Overview of Financial Sector Developments in Nigeria

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I. Introduction

The financial services industry world-wide was heavily regulated in the early 80s with the control of interest and exchange rates as well as credits, leading to the misallocation of resources. This distorted the workings of the fundamental price mechanisms, as volatile and negative real interest rates retarded credit culture and appropriate risk management. This system of excessive regulations also restricted banks' operational flexibility, ability to compete amongst themselves as well as the financing of the private sector. These increased the potential for instability and complications in the implementation of monetary policy. However, in the last decade, the financial services industry around the world witnessed remarkable changes, driven largely by deregulation and liberalization, increasing wave of globalization and advances in information and communications technology, resulting in rapid financial sector development. This development has played an important role in stimulating financial innovations; integration of financial markets; greater competition among the financial institutions; and improvement in banking business with the use of computers, telecommunications and satellite technologies, opening new avenues for greater financial intermediation. These structural changes in the financial markets, have equally exposed them to various risks and posed several challenges for the supervisory authorities and policymakers in the design and implementation of monetary policy.

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Historically, the Nigerian financial sector had evolved in four stages. The first stage was the pre-existence of the Central Bank of Nigeria (1930-59), during which several poorly capitalized and unsupervised indigenous banks failed in their infancy. The second stage was the control regime (1960-1985), during which the Central Bank of Nigeria ensured that only "fit and proper" persons were granted banking license, subject to the prescribed minimum paid-up capital and in line with the provisions of the Banking Act. The third stage was the post-Structural Adjustment Programme (SAP) or de-control regime (1986-2004), during which the neo-liberal philosophy of "free entry" was over-stretched and banking licences were dispensed by the political authorities on the basis of patronage. The fourth stage is the era of consolidation (2004 to 2005), with major emphasis on ensuring a stable, safe and sound financial system through recapitalization and proactive regulation hinged on risk-based or risk-focused supervision framework.

The objective of this paper is to review the various developments (reforms) in the Nigerian financial sector since 1986, including the recent banking industry consolidation.

The paper has five main sections. Following this introduction we briefly overview the reforms in the Nigerian financial services sector in two parts namely, early reforms (1986 1998) and the recent reforms (1999 to date). Section 3 discusses the outcome of the various reforms, while section 4 highlights the main issues and challenges facing the post-financial sector reform. Section five concludes the paper.

II.0 Reforms in the Nigerian Financial Sector

II.1 Early Reform Measures: 1986-1998

II.1.1 Reforms in the Banking Sector

Prior to the reforms of 1986, the financial sector in Nigeria was highly repressed. Interest rate administration, selective credit controls, ceilings on credit expansion and use of reserve requirements and other direct monetary control instruments were typical features of the financial sector. Semi-public or government agencies owned majority of the financial institutions that dominated the sector. These included some government-owned banks, post office savings bank and some insurance companies.

The neo-liberal era witnessed the dismantling of the prolonged regime of economic and financial controls to make way for increased reliance on market forces in 1986, in line with the general philosophy of economic management under the Structural Adjustment Programme (SAP). The major reform measures implemented included, deregulation of interest and exchange rates, removal of sectoral credit allocation and free entry into banking business subject to satisfaction of conditions for obtaining a banking license. Other measures implemented were the establishment of the Nigeria Deposit Insurance Corporation (NDIC) in 1988, strengthening of the regulatory and supervisory institutions, upward review of capital adequacy standards, capital market deregulation and introduction of indirect monetary policy instruments. In addition, in 1991, the Federal Government promulgated the Central Bank of Nigeria Act (No.24) and the Bank and Other Financial Institutions Act (No.25) which spelt out comprehensive guidelines for bank regulation, supervision and liquidation. Specifically, the Act conferred greater powers on the CBN in the area of banking supervision and examination, monetary management and enforcement of prudential standards in banking. The Act also stipulated the maximum financial accommodation in the form of Ways and Means Advances that the Federal Government might obtain from the Bank.

By 1993, discount houses were established to serve as financial intermediaries between the CBN and the licensed banks. They were permitted to mobilise funds for investment in securities by providing discounting/rediscounting facilities in government short-term securities. The discount houses in Nigeria were expected to facilitate and make market in the government securities segment, thereby, promoting the efficiency and effectiveness of the money market. The number of discount houses in existence has remained unchanged at five over the years.

To achieve increase in savings during the reform period, Community banks and the People's bank were established. The two set of institutions were established to enable rural dwellers and the poor to save and have access to credit facilities at rates lower than the market rates. The structural changes were aimed at enthroning a market-oriented financial system for effective mobilization of savings and efficient resource allocation in the economy.

The liberalization of the financial services sector resulted in the establishment of many new banks. The number of operating banks almost doubled within three years of the reform (from 45 in 1987 to 76 in 1989) and tripled in the fifth year (119 in 1991). It required official re-imposition of embargo on bank licensing in 1991 to halt this growth. Access to credit and foreign exchange were identified among the major motives for bank ownership. The competition that resulted from the entry of new banks and the liberalization of interest rates brought about sharp rise in nominal deposit and lending rates. The average deposit and lending rates doubled in the third year of the reform (1989).

The financial environment that emerged from the reform was unstable, inefficient, riskier, illiquid and generated lower return on assets relative to the prereform period . The incidence of fraud and non-performing loans also increased as revealed by a CBN/NDIC study of Distress in the financial system. The quality of management, which is a major determinant of banks' long-term survival and the dearth of qualified personnel to meet the challenges of sudden growth in the industry contributed to the poor health of the banking industry (Ikhide and Alawode 1994). Thus, the incidence of distress in the industry was pervasive during the period.

