Sanusi Lamido Sanusi: Banking reform and its impact on the Nigerian economy

Lecture by Mr Sanusi Lamido Sanusi, Governor of the Central Bank of Nigeria, at the University of Warwick's Economic Summit, Warwick, 17 February 2012.

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Protocol

It is a great honor to be invited to address the Warwick Economic Summit, which has become one of the largest academic conferences in Europe. I wish to commend the entire students and staff of the University of Warwick for inviting me to share my experiences at the Central Bank of Nigeria (CBN). I am highly delighted to be part of this summit where top policymakers, professionals and technocrats around the world meet to debate and exchange views on contemporary economic issues. The outcomes of the Summit had continued to inspire policymakers in designing proactive micro and macroeconomic management policies for solving emerging economic problems in both developed and developing countries. It is against this backdrop that I urge you to sustain the Annual Summit. My address today will focus on *"**Banking Reforms in Nigeria and Its Impact on the Economy**"*. As you may all be aware, the banking sector in Nigeria has recently witnessed significant reforms and hard choices have had to be made to tackle the lingering effects of the global financial crisis, which culminated in the contraction of some banks' balance sheets with the attendant economic losses. I am pleased to note that these problems have been surmounted through series of reforms undertaken by the Central Bank of Nigeria.

Introduction

Generally, the financial system is more than just institutions that facilitate payments and extend credit. It encompasses all functions that direct real resources to their ultimate user. It is the central nervous system of a market economy and contains a number of separate, yet co-dependent, components all of which are essential to its effective and efficient functioning. These components include financial intermediaries such as banks and insurance companies which act as principal agents for assuming liabilities and acquiring claims. The second component is the markets in which financial assets are exchanged, while the third is the infrastructural component, which is necessary for the effective interaction of intermediaries and markets.

The three components are inextricably intertwined. Banks need payments system infrastructure to exchange claims securely and markets in which to hedge the risks arising from their intermediation activities. The banking system therefore functions more efficiently and effectively when there is a robust and efficient payments systems infrastructure. Moreover the concern to ensure a sound banking system by the Central Bank is underscored by the critical role of banks in national economic development. Banks for instance, mobilizes savings for investment purposes which further generates growth and employment. The real sector, which is the productive sector of the economy, relies heavily on the banking sector for credit. Government also raises funds through the banking system to finance its developmental programmes and strategic objectives. It is in view of these strategic roles of the banking system to national economic development that the issue of a sound banking system, through proactive reforms becomes imperative.

Rationale for banking reforms in Nigeria

Conceptually, economic reforms are undertaken to ensure that every part of the economy functions efficiently in order to ensure the achievement of macroeconomic goals of price stability, full employment, high economic growth and internal and external balances. Thus, banking reform in Nigeria is an integral part of the country-wide reform program undertaken to reposition the Nigerian economy to achieve the objective of becoming one of the 20 largest economies by the year 2020. As part of the vision, the banking sector is expected to effectively play its actual role in intermediation and for the banks to be among global players in the international financial markets.

As I will explore later, the various reforms we undertook in Nigeria were targeted at making the system more effective and strengthening its growth potentials. In view of the fact that banks take deposits from the public, there is a need for periodic reforms in order to foster financial stability and confidence in the system.

The recent experience from the global financial crisis has further underscored the imperatives of countries to embark on banking reforms on a regular basis. As you are all aware, the world economy was hit by an unprecedented financial and economic crisis in 2007–2009 that resulted in a global recession. This crisis led to the collapse of many world-renowned financial institutions and even caused an entire nation to be rendered bankrupt.

In Nigeria, the economy faltered and was hit by the second round effect of the crisis as the stock market collapsed by 70 per cent in 2008–2009 and many Nigerian banks sustained huge losses, particularly as a result of their exposure to the capital market and downstream oil and gas sector. Therefore, the CBN had to rescue 8 of the banks through capital and liquidity injections, as well as removal of their top executives and consequent prosecution of those who committed some infractions. These actions became necessary to restore confidence and sanity in the banking system.

A holistic investigation into what went wrong in Nigeria leading up to the banking crisis in 2008 found eight interrelated factors responsible. These were macroeconomic instability caused by large and sudden capital inflows, major failures in corporate governance at banks, lack of investor and consumer sophistication, inadequate disclosure and transparency about the financial position of banks, critical gaps in the regulatory framework and regulations, uneven supervision and enforcement, unstructured governance & management processes at the CBN/ and weaknesses in the business environment. Each of these factors is serious in its own right. Acted together they brought the entire Nigerian financial system to the brink of collapse.

