Sanusi Lamido Sanusi: Evolving financial landscape – strategies for economic resilience

Keynote address by Mr Sanusi Lamido Sanusi, Governor of the Central Bank of Nigeria, at the 4th Annual Banking and Finance Conference of the Chartered Institute of Bankers of Nigeria (CIBN), Abuja, 23 September 2010.

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Protocol

1. Let me begin by appreciating the opportunity and the honour given to me to be part of this important occasion, which is meant to chart a course for sustainable economic development of our dear country, Nigeria. The theme of this conference ***"Evolving Financial landscape: Strategies for economic Resilience"*** is indeed very apt and topical, and could not have come at a more opportune time than now, considering not only the needs of country, but the rapid changes that are taking place in the financial sector and the role it is expected to play in the evolving economic landscape. It is my expectation, therefore, that the issues that will be discussed during this conference will further assist in laying a solid foundation for the much needed economic transformation of the Nigerian economy. It is usual at this conference for the Governor, if delivering the keynote address, to update the industry on his stewardship in the past year, and the expected duration of policy.

2. As you are aware, since the commercial banking business commenced in 1892 in Nigeria, the financial system has experienced several episodes of banking crisis. The first of such crisis took place in the late 1940s and early 1950s, mainly as a result of lack of appropriate regulation, leading to the collapse of about 21 of the 25 indigenous banks which had been established by 1954. While these failures were resolved mainly through self-liquidation, the outcome was a bitter experience, especially for depositors who lost their money.

3. Systemic crises re-appeared in the Nigerian banking industry between 1989 and 1998, which many attributed to the withdrawal of public sector deposits from the banks, and as a consequence exposed the weak financial condition of most financial institutions whose financial fragility had been concealed by a combination of factors, including public subsidy and improper accounting systems. The deregulation of the banking system in the mid-1980s facilitated a dramatic increase in the number of financial institutions and also exposed the banks to intense competition for which many of them were ill-prepared for. Some of the banks attracted a significant market share through improved customer services at competitive prices. In contrast, many banks appeared to have been set up largely to take advantage of the arbitrage opportunities in the foreign exchange market, rather than undertake more conventional/traditional banking business. The consequence was a mass distress that laid the foundations for the bank consolidation exercise in 2004, which induced a breath of life to our banks, enhanced their capital position and increased their involvement in business activities.

4. The recent global financial crisis, however, strained the gains that had been achieved post-consolidation in the sector. The immediate impact of the global financial turbulence on the Nigerian financial system, particularly the banking system, mirrored global trends but was largely contained because of the limited integration with the global financial system. While offshore funding of the domestic banking system was growing before the crisis, its scale was manageable and the Central Bank was able to accommodate commercial banks foreign exchange needs in the depth of the global crisis. Coupled with major internal management problems in some of the banks, the crises impacted the economy through various channels – significant decline in oil revenue leading to revenue attrition for all tiers of government; reduced capital inflows into the economy; significant

drawdown of external/foreign reserves; demand pressure in the foreign exchange market; substantial decline in stock market capitalization and share prices; huge bank losses on margin loans and share-backed facilities as well as loans to the downstream oil and gas sector; low valuation with many banks trading below book value; declining asset values; and declining credit growth.

5. Distinguished ladies and gentlemen, it became clear that the CBN had to act decisively when it became evident that some of the banks had more deep-rooted problems that were not discernable from the regular reports rendered to the regulatory authorities. Some of these actions included replacing the chief executives/executive directors of the banks identified as the source of instability in the industry and injection of the sum of N620.0 billion into the banks in an effort to prevent a systemic banking crisis. The injection of this fund (Tier II capital) into these banks then was considered sufficient to resolve and stabilize them to enable them to continue normal business operations, with arrangements made to recover non-performing loans from the banks' debtors while guaranteeing all foreign credits and correspondent banking commitments.

6. As an additional measure to strengthen the reform process, the CBN commenced the process of creating an Asset Management Company, as an important vehicle for dealing with Non Performing Loans of the banks. As you are all aware, the Asset Management Corporation of Nigeria (AMCON) has already been established by law and its Board is awaiting Senate confirmation for it to formally take-off. As a resolution vehicle, AMCON is expected to soak in the toxic assets of the CBN-intervened banks and provide liquidity to them while facilitating their eventual re-capitalization.