II.2 Developments in the Nigerian Financial Sector since 1999

Following further efforts at the liberalization of the financial sector, the universal banking scheme was introduced in 2001 by the CBN to, create a level-playing field for banks, encourage greater efficiency through economies of scale and foster competition by opening up various areas of entry to banks. To enhance credit delivery to the small and medium-scale enterprises and facilitate the rapid achievement of higher economic growth in the country, the Small and Medium Enterprises Equity Investment Scheme was established in 2001. In 2002, the CBN rediscounting and refinancing facility was introduced to encourage banks to lend long, particularly to the productive sectors of the economy. The scheme was designed to provide liquidity support to banks so as to encourage them to lend for agricultural and industrial activities. Also, the enactment of BOFI Act No. 41 of 1999 subsequently streamlined the relationship between the Bank and other economic agencies of the Federal Government, as well as confer some degree of instrument autonomy on the Bank.

Mindful of the need to further grow the economy, various economic and structural reforms were introduced from 2003 under a comprehensive economic reform blueprint the National Economic Empowerment & Development Strategy (NEEDS). The reforms in the financial system are highlighted below.

II.2.1 Reforms in the CBN

In order to reposition the Bank to play its role in the anticipated modern financial sector, the Bank embarked on the re-engineering of its processes and staff, code-named "Project EAGLES", (acronym for Efficiency, Accountability, Goal-orientation, Leadership, Effectiveness and Staff Motivation) in 1999. Thus, the CBN in 2004, reduced the number of its departments from 23 to 17 and later to 16 in 2005; redeployed staff on the basis of the roles they were expected to perform; devoted additional resources in skills development; and further strengthened the Economic Policy Directorate with the establishment of the Monetary Policy Department with a focus on monetary policy. Furthermore, in order to enhance the achievement of its mandates, the Bank embarked on other reforms in the areas of monetary policy; currency restructuring and payments system; foreign exchange market; agricultural and micro-enterprises financing; as well as banking supervision.

II.2.1.1 Monetary Policy Implementation

The CBN introduced a new monetary policy implementation framework with an interest rate corridor in December, 2006 to stabilize the interbank rates and encourage transactions among banks as well as strengthen the Bank's position as a true lender of last resort. The hitherto nominal anchor rate, the Minimum Rediscount Rate (MRR) was replaced with a transactions rate - the Monetary Policy Rate (MPR).

II.2.1.2 Foreign Exchange Market

Since the introduction of the SAP the CBN has evolved a market-based foreign exchange market with a variant of mechanisms for determining the exchange rate. The variants include: Inter-bank Foreign Exchange Market (IFEM), Autonomous Foreign Exchange Market (AFEM), and the auctioning system namely retail and wholesale Dutch Auction Systems. The management of the exchange rate was strengthened in 2002 with the introduction of the Retail Dutch Auction System (RDAS). To anchor expectations, the Bank introduced a 3.0 per cent band for the exchange rate. These resulted in the stability of the naira exchange rate at the DAS. Furthermore, the CBN took steps in early 2006 to further liberalize the foreign exchange market by shifting to a Wholesale DAS (WDAS) from the Retail DAS. In line with the liberalization, the CBN supplies foreign exchange directly to bureaux-de-change (BDCs); authorized banks can import foreign exchange; and BDCs can effect foreign exchange transfers through their domiciliary accounts.

Moreover, the needs of the traveling public have been addressed through an increase in both the threshold and frequency of Personal/Basic Traveling Allowances, while other needs for the payment of school fees, medical fees and mortgages have been included in this category of eligible foreign exchange transactions. In order to encourage non-oil exports and enhance the supply of foreign exchange into the country, non-oil exporters have unfettered access to their export proceeds as long as they are repatriated. Furthermore, the non-oil exports domiciliary account has been liberalized to the extent that in case of transfer of the proceeds to third parties or withdrawal for own use, the instruction of the account holder is sufficient, irrespective of the payment mode. In the continuing effort to deepen the interbank market, oil and oil services companies were allowed to sell foreign exchange earned to banks at the prevailing exchange rate.

To discourage the patronage of the informal market, huge documentation requirements in respect of some transactions have been reduced, while the issue of demurrage which hitherto was not eligible for foreign exchange has now been made eligible with minimum documentation. Also, capital controls have been partially liberalized without compromising the Know Your Customer (KYC) and

Anti-Money Laundering (AML) principles.

II.2.1.3 External Reserve Management

In order to enhance the efficiency and effectiveness of reserve management, the CBN introduced the participation of domestic banks in external reserves management. Furthermore, the CBN appointed a Global Custodian and fourteen (14) External Asset Managers to manage part of the country's external reserves. The asset managers were to enter into partnership agreement with Nigerian banks with the aim of transforming them into global operators. To build capacity for the management of external reserves, the World Bank provided a three-year programme of assistance to the CBN. The programme, known as Reserve Assets Management Programme (RAMP), involves training and capacity building to enable Nigeria maximizes the yield on its external reserves. The ultimate goal is to establish a trading floor for investment in foreign securities at the CBN.

II.2.1.4 Issue of Legal Tender Currency and Improved Payments System

(i) Issuance of Legal Tender Currency: In the continued efforts to restructure the naira, the Bank introduced the ₦100, ₦200, ₦500 and the ₦1000 note denominations in 1999, 2000, 2001 and 2005, respectively, bringing the number of banknote denominations in circulation to eight (8). Furthermore, in order to achieve greater efficiency in currency management, the Bank recently restructured the Nigerian currency involving the redesign of the lower denomination currency notes namely ₦5, ₦10, ₦20, ₦50 as well as 50 kobo, ₦1 coins and issuance of ₦2 coin.