We all know that a well-functioning financial system matters to everyone and to the economy at large. The Nigerian economy has huge potential for growth. To realize this potential, it is imperative that we learn lessons from the crisis and take steps to not only fix the problems, but to also introduce measures to establish financial stability, a healthy evolution of the financial sector and ensure the banking sector contributes to the development of the real economy.

As a result, the Nigerian banking system has steadily evolved, following wide and far-reaching reforms embarked upon by the regulatory authorities. Following the banking crisis of 2008, the Central Bank of Nigeria articulated a blue print known as ***"The Project Alpha Initiative"*** for reforming the Nigerian financial system in general and the banking sector in particular. The reforms aimed at removing the inherent weaknesses and fragmentation of the financial system, integrating the various ad-hoc and piecemeal reforms and unleashing of the huge potential of the economy.

Critical elements of banking reform in Nigeria

The current reforms which began in 2004 with the consolidation programme were necessitated by the need to strengthen the banks. The policy thrust at inception, was to grow the banks and position them to play pivotal roles in driving development across the sectors of the economy. As a result, banks were consolidated through mergers and acquisitions, raising the capital base from N2 billion to a minimum of N25 billion, which reduced the number of banks from 89 to 25 in 2005, and later to 24.

Beyond the need to recapitalize the banks, the regulatory reforms also focused on the following:

- Risk-focused and rule-based regulatory framework;
- Zero tolerance in regulatory framework in data/information rendition/reporting and infractions;
- Strict enforcement of corporate governance principles in banking;
- Expeditious process for rendition of returns by banks and other financial institutions through e-FASS;
- Revision and updating of relevant laws for effective corporate governance and ensuring greater transparency and accountability in the implementation of banking laws and regulations, as well as;
- The introduction of a flexible interest rate based framework that made the monetary policy rate the operating target. The new framework has enabled the bank to be proactive in countering inflationary pressures. The corridor regime has helped to check wide fluctuations in the interbank rates and also engendered orderly development of the money market segment and payments system reforms, among others.

The Bank has over the years identified key priority sectors and developed tailored interventions to support and promote their growth. Some of the key interventions in the real sector include:

- N200 Billion Refinancing/Restructuring of SME/Manufacturing Fund
- N300 billion for long term funding of Power and Aviation
- Commercial Agricultural Credit Scheme (CACS)
- The Small and Medium Enterprises (SME) Credit Guarantee Scheme (SMECGS)
- In addition the Nigerian Incentive-Based Risk Sharing System for Agricultural Lending (NIRSAL) was established. The programme is a demand-driven credit facility that would build the capacity of banks to engage and deliver loans to agriculture by providing technical assistance and reducing counterparty risks facing banks. It also seeks to pool the current resources under the CBN agricultural financing schemes into different components of the programme.

Furthermore, the Bank has been collaborating with the Securities and Exchange Commission (SEC) and the Nigerian Stock Exchange (NSE), to reduce the cost of transactions, particularly bond issues, so as to diversify funding sources away from banks as well as attract more foreign portfolio investors into the sector.

In 2010, the Asset Management Corporation of Nigeria (AMCON) was established following the promulgation of its enabling Act by the National Assembly. It is a special purpose vehicle aimed at addressing the problem of non-performing loans in the Nigerian banking industry, among others. In line with its mandate, AMCON recently acquired the non-performing risk assets of some banks worth over N1.7 trillion, which is expected to boost their liquidity as well as enhance their safety and soundness. With the intervention of AMCON, the banking industry ratio of non-performing loans to total credit has significantly reduced from 34.4 per cent in November 2010 to 4.95 per cent as at December 2011.

In order to ensure that AMCON achieves its mandate, the CBN and all the deposit money banks have signed an MOU on the financing of AMCON. The CBN shall contribute N50 billion annually to AMCON, while each of the participating banks shall contribute an amount equivalent to 0.3 per cent of its total assets annually into a sinking fund as at the date of their audited financial statement for the immediate preceding financial year. Therefore, the cost of the resolution to the Nigerian taxpayer is significantly minimized.

To further engender public confidence in the banking system and enhance customer protection, the CBN established the Consumer and Financial Protection Division to provide a platform through which consumers can seek redress. In the first three months of its operation, the Division received over 600 consumer complaints, which was a manifestation of the absence of an effective consumer complaints resolution mechanism in the banks. The CBN has also issued a directive to banks to establish Customer Help Desks at their head offices and branches.

In addition, the CBN has commenced a comprehensive review of the Guide to Bank Charges with a view to making the charges realistic and consumer friendly.

