Nigeria's Banking Industry:

The Case for Redefining Tier 1 Banks

Memo to the **Market**

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Proshare.

Contents

Executive **Summary**.

"Banking is a very good business if you don't do anything dumb."
-Warren Buffett

Nigeria's banking industry has swung from one model to another between 1999 and 2022. From universal banking in 1999, it steered towards the old, specialized banking model before the recent hard brake reset sent the sector into a more contemporary 'Holding Company (Holdco)' mode. The new banking structure mixes specialized banks like investment and merchant banks with a universal banking-like feature condensed into Holdco structures.

In simpler days, banks gained respect by their asset sizes; tier 1 banks would be banks with the largest assets above the industry's median asset value. Today, asset or share capital size would be inadequate to determine whether a bank was tier 1 or 2. The measuring tape has increasingly become elastic.

This report, therefore, critically appraises the extant approach to Tier based classification of Nigerian Banks and proffers a testable methodology as a credible alternative. This report notes that while there is no statutory guidance on the qualifying features of a Tier 1 bank, the Afrinvest Tier Based Classification of 2013, which produced the first-tier banks known by the moniker 'FUGAZE', has been widely adopted.

This is despite its over-emphasis on Assets and its failure to consider non-financial measures like governance. Nonetheless, such banks as have been classified as Tier 1 tend to edge out the so-called Tier 11 banks in big-ticket public and private-sector mandates to raise capital. Hence the need to ask questions about the very basis of the classification.

Following detailed research and investigation conducted over 180 days, Proshare analysts have developed the Proshare Bank Strength Index (PBSI) an aggregate index that selects, weighs, and sums the most important determinant of long-term profitability. Before now, the emphasis all along has been on the size of a bank's total assets, the PBSI lays more emphasis on efficiency metrics such as the quality of the loans and advances on its books.

The meaning is that even though a bank has large total assets on its statement of financial position, this would not count for much in assessing its tier 1 credentials if most of its loan assets are doubtful or of bad quality. Tier 1 banks should have good quality loan assets unimpaired by losses. These assets should be within the top 70 percentile of total unimpaired industry loans.

The proposed criteria are yet to be standard fare amongst Nigerian banks. However, **Proshare** analysts believe that this kind of measure or one expanded to cater to operational and managerial considerations would be better than simply looking at asset size, tier 1 capital, or adopting a loose notion of who belongs and does not belong to the tier 1 banking category.

By the old approach, which is essentially asset-based, and which selects pre-qualifying metrics rather arbitrarily, the banks that make up the moniker 'FUGAZE' retain their positions as tier 1 banks in 2021. Access bank leads the pack with an asset size of N11.73tr, then ETI(N11.69tr), Zenith(N9.45tr), UBA(N8.50tr), FBNH, and GTB complete the list of first-tier banks having recorded assets in excess of the N5tr cut-off. This would however presume that the aforementioned banks all met the pre-qualifying conditions (*see table 1*).

Table 1: **2021 Ranking – The Afrinvest Paradigm (Old Model)**

2021 RANKING - THE AFRINVEST PARADIGM (OLD MODEL)

Year	Rank	Company	Assets(tn)	NPL	Tier
FY 2021	1	ACCESS	11.73	4.00%	1
	2	ETI	11.69	6.25%	1
	3	ZENITH	9.45	4.2%	1
	4	UBA	8.50	3.6%	1
9M 2021	5	FBNH	8.50	7.3%	1
FY 2021	6	GTB	5.44	6.04%	1
	7	FIDELITY	3.29	2.9%	2
	8	Stanbic	2.74	2.1%	2
	9	UBN	2.60	4.3%	2
	10	FCMB	2.51	4.1%	2
	11	Sterling	1.63	0.7%	2
	12	WEMA	1.16	4.9%	2

**FBNH figures were obtained from the bank's 9M 2021 result presentation.*

Source: Result Presentations (2021)

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By the PBSI calibration, however, FBNH and ETI exit the tier 1 category, while Fidelity Bank and Stanbic make a first-time entry into the class of first-tier banks. But this doesn't come as a surprise, since both FBNH and ETI recorded NPLRs over the 5% threshold and would in fact be technically regarded as Tier 11 banks even under the old paradigm.

The PBSI model represents a refinement of the old approach as it not only employs an econometric approach to identify the most critical performance metrics to consider when conducting a Tier-based classification but also follows an equally scientific approach to assigning weights to each selected metric. The result is an index that ranks Nigerian banks based on their aggregate points from CAR, NPL, LR, and Board's Gender Mix (a proxy of Governance). These performance ratios were selected after querying half a dozen other variables namely: Assets Size (Ass), Gross Earnings (GRE), Net Interest Margin (NIM), Cost to Income Ratio (CIR), Digital Earnings, Loans to Deposit Ratio (LDR) Cost of Risk (CoR) and Ratio of Non-executive-to total directors (*see table 2*).

Table 2: **2021 Ranking – The Proshare Paradigm (New Model)**

2021 RANKING - THE PROSHARE PARADIGM (NEW MODEL)

Period	Weights		0.924	-0.27	0.228	0.214			
	Banks	ROE	CAR	NPL	LIQ	BDV	Score	Percentile	Tier
FY 2021	ACCESS	17.80%	24.50%	4.00%	51.00%	38.20%	41.39%	100.00	1
	UBA	15.60%	24.90%	3.60%	47.60%	30.00%	39.34%	90.90	1
	Stanbic	14.70%	21.10%	2.10%	38.00%	43.20%	36.86%	81.80	1
	ZENITH	20.40%	21.00%	4.20%	71.60%	7.07%	36.14%	72.70	1
	GTB	20.60%	23.80%	6.04%	38.26%	21.00%	33.60%	63.60	1
	FIDELITY	12.50%	20.10%	2.90%	40.40%	20.00%	31.30%	54.5	1
	ETI	18.99%	14.80%	6.25%	49.60%	31.25%	30.01%	45.40	2
	WEMA	17.80%	15.46%	4.90%	30.00%	33.00%	26.88%	36.30	2
	UBN	7.30%	14.60%	4.30%	35.10%	29.00%	26.56%	27.20	2
	FCMB	8.90%	16.88%	4.10%	35.30%	18.00%	26.41%	18.10	2
	Sterling	10.40%	14.80%	0.70%	37.90%	4.00%	23.00%	9.00	2
9M 2021	FBNH*	7.2%	15.5%	7.3%	32.80%	11.00%	22.41%	0.00	2

**FBNH figures were obtained from the bank's 9M 2021 result presentation.*

Source: Result Presentations (2021)

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One important observation Proshare analysts made is the fact the bigger banks have generally maintained lower Loans to Deposit Ratio (LDR) and necessarily higher effective Cash Reserve Ratio (CRR). The fact that larger banks tend to have larger deposits means that a ranking based on LDR and effective CRR would be ab initio rigged against the bigger banks. Meanwhile, analysts have questioned the regulator's frequent CRR debits which although seeks to penalize banks for not meeting their lending requirement but fails to take into consideration the fact that larger banks are in a catch-22 as they must also avoid exceeding the NPLR limits associated with creating risk assets in a bad economy.

Under pressure to lend, higher NPLs have been recorded industry-wide forcing the regulator to extend regulatory forbearance to the banks. This particularly played out during the COVID-19 global pandemic when subsequent international government actions affected bank loan assets worldwide. Supply chain disruptions, manufacturing furloughs, lockdown of cities, and restrictions on movements resulted in bank assets looking poorer than book values.

The COVID-19 virus hurt banks' profit and loss accounts between 2019 and 2021, resulting in slower loan asset expansion and reserve liability growth. The key features of Nigeria's banking sector over the last thirty-six months indicate that:

- Nigerian banks have recovered from their COVID-19-induced financial rut, hale and hearty. A return to modest growth (Nigeria's gross domestic product (GDP) fell by -1.92% in 2020 and grew

3.4% in 2021) has helped local financial lenders sustain profitability with lower-risk asset defaults.

- Despite large and growing shareholders' funds, local banks have posted minimal share capital. Liquidity has not been a problem for Nigerian banks as a global liquidity glut in 2021 made some inroads into the domestic money market. The sector's low non-performing loan ratios (NPLRs) have a bright side to the domestic banking narrative. Several banks listed on the Nigerian Exchange Limited (NGX) saw NPLRs settle below 5%.
- The sector, however, faces a slow growth risk in 2022. Proshare forecasts that GDP growth in the year will be between 2.5% and 2.7%, or 0.3% lower than Fitch Solutions 2022 forecast of 3%. The slow economic growth expectations would cycle into slower growth of gross bank earnings and net interest margins.