The CBN acquired 77.0 per cent shareholding in the Nigeria Security Printing and Minting (NSPM) Plc. in February 2005, following the approval by the Federal Government in 2004. This was with a view to transforming the NSPM to a more efficient organization, capable of meeting the nation's printing needs on bank notes and security documents in the medium term and abolishing currency import by December 2006.

(ii) Payments System:

The efforts to deal with the challenges of the payments system led to the establishment of the Nigerian Automated Clearing System (NACS) in 2002. While the NACS is a private sector-driven project, the role of the CBN remains the provision of the rules and regulations for efficient functioning of the payments arrangement. As part of the efforts to improve the payments infrastructure, the CBN implemented three major Information Technology (IT) initiatives, the Central Bank Inter-bank Funds Transfer System (CIFTS) which is a Real Time Gross Settlement (RTGS) System for large value payments, Temenos 24 (T24) banking application; and the CBN/NDIC IT initiative, e-FASS for electronic on-line data rendition, all of which have become operational.

The CBN also adopted a new clearing and settlement arrangement with the appointment of Settlement Banks, which came into effect on April 1, 2004, in order to eliminate the settlement lag for high-value and time-sensitive payments and minimize settlement risks. Furthermore, to boost the electronic transactions and payments, a central switch was established at the Nigeria Inter-bank Settlement System (NIBSS) in 2006. Stand-alone switches are expected to be connected to the central switch to ensure interconnectivity and interoperability of switches in the country. This has the advantage of efficient use of resources as only a single card would be needed to access the services of the switches.

The CBN also took the initiative to deal with the problem of relatively high level of Magnetic Ink Character Recognition (MICR) reject in cheque clearing which had persisted over the years. To this end, the CBN approved the Nigerian Cheque Printers Accreditation Scheme (NICPAS) in 2005.

II.2.1.5 Bank Supervision

The CBN has reformed and strengthened its supervisory function by adopting the risk based supervision framework and has issued guidelines for its implementation. Furthermore, the Bank has developed the framework for consolidated supervision to strengthen the financial sector.

II.2.2 Reforms in the Banking Sector (The 13-Point Agenda)

The key elements of the reforms included:

- Adoption of the universal banking system in January 2001
- Re-capitalisation for banks to a minimum of N25 billion through mergers and acquisition or Initial Public Offerings (IPOs);
- Issuance of a new code of corporate governance for the financial sector to guide the conduct of management and staff of banks in order to ensure transparency and accountability in the sector;
- Minimal reliance on public sector funds by banks;
- Adoption of a risk focused, and rule-based regulatory framework ;
- Adoption of zero tolerance in the regulatory framework; especially in the area of data/information rendition/reporting and infractions;
- Expeditious automation process for rendition of returns by banks and other financial institutions through the Electronic Financial Analysis and Surveillance System (e-FASS);
- Strict enforcement of the contingency planning framework for systematic banking distress;
- Work towards the establishment of an Assets Management Company as an important element of distress resolution; and
- Promotion of the enforcement of dormant laws, revision and updating of relevant laws for effective corporate governance.

II.2.3 Reforms in the Other Financial Institutions:

Apart from the banking industry, some reforms took place in other sub-sectors of the financial sector namely the insurance, capital market and mortgage sub-sectors, in order to further deepen the financial markets.

II.2.3.1 Insurance Sub-sector

Following the successful recapitalization of banks, the Federal Government, through the National Insurance Commission (NAICOM), announced the recapitalization of the insurance companies operating in the country in September 2005. The insurance companies were allowed 18 months (September 2005 - February 2007) to achieve the graduated levels of capitalization.

At the expiration of the deadline of end-February 2007, seventy-one (71) insurance companies, comprising 45 non-life companies, 24 life companies and 2 re-insurance firms emerged out of the 168 companies that existed before the commencement of the exercise. At the end of the recapitalization exercise, the industry capital grew to over N200 billion as against the N30.0 billion recorded before the commencement of the exercise.

II.2.3.2 Capital Market

To help achieve the objective of attracting fresh investment capital into the economy, the Securities and Exchange Commission (SEC) recently embarked on strengthening the capital market infrastructure as well as increasing the required capital base of the operators. Locally, the banking sector consolidation increased the awareness of the capital market. The Nigerian Stock Exchange (NSE) made remarkable progress in the internationalization of the market in 1999 with the cross-border listing of "M-net"/Supersports" on the Exchange. The company was also concurrently listed on the Johannesburg Stock Exchange (JSE). Furthermore, the Exchange signed Memoranda of Understanding (MOU) with the Ghana Stock Exchange and the Nairobi Stock Exchange to facilitate cross-border listing of securities. Consequently, a Nigerian company - Oando Plc was granted secondary listing on the JSE Securities and Exchange of South Africa in 2005.

The Government resolved the status of the Abuja Securities and Commodity Exchange, which commenced operations in August 2006. It is expected that with this, the potentials in the agricultural and minerals sectors would be fully realized.

II.2.3.3 Pension Reform

Prior to the National Pension Reform Act of 2004, pension was only mandatory in the public sector but optional in the private sector. The government relied on taxes paid by the active working population to fund the pensions of retired workers. With an ageing workforce, the system proved to be unsustainable, resulting in public sector pension funding deficit of over ₦2.0 trillion by 2006. The new structure provides for uniform, contributory, private sector-managed and fully funded pension scheme. The newly created National Pension Commission has been charged with the responsibility of regulating the sector. Several Pension Fund Administrators and three Pension Fund Custodians were licensed accordingly.