The CBN has taken steps to integrate the banking system into global best practice in financial reporting and disclosure through the adoption of the International Financial Reporting Standards (IFRS) in the Nigerian banking sector by end-2010. This should help to enhance market discipline, and reduce uncertainties, which limit the risk of unwarranted contagion.

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. Some operators abused the laudable objectives of the UB Model with banks operating as private equity and venture capital funds 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 their core banking business only. Under the new model, licensed banks will be authorized to carry the following types of business:

- Commercial banking (with either regional, national and international authorization);
- Merchant (investment) banking;
- Specialized banking (microfinance, mortgage, non-interest banking (regional and national); and
- Development finance institutions.

The introduction of the non-interest banking in Nigeria is expected to herald the entry of new markets and institutional players thus deepening the nation's financial markets and further the quest for financial inclusion. In fact, the first fully licensed non-interest bank in the country (Jaiz Bank Plc.) started business on Friday, January 6, 2012.

Similarly, the importance of Microfinance in a growing economy cannot be over-emphasized, given its potential in addressing the challenges of excluding a large population from full participation in economic activities. As at December 2011 there were 24 deposit money banks with 5,789 branches and 816 microfinance banks bringing the total bank branches to 6,605. The ratio of bank branch to total population is 24,224 persons, indicating a high level of financial exclusion. This is further substantiated by the 2010 Enhancing Financial Innovation and Access (EFInA) survey, which observed that 46.3 per cent of Nigeria's population is still financially excluded compared to South Africa, Kenya, Botswana with 26.0 per cent, 32.7 per cent and 33.0 per cent, respectively. Thus, in 2012 the Bank is looking to establish a Microfinance Development Fund (MDF) aimed at improving access to affordable and sustainable sources of finance by Microfinance Institutions (MFIs) and Microfinance Banks (MFBs). It would have both commercial and social components. This would enhance their operations and outreach and support the capacity building activities of the MFBs/MFIs.

The Bankers' Committee has declared 2012 the year of "Women Empowerment" in the banking industry. A sub-committee on Women Empowerment has been formed, with the CEO of Standard Chartered Bank Nigeria as Chairperson. The CBN is working on establishing a special fund by the end of the year that would provide credit facilities to women at a single digit interest rate. The CBN is also working with banks to ensure that a certain percentage of senior management and board seats are reserved for women.

The Bank recently introduced a new policy "Cash less Policy" as part of ongoing reforms to address currency management challenges in Nigeria, as well as enhance the national payments system. As may be aware the Nigerian economy is heavily cash-oriented in the transaction of goods and services. This huge cash transaction increases the operational costs of the banking sector, which is passed on to the customers in the form of higher service charges and high lending rates. These operational costs are significant due to the high cost incurred in cash management, currency sorting, cash movements and frequent printing of currency notes.

The direct cost of cash management to the banking industry is estimated to be about N192 billion by 2012. Research has shown that about 90 per cent of withdrawals by bank customers' are typically below N150,000 whereas, only 10 per cent of bank customers who withdraw over N150,000 were responsible for the rise in cost of cash management being incurred by the generality of bank customers. There are also risks involved in keeping or moving large amounts of cash, namely the high incidence of robberies, encouraging corrupt practices and the public's propensity to abuse and mishandle currency notes.

The CBN, in collaboration with the Bankers' Committee, aims to achieve an environment where a higher and increasing proportion of transactions are carried out through cheques and electronic payments in line with global trends. The enforcement of the T+2 cheque clearing cycle is being stepped up and efforts are on-going to reduce the cycle to T+1. Anybody can now make payments of up to N10 million through the clearing system with a cheque.

The CBN recognizes the need to balance the objectives of meeting genuine currency transaction demand and combating speculative market behavior that may negatively affect economic growth and stabilization measures. The new cash withdrawal policy will ensure that a larger proportion of currency in circulation is captured within the banking system, thereby enhancing the efficacy of monetary policy operations and economic stabilization measures.

The policy does NOT in any way stop account holders from withdrawing any amount of money they desire from their accounts. The policy simply recognizes that banking is a business and, as with any business, there are costs that are sometimes shared between the business and the customers. The policy stipulates that to withdraw more than N150,000 (for individual account holders) and more than N1,000,000 (for corporate account holders), there will be a transaction cost.

The various measures notwithstanding, there was need for some intervened banks to merge in order to strengthen their capital base and to remain competitive in the market. Accordingly, five Transactions Implementation Agreements (TIAs) were signed among the banks, and the CBN issued a letter of no objection to the banks being acquired to proceed with the merger of the entities. The signing of legally binding TIAs for the five (5) banks and the full capitalization of the 3 new banks by AMCON had resolved the issue of the combined negative asset value of the eight CBN intervened banks. Similarly, the recapitalization of all the five banks that signed TIAs was completed in 2011.

