified priority sectors and developed tailored interventions to support and promote growth in these sectors. Some of the key interventions in the real sector under this pillar include the following:

- N200 Billion Restructuring/Refinancing to the Manufacturing Sector/SME
- N200 Billion Small and Medium Scale Enterprises Guarantee Scheme (SMECGS)
- N200 Billion Commercial Agricultural Credit Scheme (CACS)
- N300 Billion Power and Aviation Intervention Fund
- The Nigeria Incentive-Based Risk Sharing for Agricultural Lending (NIRSAL)
- Moreover, in 2010, the CBN signed an agreement with the Alliance for a Green Revolution in Africa (AGRA), aimed at developing an innovative mechanism that will unlock financial resources to serve the needs of all farmers, especially smallholder farmers, agro-processors,

agribusinesses and input suppliers in the agriculture value chain as well as provide food security for the country's teeming population. The initiative, simply called the Nigerian Incentive-Based Risk Sharing System for Agricultural Lending (NIRSAL) would assist small holder farmers, agro-processors, agro-business and input suppliers in the agricultural value-chain in improving their access to finance. NIRSAL would enable farmers have access to affordable financial services, reduce the risks of lending by banks, build capacities for banks to expand their lending to agriculture, deploy risk sharing instruments, develop a bank rating mechanism that would rate banks based on their commitment to lending to the agricultural sector and above all create stable employment for young school leavers. As at end-December 2012, NIRSAL had moved from the design level to implementation stage as it has secured the necessary presidential approval to formally commence operations.

26.0 These initiatives were predicated on the fact that the sustainability of the banking system depends critically on the robust performance of the real economy, and that the banking sector cannot survive when the real economy is comatose. It is envisaged that these measures/reforms will guarantee the long-term survival of the banking sector.

27.0 The universal banking (UB) model adopted in 2001, allowed banks to diversify into non-bank financial businesses. Following the consolidation programme, banks became awash with capital, which was deployed to multiples of financial services. In effect, the laudable objectives of the UB model were abused by operators with banks operating as financial supermarkets to the detriment of core banking practices. To address the observed challenges, the CBN reviewed the UB model with a view to directing banks to focus on core banking business. Under the new model, banks are not allowed to invest in non-bank subsidiaries, while banks with such investments were required to either divest or spin-off the businesses to holding companies that were licensed by the CBN as other financial institutions. Three major categories of banks, namely commercial, merchant and specialized banks are now licensed to operate in the country.

28.0 To engender confidence and ensure financial stability in the banking sector, the CBN established the Asset Management Corporation of Nigerian (AMCON). The AMCON, as a resolution vehicle was created to soak the toxic assets of the CBN-intervened banks and provide liquidity to them as well as assist in their re-capitalization. The establishment of the banking sector resolution sinking fund would not only remove the burden of the cost of stabilising the banks and preventing bank failures solely on the Nigerian tax payer, but also placed it on the banking industry. Under the sinking fund arrangement, the CBN contributes N50 billion and each Nigerian bank contributes an amount equivalent to 0.3 per cent of its total assets, as at the date of its audited financial statements, annually to the Asset Management Corporation of Nigeria (AMCON) for a period of ten years. Similarly, the NDIC had engaged the Asset Management Corporation of Nigeria (AMCON) with a view to capitalizing the Bridge Banks. The AMCON had injected substantial funds to recapitalize the three banks and planned to run them for two-three years before finding suitable investors. It is worthy of note, that unlike other parts of the world where depositors lost funds in the resolution of banking crises, no depositor lost any funds in this reform process in Nigeria.

29.0 To further engender public confidence in the banking system and enhance customer protection, the Consumer and Financial Protection Department was established at the CBN to provide a platform through which consumers can seek redress. The Department had since commenced a programme of consumer education and enlightenment and is also collaborating with the Consumer Protection Council of Nigeria on the review of the Consumer Protection Council Act No. 66 of 1992, to regulate and enforce discipline in the market. The CBN also issued a directive to banks to establish Customer Help Desks at their head offices and branches. In addition, the CBN is carrying out a comprehensive review of the Guideline on Bank Charges with a view to making the charges realistic and consumer friendly.

30.0 The CBN took steps to integrate the banking system into the global best practices in financial reporting and disclosure through the gradual adoption of some aspects of the International Financial Reporting Standards (IFRS) in the Nigerian Banking Sector. This is expected to enhance market discipline, and reduce uncertainties which limit the risk of unwarranted contagion. The CBN is also, closely collaborating with other stakeholders like the Nigerian Accounting Standard Board (NASB), Federal Ministry of Finance (FMF), NDIC, Securities and Exchange Commission (SEC), National Insurance Commission (NAICOM), Pension Commission of Nigeria (PENCOM), Federal Inland Revenue Service (FIRS), and the Institute of Chartered Accountant of Nigeria (ICAN), among others, towards ensuring 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 inaugurated by the NASB and facilitated by the World Bank.