II.2.3.4 Community Banks/Microfinance Banks

The community banks were established in the 1990s to promote rural development and enhance economic growth and development at the grassroots level. Their activities were also to complement those of rural bank branches. However, these roles were not being effectively fulfilled by the community banks. In order to address this problem, the CBN designed and launched the Microfinance Policy Regulatory and Supervisory Framework on December 15, 2005. The main objective of the policy is to make financial services accessible to a large segment of the potentially productive Nigerian population, who otherwise would have had little or no access to financial services and empower them to contribute to rural transformation. Consequently, all existing community banks were required to convert to microfinance banks with a deadline of end-December 2007. Two categories of microfinance banks were spelt out in the policy, namely unit microfinance banks with a capital base of ₦20.0 million and state ones with a capital base of ₦1.0 billion. At the end of December 2007, a total of 600 community banks had met the requirement for conversion to microfinance banks. As at October 15, 2008, the number of microfinance banks in the country had risen to 815.

II.2.3.5 Primary Mortgage Institutions (PMIs).

Prior to the enactment of the Primary Mortgage Act of 1989 which ushered in the primary mortgage institutions, the Federal Mortgage Bank of Nigeria was the major mortgage institution in the country. Thus, the emergence of PMIs engendered competition in the mortgage industry which could, however, not be sustained because of the distress in the banking system in the 1990s., as many of the PMIs were affected. Under the CBN Act 1997, as amended, the licensing and regulation of the PMIs was transferred to the CBN. In an effort to reposition the mortgage institutions, the CBN withdrew the operating licenses of 97 PMIs in 2003.

II.2.3.6 Re-organisation of the Development Finance Institutions (DFIs)

In 2001, there was a major restructuring of the DFIs owing to problems ranging from poor asset quality to management as well as the erosion of their capital base. The exercise led to the merger of the Nigerian Agricultural and Cooperative Bank (NACB), Peoples Bank of Nigeria (PBN) and the Family Economic Advancement programme (FEAP) to form the Nigerian Agricultural Cooperative and Rural Development Bank (NACRDB). Also the Nigeria Industrial

Development Bank (NIDB), Nigerian Bank for Commerce and Industry (NBCI) and the National Economic Reconstruction Fund (NERFUND) were merged to form the Bank of Industry (BOI). The bank took-off in 2002 with an initial capital of ₦50.00 billion, 40 per cent of which was contributed by the CBN. The primary function of the bank is to provide financial assistance for the establishment of large, medium and small-scale industries as well as the expansion, diversification, and modernisation of existing enterprises and the rehabilitation of ailing industries. The restructuring was intended to achieve a sharper focus for the new institutions and to address the issue of development financing from a holistic perspective.

II.2.3.7 Financial System Strategy 2020 (FSS2020)

In line with Nigeria's goal to become one of the top 20 economies in the world by 2020, the CBN initiated a strategy that will transform Nigeria into an international financial centre and provide the safest and the fastest growing financial system amongst emerging economies. The strategy, known as the Financial System Strategy (FSS 2020) is the blue-print for achieving the goals of developing and transforming Nigeria's financial sector into a growth catalyst.

Following the international conference held in Abuja in May 2007 to sensitize the public and foster wider ownership of the vision and strategy, the various committees on ten (10) sub-sectors of the financial sector have completed and submitted their reports to the Presidency for approval before implementation.

II.2.3.8 Africa Finance Corporation (AFC)

A major institutional initiative was also taken by the CBN in 2006 to meet Africa's quest for private sector-led investment growth through the promotion of the Africa Finance Corporation (AFC). The AFC has been packaged to bridge the resource gap in the financing of infrastructure in Africa which has been noted to have the weakest physical infrastructural facilities such as electricity, roads and telecommunications. As an investment bank, its intermediation process would help to mobilize and disburse funds towards driving the continent's economic development. Thus, the institution would contribute positively to the reversal of the dependence on foreign financing by empowering key African institutions to build large private sector businesses into global players in key sectors.

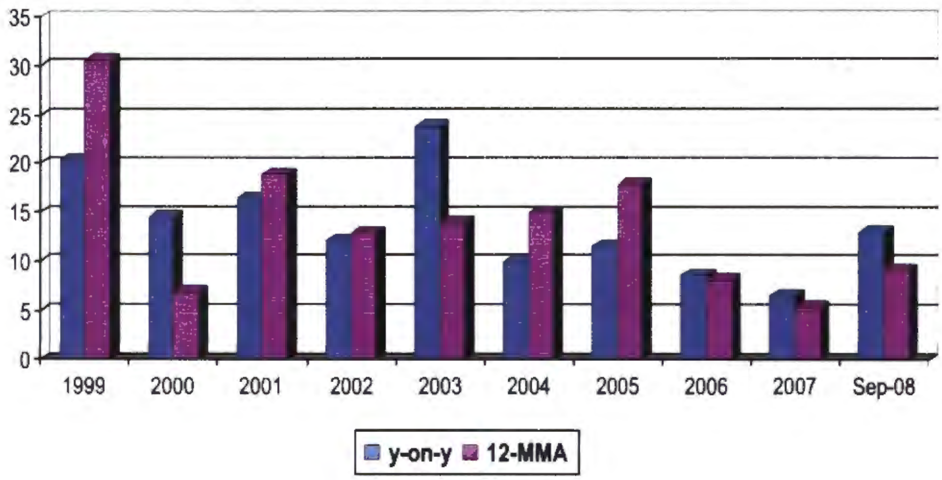
III.0 Outcome of the Reforms

The various reforms that have taken place in the financial sector between 1999 and 2008 have greatly improved the macroeconomic environment as highlighted below:-

III.1 Inflation

The general price level as measured by the composite price index (CPI) moderated from 10.0 per cent in 2004 to 6.6 per cent (year- on -year basis) in December 2007, then rose sharply to 13.0 per cent in September 2008. The twelve-month moving average moved in the same direction, falling from 15.0 per cent in 2004 to 5.4 per cent in 2007 and later inched up to 9.2 per cent in September 2008 (Chart 1). These positive price developments were attributed, among others, to the sustained fall in price of food, stability in the exchange rate and the effective conduct of monetary policy. A single digit rate of inflation is targeted between 2007 2011 due to the expected expansion in real sector productivity, fiscal discipline and stable exchange rate.