A review of the Credit ratings of Nigerian banks shows that **Stanbic IBTC** and **Zenith Ban**k received 2021 Fitch ratings of AAA(Prime) and AA- (High grade) respectively. Two Nigerian banks fall within Fitch's upper-medium grade namely **Access Bank** and **UBA**. The meaning of this is that only Stanbic IBTC, Zenith, Access, and UBA, make the cut-off for Investment grade rating. GTB received a B rating, while Fidelity Bank and other Tier 11 lenders were rated B- (which Fitch considers to be in the highly speculative class). ETI got a similar rating as of May 2021. Other banks obtained a B- rating attributable to the adverse macro-economic conditions that affected the banking business in Nigeria in 2021 (*see table 3 below*).

Table 3: **Credit Rating of Nigerian Banks in 2021**

CREDIT RATING OF NIGERIAN BANKS IN 2021

Rank	Fitch Rating	Description	Period*
STANBIC	AAA	Prime	FY 2021
ZENITH	AA-	High Grade	FY 2021
ACCESS	A+	Upper Medium Grade	FY 2021
UBA	A+		FY 2021
GTCO	B	Highly Speculative	FY 2021
FBNH	B-		9M 2021
ETI	B-		H1 2021
FIDELITY	B-		FY 2021
FCMB	B-		9M 2021
UNION	B-		FY 2021
STERLING	B-		9M 2021
WEMA	B-		9M 2021

** The most recent available fitch ratings*

Source: 2021 Annual Reports, Fitch Rating

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We note that the available data on bank ratings applies to different periods the **Proshare Bank Strength Index (PSBI)** for 2021 did not include credit ratings. However, the PBSI methodology would be updated to include bank credit ratings in a follow-up report in June 2022.

Banking Changing Complexion

In the last three decades, the Nigerian banking industry has run the gauntlet of subdued progress and frenzied expansion. Between 2000 and 2005, the universal banking model was tested and failed. Exuberant greed and managerial incompetence conspired to bring about the Soludo solution requiring family-owned banks to merge with bigger rivals or be taken over by more professionally run competitors. The then erstwhile Central Bank of Nigeria (CBN) governor Chukwuma Soludo raised the share capital of banks from N2bn to N25bn and effectively chiseled down the number of deposit lending institutions from the number of banks from 89 to 25.

> **"…under CBN governor Godwin Emefiele, tier 1 banks have been captured under FUGAZE, a collective acronym for FBNH, UBA, GTCO, Access Bank Zenith Bank, and ETI.**

The Soludo potion for poor bank management was administered again when HRH Sanusi Lamido Sanusi, former Emir of Kano, became the CBN governor in 2010. Sanusi did not raise the share capital of banks' but insisted on higher standards of corporate governance and supported the second round of financial sector takeovers.

The Sanusi era reinforced the notion of tier 1 and tier 11 banking system competition. The perception was a carryover from the Soludo era, which created an inner circle of enormous banks surrounded by a galaxy of smaller competitors. Unfortunately, the CBN never defined a tier 1 and tier 11 bank, leading to a fluid interpretation of where particular banks belong.

More recently, under CBN governor **Godwin Emefiele**, tier 1 banks have been captured under FUGAZE, a collective acronym for FBNH, UBA, GTCO, Access Bank Zenith Bank, and ETI. If the measure were market capitalization, one or two banks would be in and out of the categorization depending on share price movement. If the measurement were share capital, all the banks listed on the Nigerian Exchange Limited (NGX) have their share capital below the N25bn statutory minimum prescribed by the CBN. None would qualify as a tier 1 bank (*see illustration 1*).

Illustration 1

Illustration 1: **Nigeria's Curved Ball Classification of Banks**

NIGERIA'S CURVED BALL CLASSIFICATION OF BANKS

Tier 1	Tier 2	Tier 3
Tier 1 capital is large	Tier 1 capital is modest	Tier 1 capital eroded
Large reserves	Liquidity ranges from modest to high	Liquidity low except for Unity Bank with high liquidity of 45% (Dec 2021)
Liquidity ranges from modest to high	CIR is between 55% and 65%	CIR is high (90.1% for Unity Bank as of Dec 2021, 91.3% in Dec 2020)
Cost-to-income (CIR) around or below 50	Market capitalization is modest	Market price is below N1 per share
Market capitalization is high	Market price is unpredictable	Market capitalization is low
Market price is high		

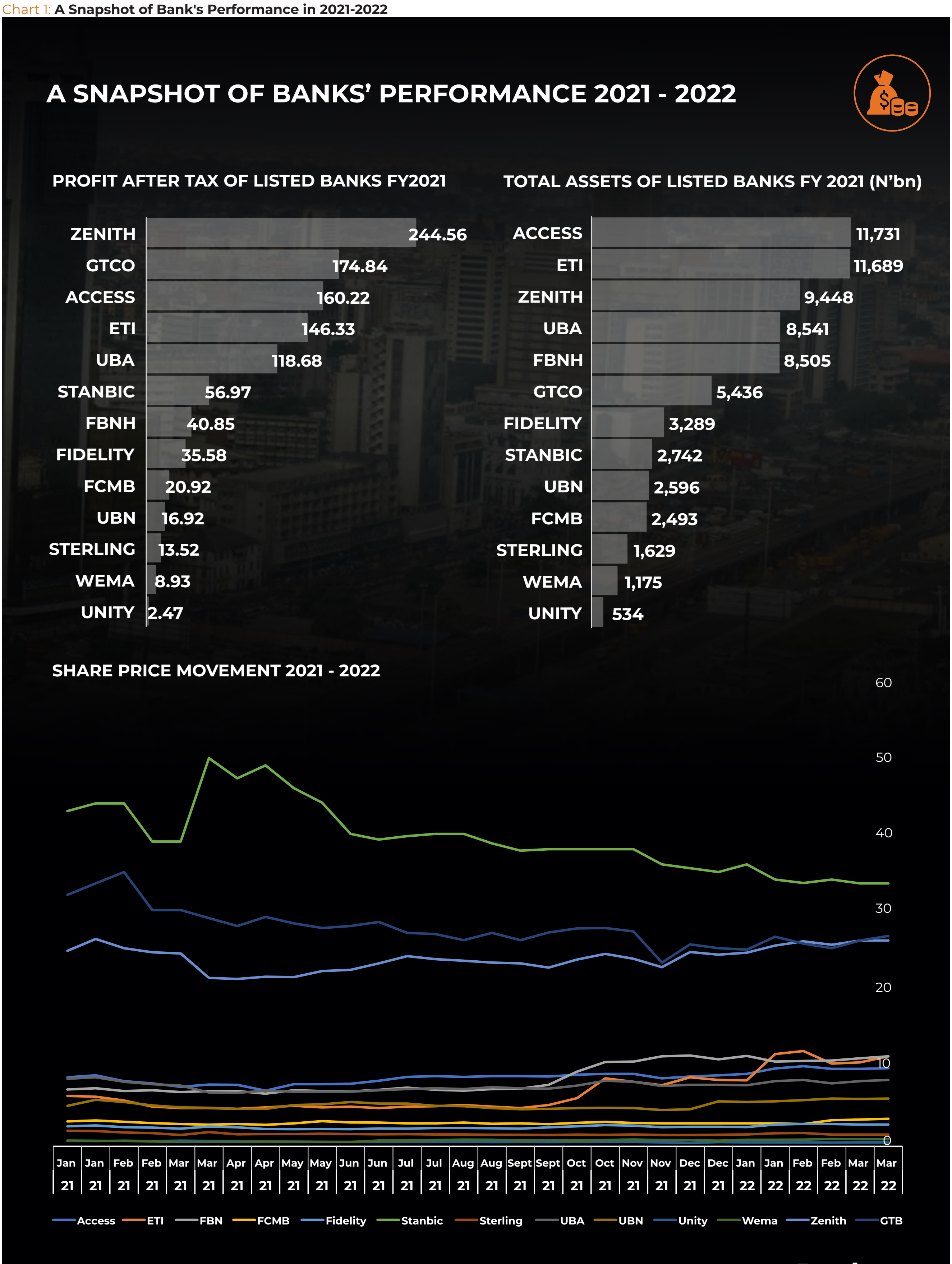
Tier 1	Tier 2	Tier 3

These banks may qualify to be Tier 1

Source: **Proshare** Research

Analysts have noted that size and profitability are different concepts. The largest banks by asset size are not necessarily the most profitable. So, neither asset size nor gross or net earnings are good enough measures to establish a bank's industry status (*see chart 1*).

Chart 1: **A Snapshot of Bank's Performance in 2021-2022**



Source: **NGX, Proshare** Research

However, combining corporate performance criteria can roll into some indicative metrics of tier 1 or tier 11 banks. ***Proshare researchers have considered a set of compressed metrics that review a bank's cost-to-income ratio, loan-to-deposit ratio, non-performing loans ratio, and governance quality (using board members' meeting attendance performance and board gender mix as proxies. Multiple regression analysis showed that the more women appeared on a bank's board, the better its performance as measured by its return on equity (ROE). The explanation for this could be debated.). In contrast, asset and equity size become guard rails for assessing whether a bank is tier 1 or tier 11.***

The earlier dashboard shows that a bank with the largest total assets is not necessarily the most profitable. In 2021 Access bank had the largest total assets of 11.73tn, but Zenith Bank posted the largest profit of N244.56bn. ETI was the second-largest bank by assets, but it was the fourth-largest by profit, posting a profit after tax (PAT) of N146.33bn. Zenith Bank was the third-largest bank in the country by asset size at N9.45trn, but it was equally the most profitable. FBNH was the fifth-largest bank by assets but was the seventh-largest with an after-tax profit of N40.85bn. The largest bank by assets after what has become known as the big six or FUGAZE was Fidelity Bank, with a total asset size of N3.29trn and profit after tax of N35.58bn.