7. While efforts are being made to stabilize the Banking system and, indeed, the financial system and restore public confidence, the CBN is also focusing attention on ensuring that the financial system, in general, and the banking system, in particular, begin to serve the needs of the Nigerian economy so as to make the Nigerian economy to be resilient. This, the Bank has been doing through ensuring the availability of long-term funds at an affordable interest rate to drive industrial activities and infrastructural developments in the country, having identified low industrial basis and huge infrastructural deficit as binding constraints on achieving Nigeria's economic development objectives. In a bid to address the problem of infrastructure deficit and enhance credit to the real sector, a total of N500.0 billion Fund was set up by the CBN made up of N300.0 billion for Power/Infrastructure projects and for intervention in the Aviation sector and N200.0 billion for the Refinancing/Restructuring of banks' existing loan portfolios to manufacturers and small and medium enterprises (SMEs). A N200.0 billion Credit Guarantee Scheme for SMEs and N200.0 billion Commercial Agricultural Fund for the agricultural sector were also established. In addition, the CBN had recently released N150.0 billion credit facility to the manufacturers at a fixed rate of 7% through the Bank of Industry (BOI) and deposit money banks. Pencom to unlock pension assets for private sector – AGRA-UNIDO – Fund plan chain.

8. In addition, the Bank has also collaborated with the Securities and Exchange Commission (SEC), the Nigerian Stock Exchange (NSE), FPLS and Ministry of Finance to reduce the cost of transactions, particularly bond issues so as to diversify funding sources away from banks as well as attract more long term foreign 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. These efforts are expected to 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. FSRCC revamped, joint CBN/SEC examinations.

9. Standby teams of target examiners are being deployed to any bank at any time to ensure timely regulatory actions, if it is deemed necessary. In addition, 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 could seek redress, and directive has been given to banks to establish Customer Help Desks at their head offices and branches. Also, a comprehensive review of the Guide to Bank Charges has commenced with a view to making the charges realistic and consumer-friendly. Furthermore, the Consumer and Financial Protection Division is expected to commence a programme of consumer education and enlightenment and is also collaborating with the Consumer Protection Council on the review of the Consumer Protection Council Act No. 66 of 1992 to enforce discipline in the market.

10. The CBN has taken steps to integrate the banking system into the global best practices in financial reporting and disclosure through the partial adoption of the International Financial Reporting Standards (IFRS) in the Nigerian Banking Sector by end 2010. 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, SEC, and NAICOM; PENCOM, Federal Inland Revenue Service (FIRS), and Institute of Chartered Accountant of Nigeria (ICAN), among others, towards ensuring a seamless full 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.

11. The universal banking (UB) model adopted in 2001, allowed banks to diversify into non-bank financial businesses. Following the consolidation programme in 2004, banks became awash with capital, which was deployed into various high-risk areas. The system was abused by operators with banks engaging in non-banking practices to the detriment of core banking practices. Banks took unnecessary speculation provisions and bets on asset prices. To address the observed challenges, the CBN has reviewed the UB Model with a view to steering the banks towards core banking businesses. Under the new model, banks would not be allowed to invest in non-bank subsidiaries, while banks currently with such investments would be required to either divest or spin-off the businesses to holding companies that will be licensed by the CBN as other financial institutions. Depositors' funds can no longer be used for insurance, stock broking and other non-banking activities. This will pave the way for the orderly development of the capital market.

12. Other measures that have been taken to drive the evolving financial landscape include: the strengthening of the institutional coordination through the Financial Services Regulation Coordinating Committee (FSRCC), adoption of a 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/Directors of Banks to 10 years and non-Executive Directors to 12 years; limiting the tenor of a bank's auditing firm to 10 years; sound and timely regulation and supervision of the financial sector; stringent demand for transparency in the financial sector; and improved transparency in structured credit instruments for easy assessment of associated risk.

13. Activities at the Central Bank of Nigeria are being guided by the Bank's blue print, christened "The Alpha Project (A4) Initiatives of the CBN", which is built on 4 pillars, of enhancing the quality of banks, establishing financial stability, enabling healthy financial sector evolution and ensuring that financial sector contributes to the real economy.

14. Furthermore, leveraging on the CBN Governor's role as Adviser to the President on Economic Matters to ensure that the financial sector contributes to the real economy, the CBN is taking the lead in measuring more accurately the relationship between the real economy and financial sector, as well as cooperating with state governments to run pilot programmes in directing the financial sector's contribution to social and economic development within the states. Priority is being given to Power, Agriculture, Transportation infrastructures. The Bank has continued to fine-tune its monetary policy instruments against

the backdrop of developments in the economy to ensure the effectiveness of monetary policy. As adviser to the government, the CBN has played a critical catalytic role in kickstarting the power programme and reopening the debate on deregulating the sector, we are now engaging actively in the funding of agricultural and industrial policy to ensure that banks' lending goes into the real economy.