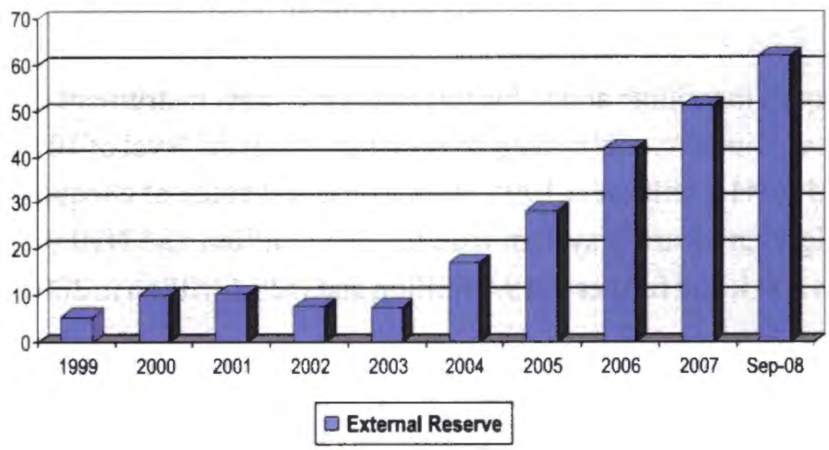
Chart 1: Inflation rate 1999 - September 2008



III.2 Exchange Rate and External Reserves

The reforms have delivered a strong and robust external sector. The external reserve increased substantially from US$5.5 billion in 1999 to US$ 51.33 billion at end-2007 and later to US$62.10 billion at end-September 2008. Thus, the domestic currency has strengthened as the exchange rate has appreciated and remained stable. More importantly, exchange rate convergence has been achieved between DAS/WDAS and inter-bank rates since December 2005, while convergence of rates has been achieved in all segments of the market since July 2006 a feat achieved for the first time in Nigeria.

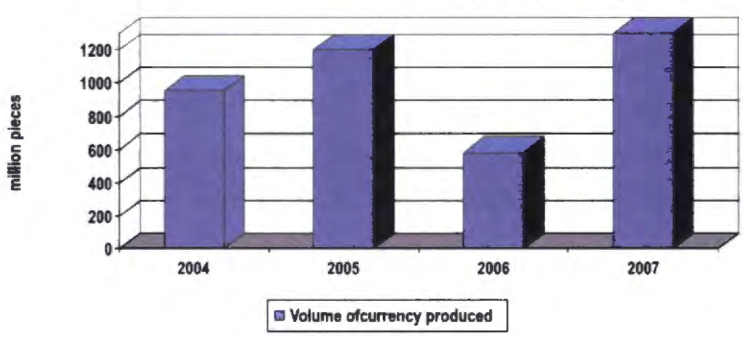
Chart 2: External Reserves in US$ 1999 - September 2008



III.3 Payments and Clearing System

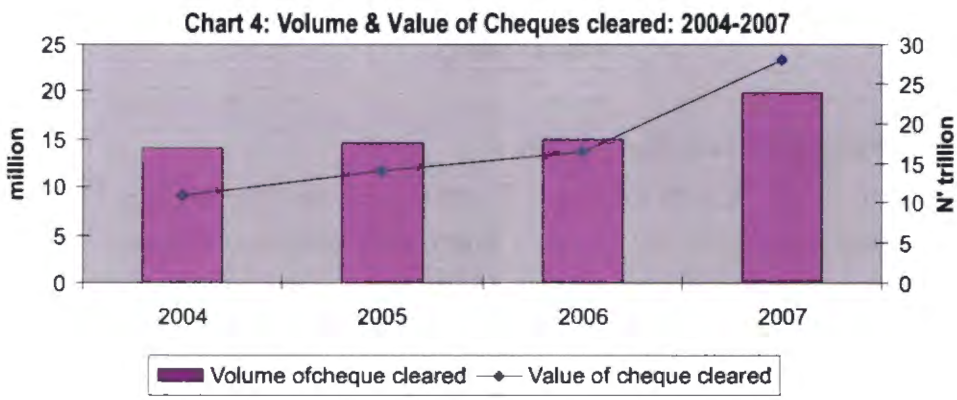
The reforms in the payments system have produced salutary results. The NSMP Plc has become more efficient as the volume of local production of banknotes produced by the company increased to 1.7 billion pieces in 2007 from 958 million pieces in 2004.

Chart 3: Volume of Currency Produced by NSPMC 2004 - 2007



The clearing system has witnessed significant improvements and these included: the efficient and cost effective clearing process based on electronic data presentation; reduction of the clearing cycle to 3 days (T+2) for both inter and local instruments from 15 days and 5 days, respectively and discipline in the clearing process as standards are now enforced, among others.

The use of cheques in volume and value terms as a payment instrument in Nigeria has increased over time. Available data showed that, from the level of 10.6 million cheques valued at ₦1.2 trillion in 1995, the volume and value of cheques cleared through the Nigerian clearing system rose to 13.99 million and ₦10.99 trillion, respectively, in 2004, and further to 19.9 million and ₦28.1 trillion in 2007.



Following the encouragement for shared Automated Teller Machine (ATM) among the banks by the CBN, some banks have formed consortia and implemented the initiative. Since then, public awareness on the use of ATM cards has continued to increase. Available data showed that the volume and value of ATM transactions increased to 1.0 million and ₦4.3 billion, respectively in 2004, from 240,192 and ₦1.2 billion in 2003. The trend continued in 2006 and 2007 with the volume and value of transactions at 12.1 million and ₦63.2 billion, and 15.7 million and ₦131.6 billion, respectively.