In the financial services sector, economies of scope (average cost) and scale (quality and size of service delivery) are essential but not definitive in assessing a bank's tier 1 status. Asset or equity size alone is a poor measure of which bank is qualified to be a tier 1 bank. Proshare researchers argue in the report that a combination of metrics is needed to establish the size, board, and management quality of a deposit money bank (DMB) in determining its tier 1 status. They observed that banks propped up by CBN forbearance should not qualify as tier 1, regardless of their asset and deposit sizes. They argue that a tier 1 bank may not necessarily be a systemically important bank (SIB).

The analysts observed that the concept of a tier 1 bank and a SIB tend to be interchanged, although they require separation for clarity. The money market's principal regulator, the Central Bank of Nigeria (CBN), recognizes that a systemically important bank (and tier 1 bank) needs to have large **tier 1 capital**. In addition, a tier 1 bank must avoid regulatory forbearance and meet a combination of metrics that places it in the ***50th percentile*** of Proshare's proposed **Bank Strength Index (PBSI).**

A Remodelled World of Banking

The ice age ended, but rather than lead to the termination of the world, it brought about a new order, an order with novel dominant species of animals and fauna and revised expectations accompanied by freshly minted frustrations. As with the old ice age, so with the unfolding digital age. Banks are going into a dignified decline as banking enters an era of adaptation and innovation. Bankers' unwilling to ride the new wave of agile, innovative, and flexible service delivery will wear their undergarments around their ankles as the fierce tide of technology reveals who is digitally naked and who is not. Buffett's perception of banking as an excellent business may require a rethink.

The new era of decentralized finance (DeFi) will reshape the way banks engage in financial intermediation. The latest banking platforms will enable digital payment and settlement of transactions speedily and interactively unhindered by time or space. Traditional deposit money banking days may be ending, but the digitally interactive banking days are well on their way. A shift in banking products, processes, and service delivery conduct would require a change in culture, capital, credit, and controls. These four Cs explain why some banks would become gainers, other losers, and many more, benchwarmers in the fierce battle for corporate sustainability.

The Culture Crusade

With banks seeing much more of their businesses going digital after the COVID-19 pandemic, corporate culture has changed. The Information Technology (IT) department has moved from being a corporate appendage for the maintenance of computer systems and networks to leading the charge to improve the customer's journey experiences. The head of IT needs to be part of the service delivery planning architecture from the beginning as customers' expectations rise and their patience with delays or imprecision. The higher quality demands and need for speed require a culture change. Financial service producers must rethink corporate culture to align with evolving customer expectations. Mobile devices are the new branch network, and bank service delivery must rest on these delivery channels to meet the customers' aspirations and desires. Holding back on meeting customer expectations could mean the difference between glaring success and an assured failure.

The Capital Consensus

If banks are to invest in long-term technology, they must shore up capital and invest in tech foundries to enable them to play at the cutting edge of emerging technology. The new capital size would support 'space' rather than 'place' expansion, with products steadily emerging from the bank's product and service pipeline that enables them to dominate areas of uncontested competitive advantage. Besides being a risk-protection mechanism, the capital size must be a service delivery catalyst. The bridge from capital to service is technology; banks will need to shore up capital as they make a play for service excellence. One way of going about this is the Access Bank way. The bank has not been sterling in dividend payouts. Still, it has used retained earnings to support inorganic expansion, resulting in one of the highest returns on shareholders' equity.

An unanswered question is why Nigerian DMBs have issued and paid-up share capital below the statutory minimum of N25bn for national banks and N50bn for banks with international operations and why the Central Bank of Nigeria (CBN) has not called on the banks to shore up their share capital. Admittedly, most banks, except those in the lowest category of **tier 111**, have robust shareholders' funds, but their share capital almost without exception falls short of the legally required minimum. Unity Bank Plc has one of the lowest shareholders' funds in the industry with a negative value of N280bn and a share capital of N5.84bn.

The Credit Creed

Credit to customers will require a deeper and faster interface with technology, customer behaviour analysis, and past loan performance. Using Monto Carlo analytical techniques and standard forecasting tools, default probabilities depend more on statistical probabilities calculations. Banks will have to shorten the credit cycle and relax the loan decision-making process under guidance. It has known that Fintech platforms have already started to make this possible, but loan recovery rates are presently uninspiring. Defi may improve access to loans and other financial products such as investments and savings; however, a lot is required to protect customers from abuse and fraud. In addition, the credit side of the business raises concerns about the financial regulatory framework and the delinquent loan recovery process. There are concerns about the violation of an individual's privacy and the use of cyberbullying to recover customer debts.

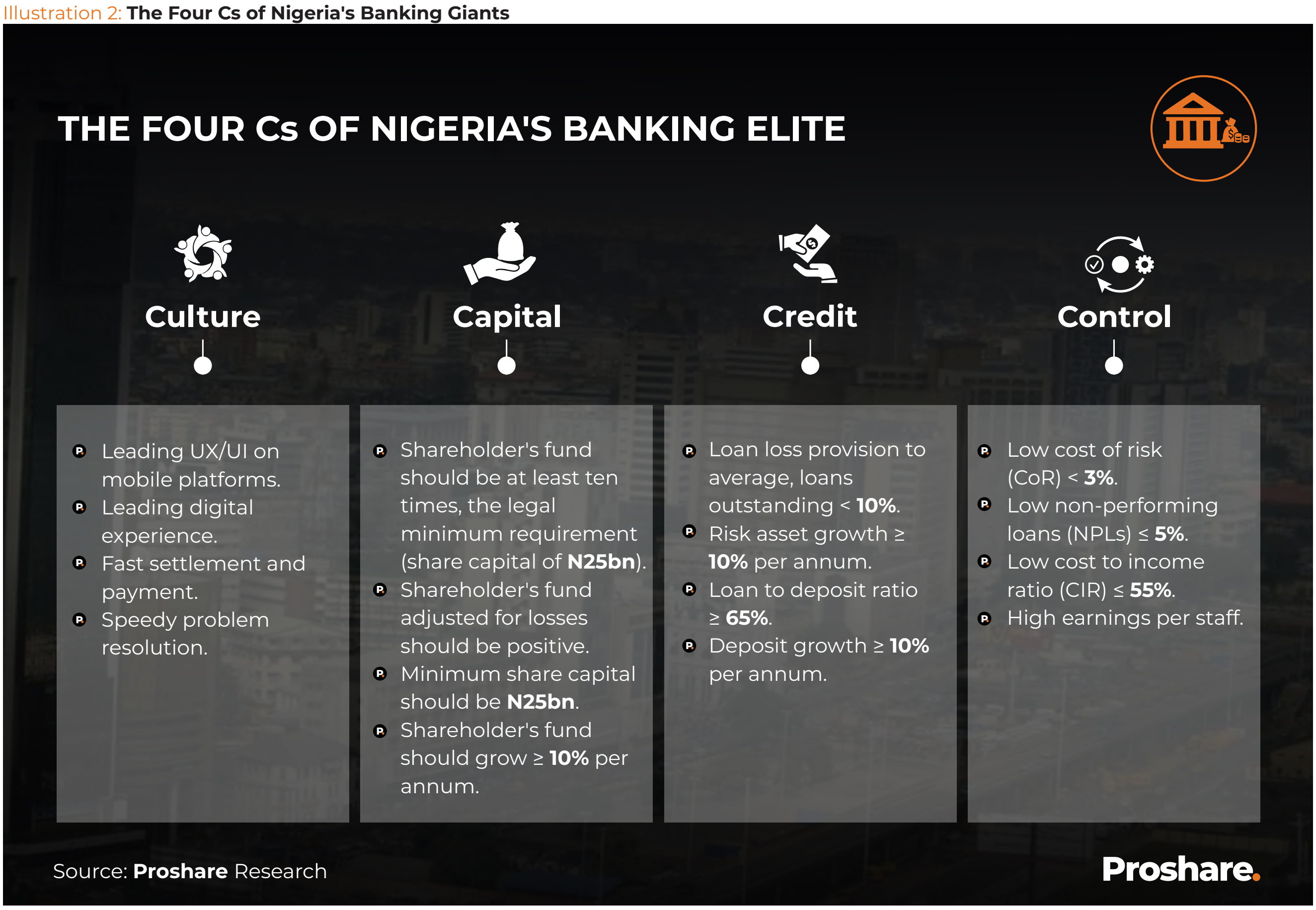
Banks will need to avoid the abrasive approach to loan recovery by Fintech firms lacking credit risk experience and legitimate loan recovery methods. The banks must lead the digital lending landscape with better intelligence and superior cash flow collateralization methods. To be meaningful digital credit expansion should be at least 10% per annum. A second-tier bank like FCMB appears to be showing the way with its 2021 digital income, as digital revenue accounts for 12% of gross earnings. The rise in digital income as a proportion of gross earnings was off the back of a 33% rise in technology cost.