Impact of the reform

The current banking reforms have yielded the following results among others:

i. The reforms have brought about a new mindset to the industry as banks are putting in place best practices in the areas of corporate governance and risk management. Transparency and public disclosure of transactions have remarkably improved.

ii. A number of banks have returned to the profit-making path and improved their balance sheets, as the recent results of their financial statements have shown.

iii. Banks are gradually resuming lending to the private sector with the additional liquidity of more than N1.7 trillion injected into the banking system through the issuance of AMCON bonds, and significant progress in re-directing credit to the power sector and SMEs at single digit interest rates. These initiatives have saved and helped create thousands of jobs in the economy.

iv. A new code of corporate governance has been issued by the Bank. The CEO of banks shall serve a maximum tenure of 10 years. Furthermore, all CEOs who would have served for 10 years by July 31, 2010 ceased to function in that capacity and have handed over to their successors.

v. Nigerian Banks are now key players in the global financial market with many of them falling within the Top 20 banks in Africa and among Top 1000 banks in the world.

vi. The reform has culminated in moderating the spread between the lending and deposit rates to 9.7 per cent as at end-December 2011, from 12.2 per cent in 2010. This has contributed to the existing macroeconomic stability in the economy with inflation moderating to 10.3 per cent as at end-December 2011.

vii. The hitherto volatility in the exchange rate witnessed in the foreign exchange market has been brought under control. The premium is within the international standard of 5.0 per cent.

Table1: Selected Banking and Macroeconomic Sector Indicators

Indicators	2005	2006	2007	2008	2009	2010	2011
Prime lending rate (end period) (%)	17.8	17.3	16.4	15.3	19.6	15.7	16.8
Deposit rate (12-Months Fixed) (%)	8.8	7.5	8.0	12.4	12.2	3.5	7.1
Inflation rate (%)	11.6	8.5	6.6	15.1	13.9	11.8	10.3
GDP growth rate (%)	6.5	6.0	6.5	6.0	7.0	7.9	7.7
Bank Branches (No)	3,535	4,579	4,579	5,134	5,565	5,799	5,810
Number of Banks	25	24	24	24	24	24	24
Average Exchange rate ($/₦)	132.2	128.6	125.8	118.5	148.9	150.3	153.7

Source: CBN Annual Report.

viii. There is greater cooperation between the monetary authority and the banks through regular meetings and collaboration on policy issues.

ix. The reforms have brought about greater confidence in the banking system with the removal of distress banks and the adoption of a strict code of corporate governance.

x. Increased widespread use of e-payment services among Nigerians.

Challenges to the banking reforms

The Nigerian banking reform, despite its laudable achievements is confronted with certain challenges. First and foremost is the wrong perception of the intent of the reform. The introduction of the new banking model, especially specialized banking (non-interest banking), is intended to broaden the scope of financial services offered by banks in Nigeria. However, this has been given a religious connotation. The wrong perception and stiff resistance to the policy could potentially deter prospective investors in the banking industry.

Second, the reluctance of Nigerians to accept positive changes in global dynamics is another challenge. There is incontrovertible evidence that the excessive liquidity in the system measured by broad money (M2), narrow money (M1) and currency in circulation is partly attributable to the high cash transactions for economic activities, which has continued to undermine the efforts to achieve price stability. Yet the cashless policy has faced significant resistance, despite its prospect for economic growth and development and the global trend in the intensity of usage of e-payments.

Third, the cost of doing business in Nigeria is still high when compared with developed economies or some emerging and developing countries owing to the poor state of infrastructure.

Another challenge is that the high growth rates recorded in the last five years have not been inclusive, implying that this has not transcended into sustainable development. This situation is responsible for the high unemployment and poverty levels, which inevitably affect the low banking habit in the country.

Another key challenge is the quality of manpower: real strategic change can only take place with competent and committed workforce that is constantly exposed to training and development. The competitive financial sector environment requires a highly skilled workforce that would effectively contribute to value creation within financial institutions. Hitherto, employee recruitment was merely to comply with regulatory requirements, while training was viewed as a non-revenue function that was costly and unnecessary.

Conclusion

The banking sector occupies a vital position in the economy and must be subject to continuous reforms for it to function efficiently. The modest achievements recorded so far have been largely due to greater collaboration and commitment of purpose among key stakeholders. Thus, the CBN in its efforts to develop a sound and vibrant banking system will strive to ensure that democratization of policy is sustained. It will also continue to ensure that the banks abide strictly with the code of corporate governance for efficient functioning of the banking industry.

Thank you for listening.