III.4 Banking Sector Consolidation

Following the banking sector consolidation, notable achievements have been recorded in the financial sector among which are:-

- Emergence of 25 well-capitalized banks, which was further consolidated to 24;
- The banks raised N406.4 billion from the capital market. In addition, the process attracted a foreign capital inflow of US$652 million and £162,000 pound sterling;
- The liquidity engendered by the inflow of funds into the banks induced interest rate to fall significantly, while an unprecedented 30.8 per cent increase was recorded in lending to the real sector in 2005;
- With higher single obligor limit, our banks now have a greater potential to finance large value transactions;
- More banks now have access to credit from foreign banks;
- The capital market deepened and consciousness about it increased significantly among the population. The market has become active and total capitalization markedly increased;
- Ownership structure has been positively affected such that the problems of insider abuse and corporate governance have been reduced;
- Depositor confidence has improved due to "safety in bigness" perception by depositors;
- With virtually all banks now publicly quoted, there is wider regulatory oversight;
- With the inclusion of Security and Exchange Commission and Nigerian Stock Exchange in the regulatory team, resources would be committed to the regulation of few and more stable banks in an efficient and effective manner;
- The banks have begun to enjoy economies of scale and consequently, pass on the benefit in form of reduced cost of banking transactions; and
- The consolidation exercise has been achieved at the least cost of 1.0 per cent of GDP, one of the lowest in the world.

III.5 General Banking and Financial Environment

Since the introduction of the reforms in 2004, lending rates have continued to decline but remained positive in real terms. The weighted average maximum lending rate has fallen from 33.1 per cent in 1999 to 18.7 per cent in 2006. The rate fell to 18.21 and 18.10 per cent in 2007 and September 2008, respectively. In addition, the spread between the average savings deposit rate and the maximum lending rates has narrowed from 22.0 in 2002 to 15.24 in September 2008. The number of banks branches has equally increased over the years from 2,185 in 1999 to 4,579 in 2007.

Chart 5: Maximum Lending Rate 1999 - Sept.2008

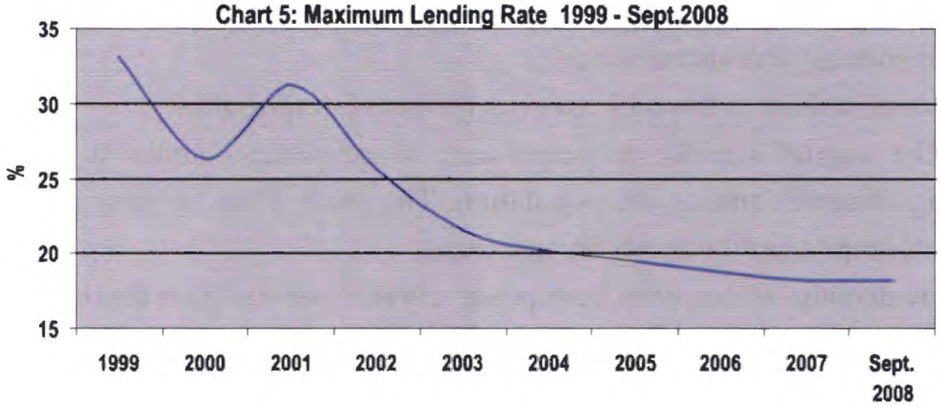
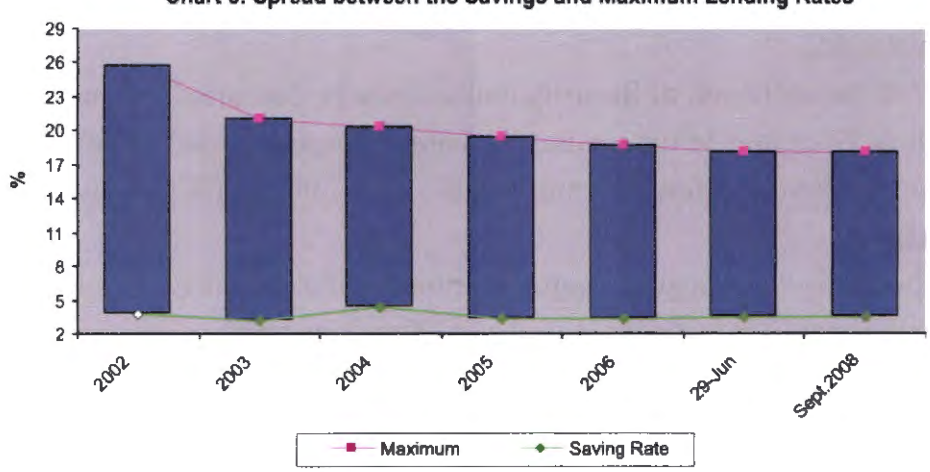
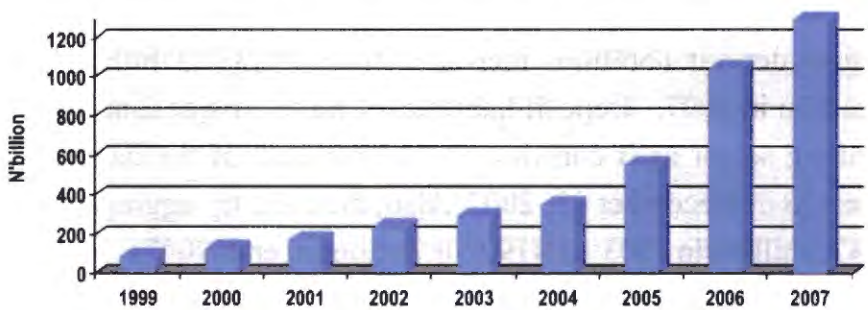