The Control Console

Banks are increasingly concerned about keeping their costs in check. Most banks have kept their cost of risk (CoR) below 3%. The tier 1 banks have generally kept their CoR below 1.5%. Tier 1 banks have also ensured they kept a lid over their loan defaults by seeing that loan delinquency rates do not rise above 5%. However, banks listed on the NGX saw non-performing loan ratios range between 0.70% (Sterling Bank Plc) and 6.25% (ETI) in 2021. The tier 1 bank NPLRs clustered around 4.8%, with Fidelity Bank as an outsider at 2.9%.

The big banks also drove down their cost-to-income ratios (CIRs); the average CIR for NGX-listed banks for 2021 was 64.56%, and the average CIR for FUGAZE banks was 57.83%, while tier 11 banks had a CIR of 71.27%. In other words, FUGAZE, as a shorthand approximation of tier 1 banks, had CIR metrics close to the preferred 55% (*see illustration 2*).

Illustration 2: **The Four Cs of Nigeria's Banking Giants**



Banks have begun to live a new reality within an era of rampant innovation, unforgiving competition, and unrelenting creativity. To walk along the stony path of corporate sustainability, executives need to break from corporate conventions and jaded customer value propositions without compromising standard operating procedures; in running the gauntlet of flexibility and agility, they must discover process precision and customer needs *alignment*.

Several analysts have noted that from now on, banking will become a set of *'commoditized'* or standardized products and services represented by a series of binary commands of ones and zeroes. Banking will no longer be about gorgeous glass buildings and exquisite architectural murals, but about easy-to-understand instructions conveyed to intelligent computer programmes that provide real-time solutions to customers' problems. The implications are vast and just as they are powerful.

The commoditization of banking means that there will be less human involvement in banking services and product delivery. Still, more digital skills, riding on the back of marketing and selling activities, would be guided by big data algorithms and the prediction and interpretation of future customer preferences. Customer service delivery would be less of a hit-or-miss game of Russian Roulette and more of a carefully thought plan of customer service optimization through data analytics.

The lending process would depend less on expressed or innate biases or personality traits but on personal borrowing histories, spending habits, and repayment profiles that provide a vignette of customer behaviour and spending patterns. Therefore, establishing loan default probabilities with real-time, data-backed analytics would be easier and more precise. Banks would increasingly become curators of massive data for products and services as they improve customer experiential journeys.

No Room for Nomads

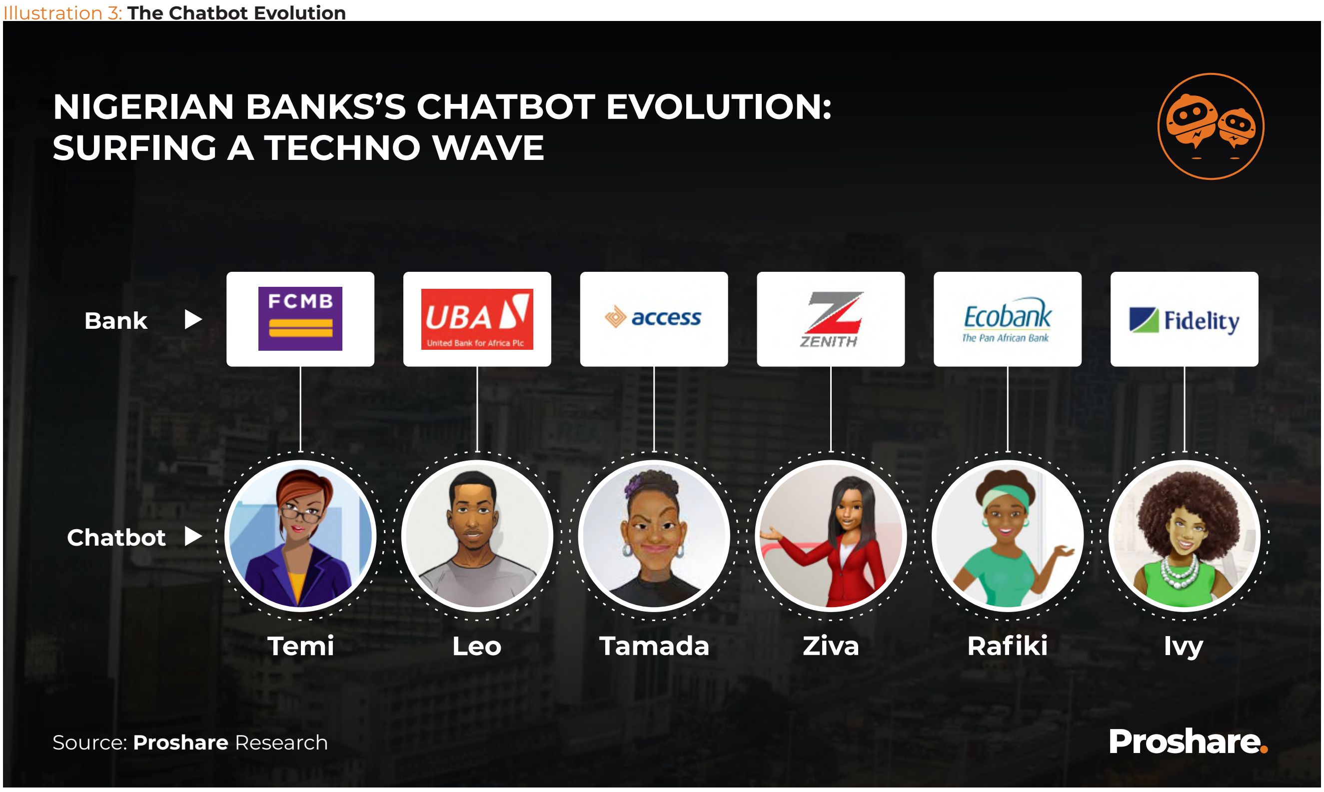
Going digital is not a choice but a standard. The thickening plot to use technology as an enabler of superior service delivery requires workers across banks to learn, unlearn, and relearn skills to make them fit-for-market. Digital nomads (those without functional digital skills) have a shrinking space to ply their trade in a world where online communication, interaction, and collaboration have become a second skin. The world is a stomping ground for digital natives (people who eat the internet and various spin-off applications for breakfast). Late adopters may be on the fringes of the expanding global digital workspace, implying weak access to more considerable operational capital, poor competitive market presence, and thinner operating margins. In places like banks and financial technology (fintech), digital technology applications and evolution will separate those at the top of the business pile from those at the bottom.

Improved global and local capital market liquidity resulting from large COVID-19-induced fiscal expenditure provided banks with increased liquidity between 2020 and 2021 but most of the added liquidity did not translate into increased equity capital. The faster-paced growth in technology relative to equity capital in recent times is ironic, as analysts expected businesses would recapitalize as a virus-induced change to work and social culture increased the need to upscale technology use.

The Banking Sector's Response to Change -
The Bot Battles and Other Matters

Indeed, as noted in the previous paragraph, banks have not been lazy and have moved swiftly to push the technology needle forward. In a rough sense, the top-tier banks in Nigeria reflect the size of bank equity capital and the extent of their technology adoption. Nigeria's top-ranking banks, usually referred to as FUGAZE (FBNH, UBA, GTCO, Access Bank, Zenith Bank, and ETI), have adopted artificial intelligence and machine learning (AI/ML) as service add-ons (*see illustration 3*). However, to drive the customer experience of tomorrow forward, banks need to go beyond the whistles and bells of creating chatbot interfaces with customers to a rethinking of the overall business of banking in such a way as to align corporate operations to customer expectations. Being big would gradually be less important than agility, flexibility, and innovativeness.

Illustration 3: **The Chatbot Evolution**



However, analysts have noted that the physical size of banks might be of lesser importance in the future. The new concept of bank size (and competitive strength) has nothing to do with buildings and branches but with customer deposit size, tier 1 equity capital, subordinated liabilities, unimpaired loans and advances, and the volume/value of digital transactions.

The size that will matter in the business of finance of tomorrow will be customers, non-fixed assets, and sundry financial liabilities. The future bank cash centres and service branches will be in the palms of bank customers as they pivot towards a wholly digital lifestyle. The growth of technology in financial service delivery would not obliterate the importance of standard measures of bank size, but it would require viewing banking metrics through prisms. A few indicators will remain critical and provide insight into competing banking operations, but 'soft' issues such as the quality of a bank's board and risk-weighted assets would become of equal importance as the size of its tier 1 capital.