31.0 The Bank in 2011 signed the United States Trade and Development Agency (USTDA) Grant for a feasibility study towards the establishment of Shared Disaster Recovery Centers for the Nigerian Financial Sector. The United States Trade and Development Agency (USTDA) provided $510,000.00 (Five Hundred and Ten Thousand US Dollars) grant for technical assistance, which would be used for developing recommendations on technical, operational, business and regulatory requirements for the establishment of a Shared Disaster Recovery Centre (SDRC) for multiple financial sector stakeholders.

32.0 The CBN also collaborated with the Securities and Exchange Commission (SEC) and the Nigerian Stock Exchange (NSE) to reduce the cost of transactions, particularly bond issuance so as to diversify funding sources away from banks, as well as attract more foreign portfolio investors into the sector. Efforts are also being intensified towards strengthening regulatory and supervisory framework and enhancing monitoring of the operations of the Deposit Money Banks (DMBs) to ensure that they remain safe, sound and healthy. In addition, these efforts will also ensure the sustenance of public confidence through the enforcement of appropriate disclosures and reinvigorating the policy of zero tolerance on all unprofessional and unethical banking practice and greater emphasis on enforcement of Code of Corporate Governance. Standby teams of target examiners are being deployed to any bank at any time to ensure timely regulatory actions, if necessary.

33.0 Other efforts of the Bank aimed at reforming the banking sector are: the strengthening of institutional coordination through the Financial Services Regulation Coordinating Committee (FSRCC), adoption of common accounting year end for all banks, aimed at improving data integrity and comparability; conducting own-risk assessments and relying less on classifications by rating agencies; limiting the tenor of Chief Executives of Banks and banks' external auditors to 10 years; sound and timely regulation and supervision of the banks; stringent demand for transparency in the banking sector; and transparency in structured credit instruments to be improved upon for easy assessment of associated risk.

Outcomes

34.0 Distinguished ladies and gentlemen, it is evident that the reform efforts have yielded gains that have impacted positively on the economic advancement of the Nigerian economy and the continent at large. In the last seven years, the general macroeconomic environment has improved in Nigeria. Gross domestic product growth has been at an average rate of 6.2 per cent; lending rates, though above single digit, have trended downwards; exchange rate of the Naira has been relatively stable, while inflation has remained largely at the low double digit.

35.0 The banking sector reform effort, in particular, has paid off significantly in the area of employment generation. In general, the economy is beginning to reap the benefits of the recent measures taken by the CBN. Public confidence of both local and foreign investors, depositors and other economic agents has been restored in the banking system. This is evidenced by the recent upgrade of Nigeria's sovereign ratings by both S&P and Moody to BB-. Moreover, some of the affected banks have returned to the path of profitability, while capital adequacy ratios have remained significantly above the required threshold of 10 percent and the non-performing loan (NPL) ratios have fallen below the stipulated benchmark of 5 percent.

What is Outstanding?

36.0 It is our sincere hope that by the time these reforms run their full course, the nation's banking sector would have become firmly rooted in the tenets of good corporate governance and market discipline so entrenched that there would be no room for the ruinous practices of the immediate past. Nevertheless, there are still some challenges manifesting today in the banking sector which poses threats to financial system stability and economic growth and development of the economy. Specifically, the next agenda in the banking sector reforms would focus on the challenges of credit flows from the banking services sector to the real sector of the economy. There appears to be a disconnect between the robust growth in the banking sector and real sector financing in the economy. However, this development is not peculiar to Nigeria. The recent global financial crisis had made banks to be more cautious in their credit operations. Moreover, trading treasury securities have provided safe havens for banks to the detriment of real sector financing. Furthermore, infrastructural deficiency which puts pressure on banks' operating cost, leading to high interest rates, particularly in Africa, is one of the key issues to be addressed. Infrastructure is a major component of the cost of fund for the banks. Providing the needed infrastructure, particularly energy would help drive down interest rate charged in the banking sector.

37.0 In the light of the foregoing, Ladies and Gentlemen, our task at this roundtable will include, among others, to critically examine the issues and problems on ground and come up with appropriate recommendations that will assist regulators/supervisors in designing appropriate framework that would bring about stable financial/banking environment in the continent so as to avoid issues associated with banking distress and failures. Thoughts should also be given to how the banks and their owners would be made liable for failures of their institutions without compromising the objective of profitability and financial intermediation in the economy.

38.0 Having set the stage, I urge us to make maximum use of this golden opportunity by harvesting thoughts from our colleagues in this august roundtable discussion, on the way forward.

Thank you for your attention.