Chart 6: Spread between the Savings and Maximum Lending Rates



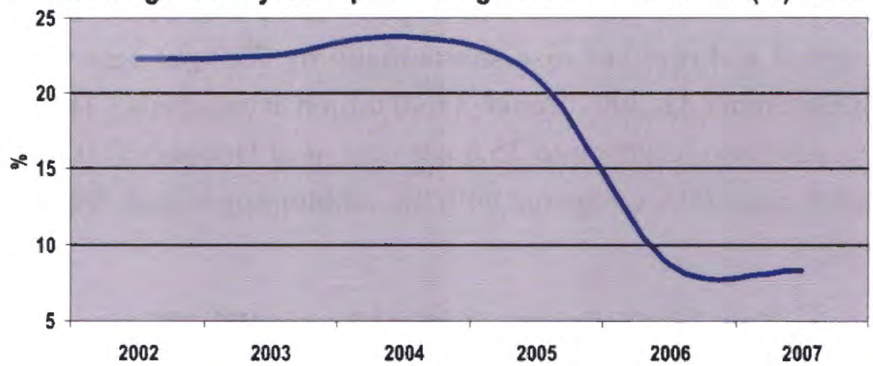
The health of banks has improved in Nigeria since end-2005. The banking industry's capital and reserves rose substantially by 72.7 per cent to N1,646.1 billion as at December 31, 2007 from N556.0 billion at end-2005. The industry's capital adequacy ratio has risen to 25.8 per cent as at December 31, 2006 from 17.8 per cent at end-2005, compared with the statutory minimum requirement of 10.0 per cent.

Chart 7: Banking Industry: Capital and Reserves 1999 - 2007



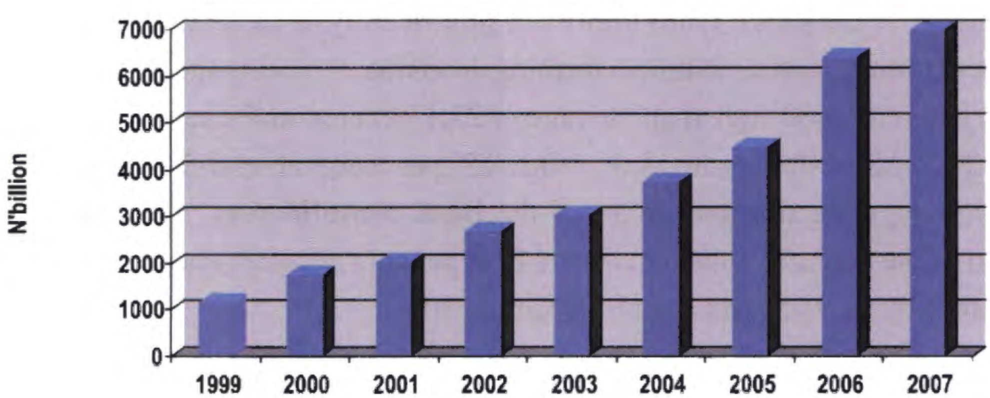
The quality of the banks' loans improved significantly as indicated by the drop in non-performing loans. Non-performing loans as a percentage of total loans, which had remained high at an average of 22.1 per cent in the seven year period, 1999-2005, fell sharply to 8.8 and 8.3 per cent at end-2006 and 2007, respectively, reflecting the effect of the bank consolidation. Aggregate loans (gross) of the banking industry rose by 25.8 per cent between end-2005 and end-2006, then by 93.9 per cent at end-December 2007.

Chart 8: Banking Industry: Non-performing Loans/ Total Loans (%) 2002 - 2007



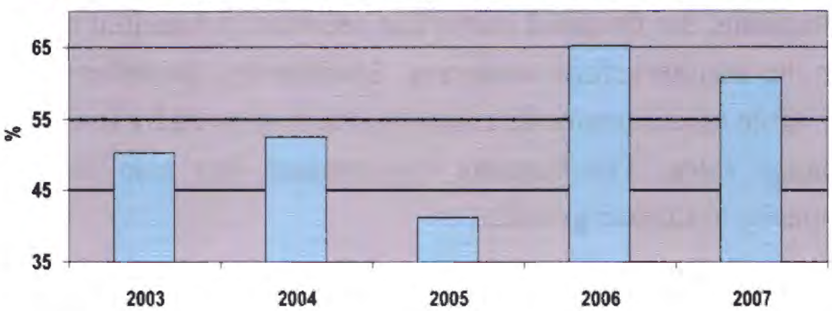
The aggregate deposit liabilities increased from ₦1,337.3 billion in 2003 to ₦4,781.5 billion in 2007. Deposit liabilities were the major sources of funding for the banking sector as it constituted 47.3 per cent of the banking system's balance sheet as at December 31, 2007. Also, the industry aggregate assets rose from ₦3,047.9 billion in 2003 to ₦19,670.7 billion at end- 2007.

Chart 9: Banking Industry: Aggregate Assets 1999 - 2007



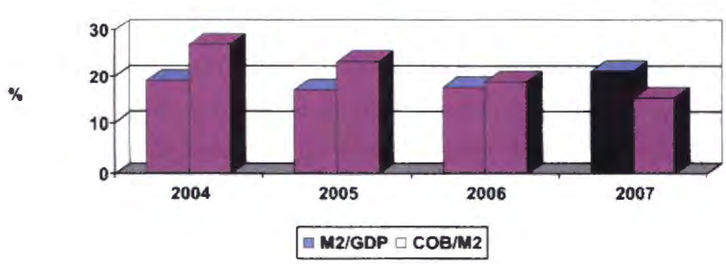
The average liquidity ratio of the industry was 60.8 per cent at end-December 2007, compared with 41.3 per cent recorded at end-December 2005, indicating an improvement in the liquidity position of the industry in the post consolidation era. In addition, the banking environment in the post-consolidation era has become increasingly competitive among the 24 banks for greater market share. This has evidently been manifested in the emergence of various banking products such as Electronic Payment Cards and Products, including Automated Teller Machines (ATMs), debit cards and most recently, credit cards, internet banking, telephone banking and mobile banking.