Experience has shown that several large tier 1 capital banks have found themselves in history's dumpster.

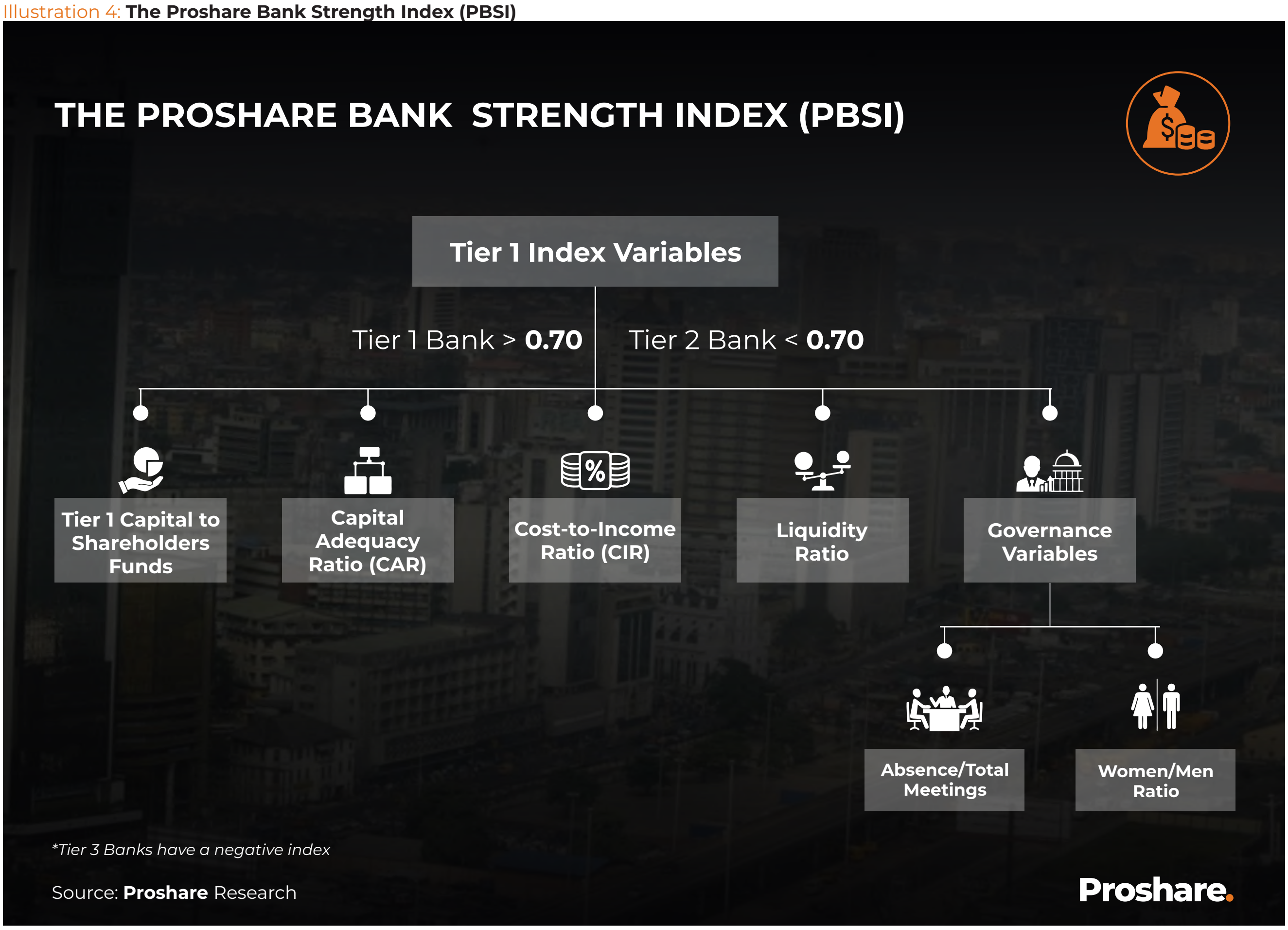
Building Banks Stronger and Better

The ranking of banks by their tier 1 capital alone is inadequate to determine whether a bank is a tier 1 bank or not. Research suggests that most countries do not organize their banks as either tier 1 or tier 11; they classify them as systemically important banks (SIBs) or non-systemically important banks (NSIBs). However, Nigeria has adopted a unique classification for its banks for ease of risk administration or peer comparison. Rather than adopt specific Credit Rating agency metrics, local regulators, bankers, and financial analysts have preferred a shadowy and imprecise notion of tier 1, tier 11, and tier 111 banks (the latter reflects banks with negative shareholders' funds).

The size of a bank's tier 1 capital is indicative of its relative systemic importance, but it does not capture the essence of its stability, liquidity, and capital cushion. To capture these elements of a bank's operations would require a broader set of indicators. Without a clear Central Bank of Nigeria (CBN) guidance on what a tier 1 and tier 11 bank is, Proshare proposes an Index of bank relative classification. The Index elements would include the size of tier 1 capital, the bank's capital adequacy ratio (CAR), the bank's cost to income ratio (CIR), the bank's liquidity ratio, and its proxy corporate governance measures. The proxy measures for governance include Board diversity (number of females to male Board members, ethnic composition, age, professional expertise), number of annual Board meetings held, and members' attendance.

Proshare's Weighted Bank Classification Index may provide a fresh perspective to categorizing banks and help in clarifying where they belong in different classes. For example, tier 1 banks would have a higher Index threshold than tier 11 banks. The tier 111 banks would likely have the leanest tier 1 capital while posting the poorest asset quality and liquidity positions (*see illustration 4*).

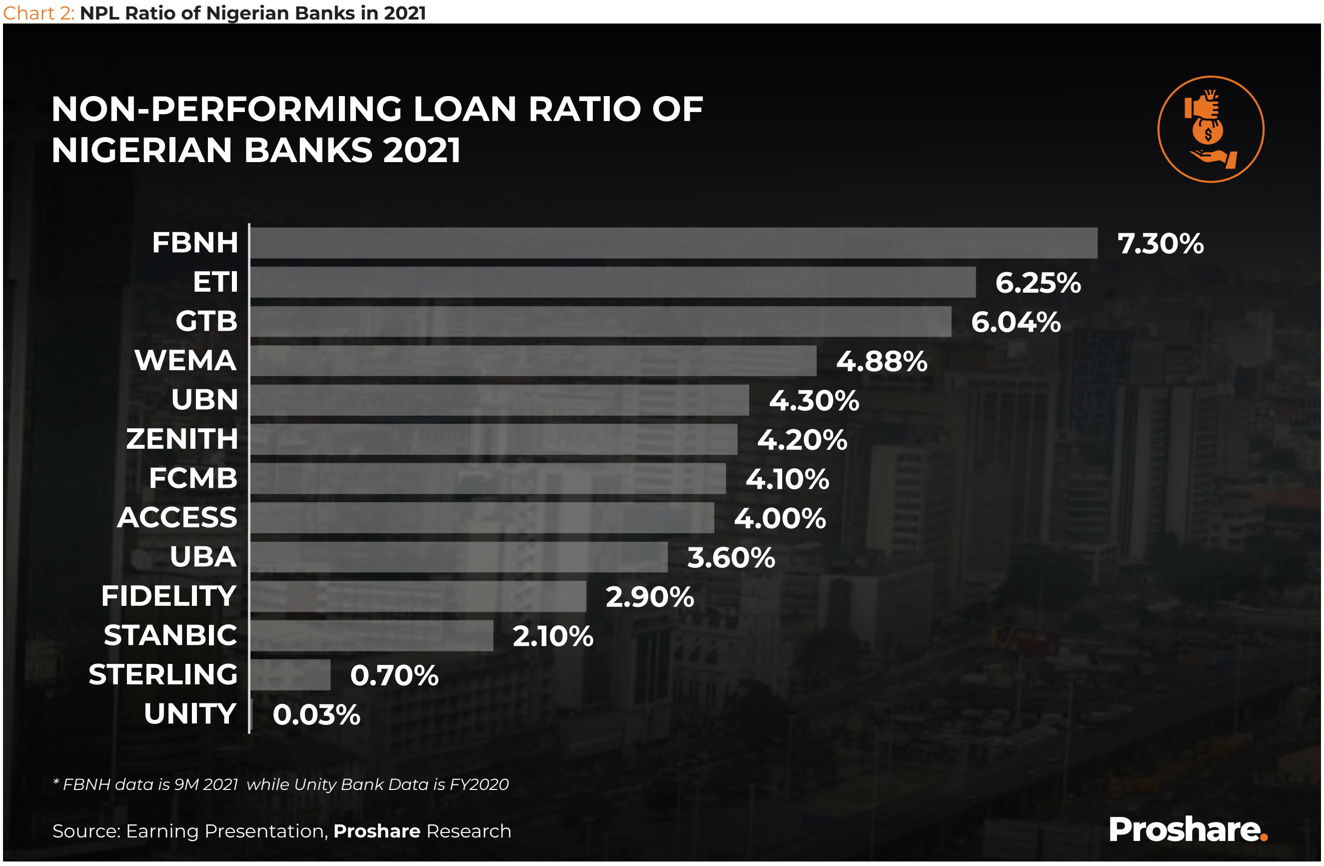
Illustration 4: **The Proshare Bank Strength Index (PBSI)**