15. The Microfinance Policy, Regulatory and Supervisory framework for Nigeria was launched in December 2005 with the main objective of making financial services accessible to the active poor, promoting synergy and mainstreaming of the informal sector in the national financial system and contributing to rural transformation. Since the launch, quite a number of microfinance institutions have been licensed while the policy is being reviewed to address key challenges such as capital base, skill gaps, operational manual, geographical spread and self regulation in the sub-sector. An audit exercise of all microfinance banks has just been launched and the CBN is determined to clean up the sector and "sanitize" it as thoroughly as it is sanitizing Deposit Money Banks.

16. Ladies and gentlemen, in order to remain relevant as financial intermediaries, financial institutions in the country would need to be sensitive to customer needs for greater efficiency and convenience. Customers' expectations have taken a quantum leap in the new global financial landscape. Financial services no longer involve providing only standard products to customers. The need for financial products to be personalized and customized to the individual needs of corporate and retail clients is the order of the day. Financial institutions would, therefore, need to be more proactive and innovative in packaging and marketing their products. Furthermore, in the new financial environment, the need to ensure adequate and effective consumer education and protection has also become even more compelling and challenging so as to prevent any disruption in the level or reliability of services to customers and their protection from potential unfair practices. Given the criticality of … efficiency to cost of funds, the Central Bank has recently started a shared services project in collaboration with banks aimed at centralizing back offices and the industrialization of common processes. In the next three years, we will reduce overhead costs in the banking industry by 30%. We are also working towards establishing an IPP for independent power supply for all banks operating in Lagos as a pilot cluster.

17. The intense competition among financial institutions call for the management of the country's banks to re-examine their existing business models to see where their strengths lie and to what opportunities these strengths could be applied to enhance returns. There may be the need to move towards strategic differentiation among the financial institutions in order to better serve the relevant market segment or niches. This may involve market or functional specialization as institutions decide which functional areas or combinations of risk management, customer services, product innovations, to exploit and maximize to their advantage thereby buttressing the new blueprint of the CBN (specialized banking) for the banking sector. The different levels of authorization introduced also allow banks to be international, national or regional players.

18. One big lesson learned from the recent crisis is the need to review the existing rules and laws relevant to the financial industry in Nigeria in line with the new financial environment and international best practice. In the wake of growth in the volume and complexity of financial transactions involving both local and foreign investors in the post-reform era, the challenge is to ensure the cooperation of both the legislature and the judiciary to work closely in the enforcement of the existing laws relating to the financial system in order to engender confidence in the system. There is a compelling need to reform the laws that pertain to the mortgage sector particularly the Land Use Act. This requires the strengthening of the primary mortgage institutions and the review of the relevant laws such as the Land Use Act. With respect to loan recovery within the framework of the financial services industry, there is need to establish special courts that will handle cases of loan defaults, credit fraud and insider abuse-related cases promptly. The CBN is scaling through

on a number of legislative reforms aimed at unlocking the bottlenecks to the smooth flow of credit to the real sector and especially to Small and Medium Enterprises.

19. A major challenge in the liquidation of the failed financial institutions in the country is the prompt disposal of their assets for the settlement of the depositors. This calls for expedited action on the operationalization of the Assets Management Corporation (AMCON) as well as the revision of the necessary laws that will make it possible for both the CBN and NDIC to liquidate failed institution(s) without prolonged litigation by the institution(s).

20. Maintaining a safe and sound banking sector is essential, given the key role that banks play in facilitating economic growth and financing developmental projects, particularly key infrastructure, agriculture and industry. Most emerging market economies have been known to use the domestic financial institutions to execute real sector big ticket projects and financial institutions in Nigeria should not be an exception if we hope to achieve our developmental objectives.

21. Distinguished ladies and gentlemen, let me conclude by noting that the evolving financial landscape, with benefit of hindsight, is capable of providing the platform for sustainable economic growth and development and economic resilience if all stakeholders in the Nigerian economic commit to all the various reforms and initiatives being implemented as well as commit to good governance and transparency in their respective areas of operation. I have no doubt in my mind that Nigeria is destined to be an economic power and a force to be reckoned with in the global economic arena if we consistently do the right things at the right time. But we have to end the past practice of seeking quick fixes and easy solution. A resilient economy requires hard work, intelligence, consistency and time. We will go through difficulties in the short term. Tough decisions have been taken and we will continue to take them. Market condition must improve. We have made the point, and will continue to make the point that there are lines in this country that cannot be crossed. And that no one can be so rich or so powerful as to get away with putting an entire system at risk to feed personal greed.

22. As a final thought, there is no uniform effect, neither is there a single remedy to every crisis. Each brings its own surprises and risks. Clearly, we should not assume that past remedies will fully solve the current and next set of problems or address all future crises. The key is to take lessons from the past and tailor them appropriately to address future situations of potential crisis.

Thank you for listening.