Chart 10: Banking Industry: Average Liquidity Ratio (%) 2003 - 2007



The depth of the financial sector, as measured by the ratio of M2 to GDP increased to 17.7 per cent in 2006 and stood at 21.0 per cent at end-December 2007, compared with 16.7 per cent at end-December 2005. The intermediation efficiency of the banks as measured by the ratio of currency outside bank to broad money supply improved, as it fell to 18.8 and 15.2 per cent at end-2006 and 2007, respectively, from 23.1 per cent at end-December 2005

Chart 11: Fnancial System Ratios



Other opportunities in the reformed capital markets include: the creation of new financial instruments to suit various market complexities; deepening of the bond market; and trading in financial derivatives.

Currently, the pension funds market has well over N960.0 billion assets with a projected annual growth rate of about 15.0 per cent. It is expected that the development of the pensions sector will help create the market for long term securities such as bonds, mortgages and asset-backed securities. It will also help in developing competencies in asset management and custodianship.

From the foregoing, the financial sector has recorded substantial achievements, arising from the various reform measures. Specifically, the reform efforts have engendered stable macroeconomic environment evidenced by low inflation and stable exchange rates. The banking environment has also improved with enhanced capacity to support growth.

IV.0 Key Issues and Challenges

A number of issues and challenges have emanated from the various developments in the financial sector since 1986, particularly the recently concluded bank and insurance consolidation exercises. Some of these include:

IV.1 Corporate Governance

One of the major causes of distress in the pre-consolidation banking sector was weak corporate governance. For the banking industry, therefore, the retention of public confidence through the enthronement of good corporate governance remains of utmost importance given the role of the industry in the mobilization of funds, the allocation of credit to the needy sectors of the economy, payment and settlement system as well as the implementation of monetary policy. Consequently, financial institutions in the post-consolidation era are expected to design, install and implement transparent and accountable corporate governance structures, processes and strategies. Boards of banks are faced with the challenge of ensuring good and effective corporate governance structures in their institutions. In recognition of the subject, the CBN in 2006 issued a post-consolidation Code of Corporate Governance for the industry.

IV.2 Capacity Building in the Sector

The evolving competitive financial environment require highly skilled workforce that would effectively contribute to value creation within the 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. Real strategic change can only take place with competent and committed workforce that are constantly exposed to training and development.

IV.3 Liquidation Process and Payment of Private Depositors

A major challenge in the liquidation of the failed banks is the disposal of their assets for the settlement of the depositors. This calls for the need to expedite action on the establishment of the Assets Management Company (AMC) as well as the revision of the necessary laws that will make it possible for both the CBN and NDIC to liquidate failed banks without litigation by the banks.

IV.4 Integration of Systems, Processes and Culture/People

The consolidation resulted in coming together of banks with different IT platforms and business processes. Research has shown that two-thirds of mergers world-wide fail due to inability to integrate personnel and systems as well as irreconcilable differences in corporate culture and management, resulting in board and management squabbles. In many instances, the merger of banks on different IT platforms pose serious challenges which management makes conscious efforts to ensure that services are not disrupted because of the perceived adverse impact on the banks. Integration of IT apart from being time consuming is also very expensive.

Integration of corporate culture and people of merged institutions is key to the success of the merger. During the period of consolidation most banks placed emphasis on financial integration in order to meet the ₦25.0 billion minimum capitalization base without giving appropriate attention to corporate culture and people issues. In the post-consolidation era, these issues have taken the front burner, posing major challenge to the management of the mega banks. For example in the merger of two or more banks, there are differences in the remuneration of staff and grade alignment. In addition, there are differences in management styles; while some are modest in approach, others are aggressive. Banks are contending with capacity building and acculturation programmes to enable Board, Management and staff integrate. The challenge, therefore, is for banks to resolve the issues of systems, processes, culture and people integration for harmonious operation.

IV.5 Legal Reforms

There is the need to review the existing rules and laws relevant to the financial industry 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. Furthermore, there is need to reform the mortgage-financing sector to fast track the development of the housing sector. This requires the strengthening of the primary mortgage institutions and the reform of the relevant laws such as the Land Use Act.

IV.6 Security of life and property

With the renewed call for foreign investment in the economy, the issue of security of life and property cannot be over-emphasized. There is the need for improved security in the country in general in other to sustain the gains of the financial sector reforms and even gain more for improved development of the economy.

V.0 Concluding Remarks

We have attempted to enumerate the various transformations carried out in the financial services sector since 1986. The various reforms have provided the building blocks for an effective and efficient financial services industry that will position the country as one of the top 20 economies in the world by 2020. The CBN as the lead regulator has initiated a lot of efforts aimed at refocusing and strengthening its capacities, processes and capabilities. These include the continued review of its strategic orientation and key priorities as well as the necessary changes that need to be made so that the financial sector is positioned to effectively deal with the new challenges and changes that are taking place in the globe today. While the foundations have been laid and plans are in place to pursue the agenda to a successful end, the future is by no means secure. It is only with the combined efforts of all stakeholders that the probability of the realization of an enduring, credible and very responsive financial sector can be achieved.

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