In other global financial markets, tier 111 banks become liquidated, nationalized, or placed under a debt resolution company like AMCON. So why do they still exist in Nigeria? A variety of reasons explain the existence of Nigeria's third-tier banking institutions. The first is the ***salience of political influence***. One of the country's present third-tier banks has two former presidents represented on its Board of Directors (BoDs). In the Nigerian context winding up this bank would be unthinkable. The second reason would be the interest of the CBN in ensuring that no bank goes into liquidation, sending a signal of systemic difficulties; this would be unacceptable to the local money market regulator. A third reason would be the instinctive dislike of failure, so bank managements try to do all they can to prevent their institutions from being put on the auction block or taken over by bigger competitors. For example, non-listed Heritage Bank has operated with negative shareholders' funds for over three years without regulatory determination of its existence or a corporate takeover or recapitalization by a new investor. Heritage Bank is, therefore, one of those anomalies thrown up by the Nigerian financial system unwilling to ***accept liquidation*** or bankruptcy.

In the report, Proshare analysts conclude that Unity Bank's situation may not be as dire as Heritage Bank's, but it does throw up some ironies. The analysts noted that the bank was very liquid in 2021 despite its negative shareholders' capital which exceeded N250bn. The large deficit in its capital would suggest a narrower opportunity to transact business on the back of thin but growing deposits. Another queer fact, according to the report writers, was that at 0.03%, the bank had the industry's lowest non-performing loans ratio (NPLR). The reason was that the bank cleaned up its most toxic risk assets in 2018 by selling them to a factoring company at a deep discount, leaving its balance sheet derisked and loan-light. The removal of bad loans from the bank's balance sheet led to the shrinking of its capital and the creation of its negative shareholders' funds. On the positive side, the bank has had the cleanest risk assets in the industry, with the lowest non-performing loans ratio (NPLR) at 0.03% (*see chart 2*).

Chart 2: **NPL Ratio of Nigerian Banks in 2021**



However, negative shareholder funds are not the only reason tier 111 banks represent the bottom of the banking pile. Tier 111 lending institutions also have challenges with their interbank positions, liquidity, and cost-to-income ratios (CIRs). Unlike Unity Bank Plc, Heritage Bank, the second Nigerian bank with known negative shareholder funds, ticks all the boxes of a tier 111 deposit money bank (DMB).

While Unity bank is liquid, Heritage Bank Limited is not. Unity Bank Plc has a low NPL; Heritage Bank Limited has a high NPL. Unity Bank Plc has a negative equity base; Heritage Bank Limited equally has a negative equity base. While Unity Bank Plc turned a profit in financial year-end (FYE) 2020, Heritage Bank continued its longstanding loss. The two banks show the broad categories reflecting the differences between so-called tier 1 banks and others.

Strategy as a Toolkit

Does it matter whether a bank is tier 1 or tier 11? Yes, it does. A growing tribe of corporate analysts understands that ever-increasing bank capital, superior corporate governance, and strategic corporate intent separate banks into the top and other tiers. The stronger the bank capital and the more precise the strategic goals, the more likely it would grow its top and bottom-line earnings.

A tier 1 bank would likely attract big-ticket public and private-sector mandates to raise third-party capital either by debt or equity. A top-tier bank would equally attract large public and private sector deposits, enabling it to scale its business activities and increase market share and competitive advantage. The notion of skill dominating size is naïve. While skill is critical to resource allocation and management, it would still hit a brick wall if not allowed to feed into growth.

For example, in 2005, STB (erstwhile Standard Trust Bank) took over UBA (an arguably more significant bank by assets and deposits) because of its market savvy and ability to navigate the changing business landscape. Still, STB needed the UBA size, brand recognition, and loyalty to support a growth model that ensured sustainable profitability. Growing bigger was synonymous with getting better, but this is not a holy grail. A bank could become more prominent and poorer if its management were Peter principled or promoted to its highest level of incompetence due to growth. The unintended consequences of growth unaccompanied by managerial capacity partly explain why most of the 89 banks that operated in Nigeria in 2000 collapsed or were acquired.

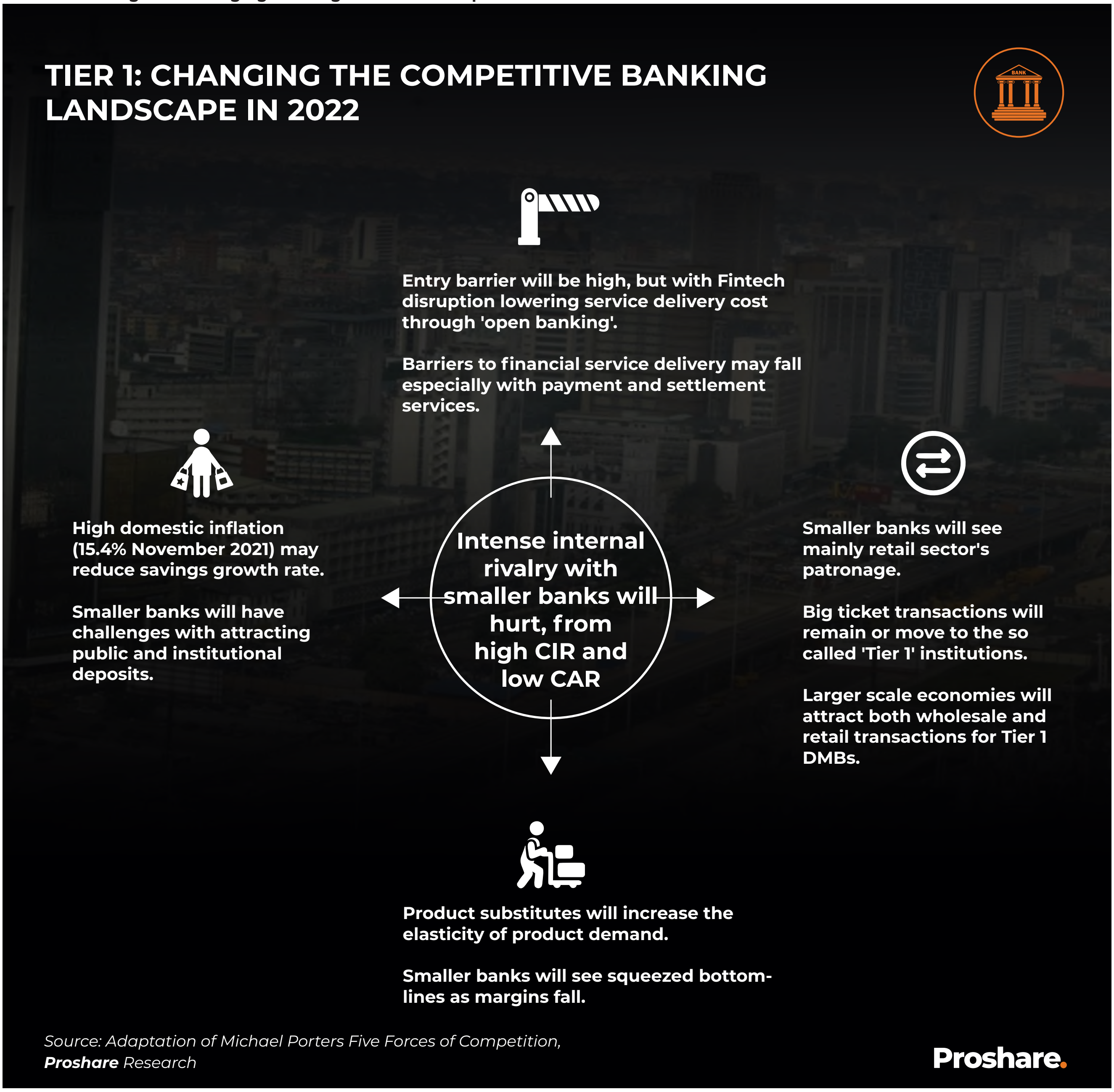
However, analysts have observed that a few smaller banks that have rolled into larger ones (tier 1) have done well. Access Bank, for instance, is seen as a tier 1 bank and a member of Nigeria's elite FUGAZE (FBNH, UBA, GTCO, Access Bank, Zenith Bank, and ETI), a tribe of tier 1 lenders responsible for 80% of total industry deposits and 90% of industry assets. Access Bank has grown massively but inorganically by acquiring larger institutions such as Intercontinental Bank Plc (2011). It recently acquired Diamond Bank Plc (a merger in 2019). The rapid growth of Access Bank both nationally and continentally has underscored the power of being big and riding on clever game planning.

Strategy and survival are different sides of the same coin. Strategy is an effective survival tool for banks as a small band of service providers dominate the industry and set the tone for operating margins, technology, and profit. In other words, the banking industry revolves around a shopping list of six large banks, popularly called FUGAZE, and a merry band of smaller and sometimes friskier rivals.

On realizing their inability to speedily ramp up their brick-and-mortar infrastructure to take on their bigger rivals, smaller banks have opted to take the technology route as a counterpoise to the competitive dominance of the big six (*see illustration 5*).

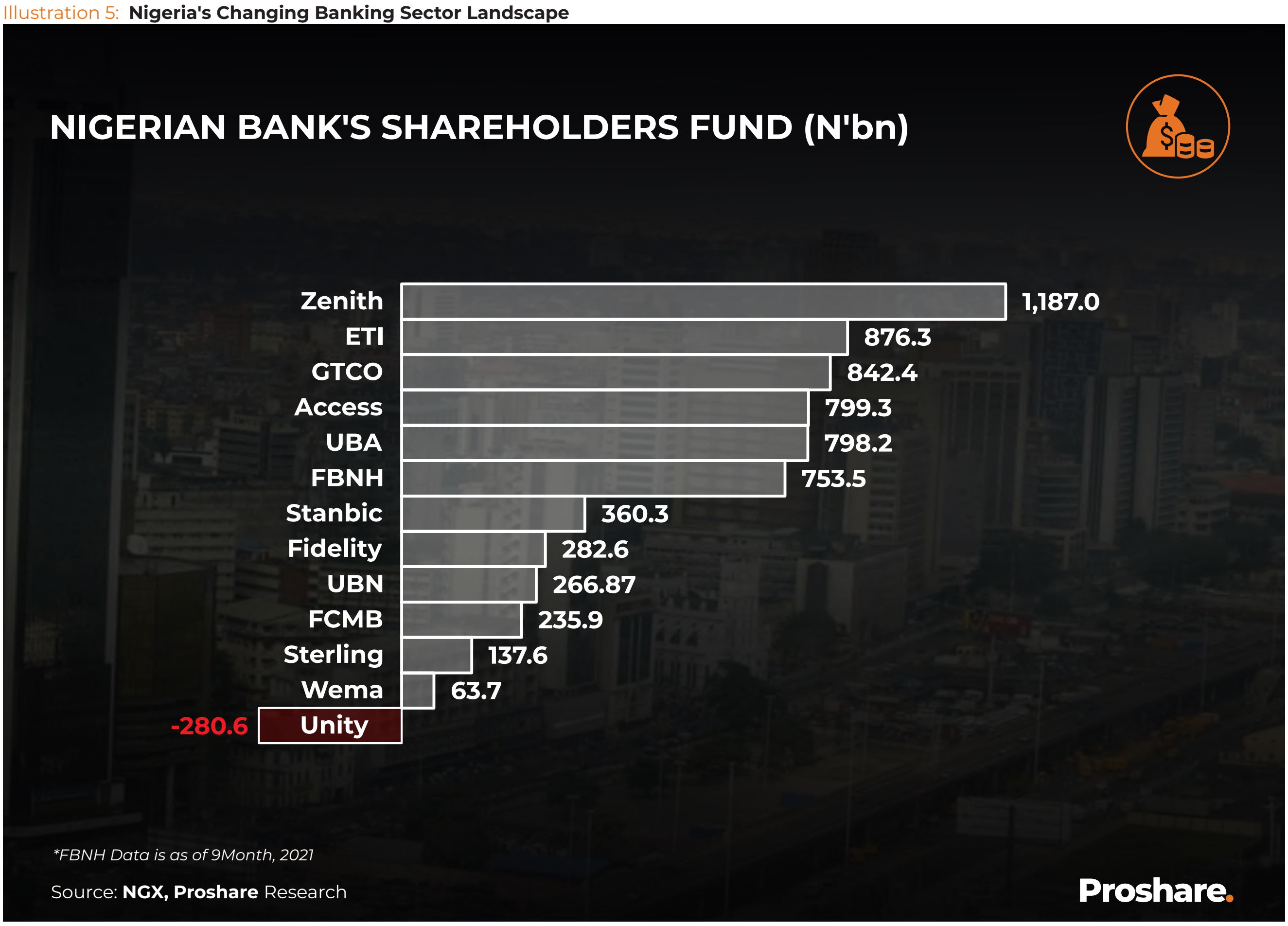
Illustration 5

Illustration 5: **Nigeria's Changing Banking Sector Landscape**



"small" is a relative term and viewed in the light of total asset size, loans and advances, and the size of a bank's customer deposits to industry averages. Interestingly, the research showed that the size of a bank's share capital is a poor measure of how large the bank's operations are. Most Nigerian banks have share capital below the CBN minimum requirement of N25bn for national banks and N50bn for international banking operations. To make for an easier comparison of capital strength, the report authors looked at the shareholders' funds of banks listed on the NGX. They discovered that using this criterion validates the notion of Nigeria's FUGAZE banks as tier 1 lending institutions, mainly if the bar is set for Nigerian deposit money banks with shareholders' funds up to and above N700bn (*see chart 3*).

Illustration 5: **Nigeria's Changing Banking Sector Landscape**



According to the report writers, Nigerian banks have relied more heavily on their reserves to shore their capital base rather than share capital. Indeed, all listed banks on the NGX have used statutory reserves, share revaluation reserves, retained earnings, and subordinated long-term debt to portray capital strength. None of this is illegal or technically incompetent. Still, the 2010 CBN law clearly states that for a bank to operate in Nigeria at the national level, it should have a minimum share capital of N25bn or N50bn for internationally operational deposit-taking institutions (*see table 4 and illustration 6*).

Table 4

Table 4: **Share Capital of Nigerian DMBs 2021**

NIGERIAN DMBs SHAREHOLDERS STAKE AND CAPITAL 2021

S/N	Banks	Issued and Paid-up Share Capital (N'bn)	Shareholders Fund (N'bn)
1	Zenith Bank	15.69	1,279.66
2	Access Bank	17.77	1,050.03
3	ETI	.....	917.90
4	GTCO	14.72	883.23
5	UBA	17.10	804.81
6	FBNH	17.95	753.55
7	Stanbic IBTC	6.48	376.87
8	Fidelity	14.48	297.77
9	UBN	14.63	266.87
10	FCMB	9.90	243.81
11	Sterling Bank	14.39	141.49
12	Wema	19.29	70.15
13	Unity Bank	5.84	-280.10

**FBNH Data is as of 9Month, 2021*

Source: **NGX, Proshare** Research

Proshare.

Illustration 6: **CBN Minimum Share Capital Requirements for Nigerian DMBs**

SHARE CAPITAL: WHAT IT TAKES TO BE A NIGERIAN BANK

6 A Commercial Bank authorised to conduct business on a national basis shall:

Minimum Standards for Commercial Banks with national authorisation

a) maintain a minimum paid-up share capital of Twenty Five Billion Naira (₦25,000,000,000.00) or such other amount as may be prescribed by the CBN from time to time.

b) comply with all prudential guidelines and regulations issued by the CBN on the required level of capital adequacy, liquidity and cash reserve..

c) observe all applicable corporate governance standards as prescribed by the CBN and other financial service sector regulatory authorities in Nigeria.

7 A Commercial Bank authorised to conduct business on an international basis shall:

Minimum Standards for Commercial Banks with international authorisation

a) maintain a minimum paid-up share capital of Fifty Billion Naira (₦50,000,000,000.00) or such other amount as may be prescribed by the CBN from time to time.

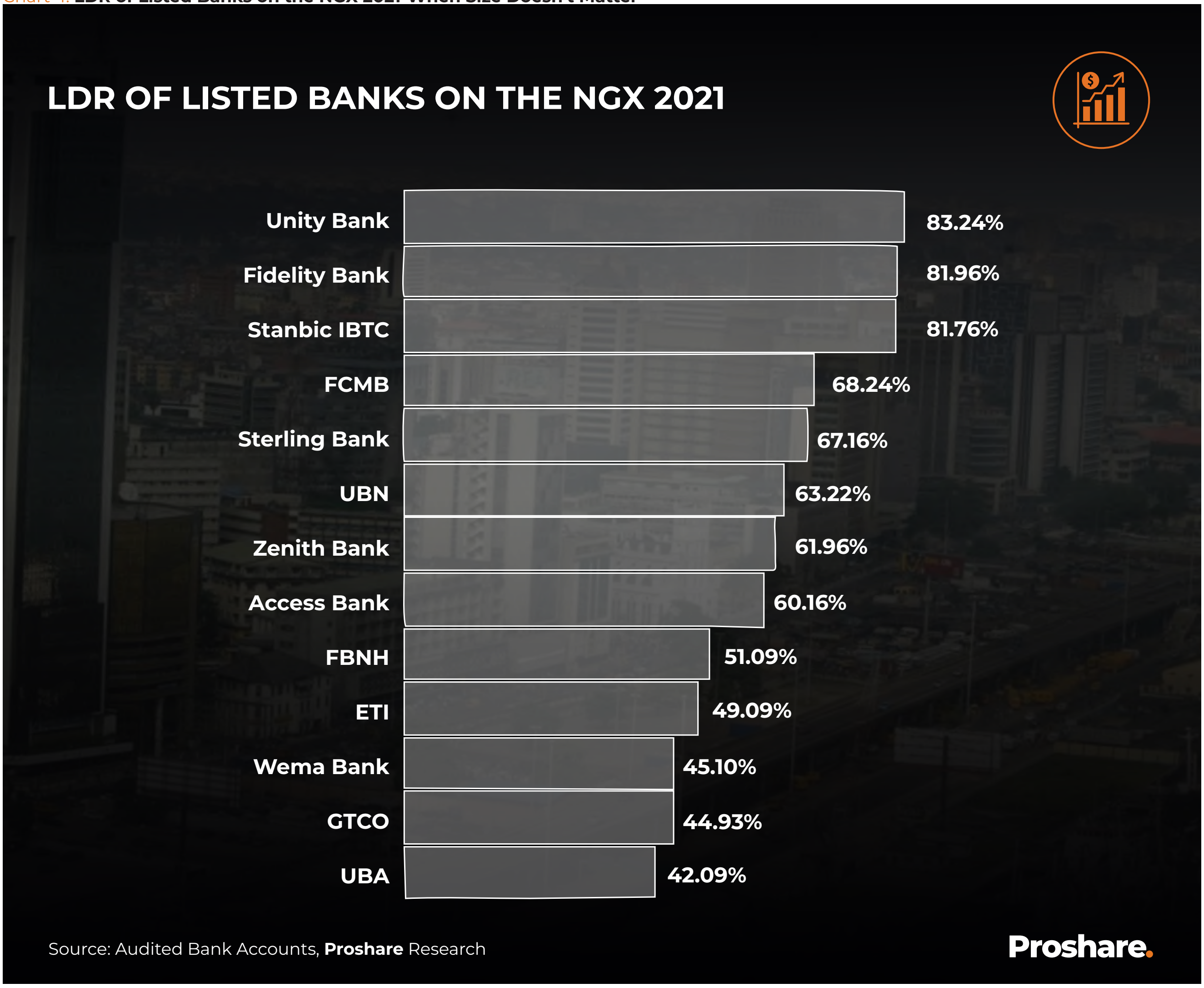
b) comply with all prudential guidelines and regulations issued by the CBN on the required level of capital adequacy, liquidity and cash reserve.

c) observe all applicable corporate governance standards as prescribed by the CBN and other financial service sector regulatory authorities in Nigeria.

Source: **CBN, Proshare** Research

The banking game of size appears to be less constrained by the magnitude of bank equity than by the CBN-imposed loan to deposit ratio (LDR) of 65% and cash reserve ratio (CRR) of 27.5%. The statutory LDR has forced banks to grow messier loan assets or cut down on their deposit liabilities or loan portfolios, slowing operational growth or paying fines on their cash reserve deposits with the CBN. Strikingly, the LDR of a bank is a poor predictor of its status. Unity Bank has a negative shareholders fund and a small loan portfolio size but has the best loan-to-deposit ratio of all banks listed on the Nigerian Exchange Limited (NGX). Fidelity Bank has been viewed as a second-tier bank but has the second-highest loan-to-deposit (LDR) ratio of banks on the NGX. Proshare researchers discovered that currently perceived tier 1 banks appear to cluster in the middle of the LDR table, with Zenith Bank posting an LDR of 61.96%, Access Bank an LDR of 60.16%, FBNH an LDR of 51.09%, and ETI an LDR of 49.09%. Bigger banks by asset size seem to find it difficult to lend out their deposits (*see chart 4*).

Chart 4: **LDR of Listed Banks on the NGX 2021-When Size Doesn't Matter**



The problem appears to be that the larger the deposits, the more conservative the bank becomes in creating risk assets to prevent a rise in its non-performing loans ratio (NPLR). Most banks want to keep their NPLR below the 5% statutory threshold. Given this scenario, analysts agree that the CBN's discretionary CRR debits will continue throughout 2022 and put downward pressure on bank asset yields.

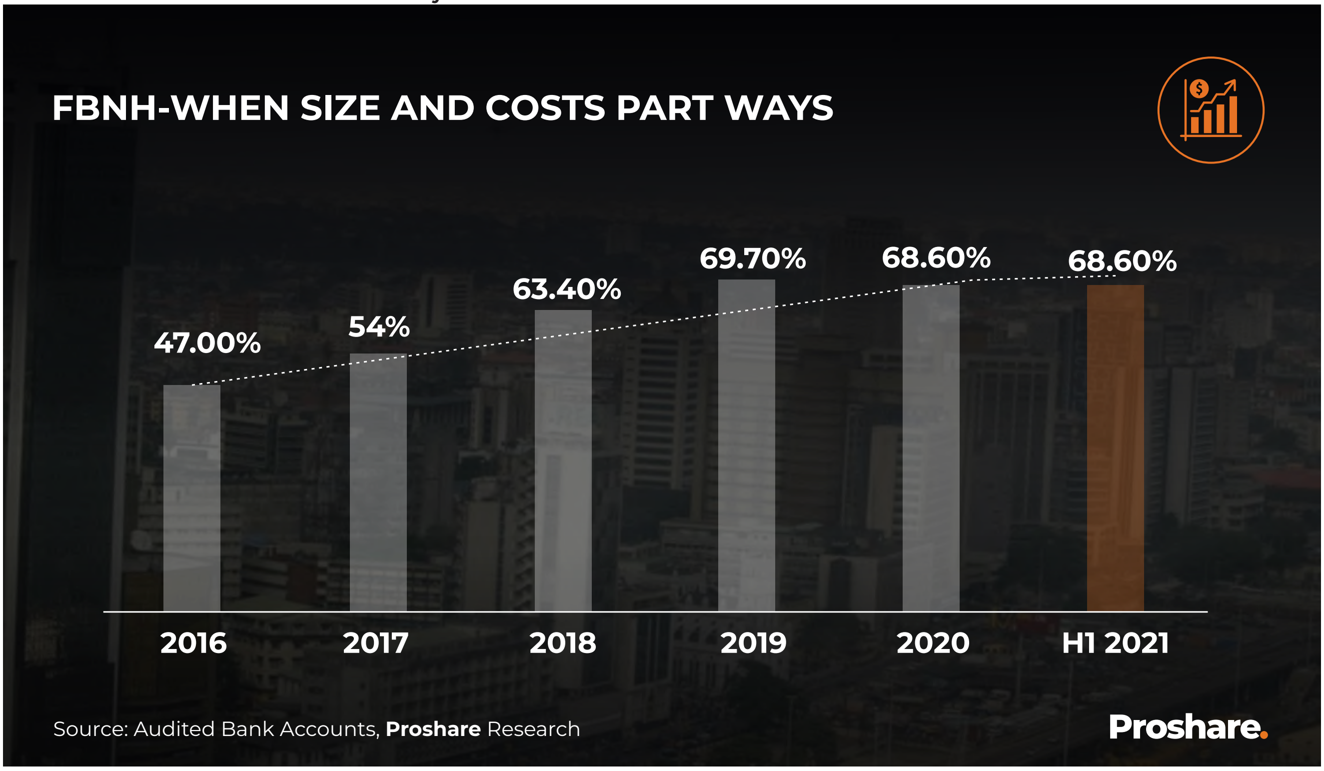
Coming to Terms with the Market

From the previous section, beyond the limitations to growth imposed by CBN's market regulation and the problems of operational size, will technology be enough to support bank profitability and sustainability? Not likely, say the report writers. While technology may enable smaller-sized banks to acquire more customers outside the traditional brick-and-mortar framework, economies of scale and scope still matter.

Larger banks have lower average operational costs than their smaller counterparts, giving them a generic strategic advantage. Banks like UBA, Zenith Bank, Access Bank, and ETI have lower cost-to-income ratios (CIRs) than Sterling Bank, FCMB, Fidelity, and Stanbic IBTC. An oddball is FBNH which has a CIR high (but falling) compared to other FUGAZE banks.

FBNH's cost-to-income ratio (CIR) has risen steadily in the last five years, rising from 47% in 2016 to 54% in 2017 before climbing to 63.4% in 2018. In 2019 the group struggled with operating costs as the CIR skipped to 69.7%. Since 2020 the bank's management has applied the breaks, with the bank's CIR stopping at 68.6% in 2020 (*see chart 5*).

Chart 5: **FBNH-When Size and Costs Part Ways**



Analysts have noted that a characteristic of large banks is that they muscle down on their costs to keep their CIR as close to 50% as possible. Proshare has developed a convenient but modifiable sustainability criterion involving a bank's CIR plus its cost of risk (CoR) plus its non-performing loan ratio (NPLR), the lower the combined ratio, the higher the prospects of operational sustainability, growth, and profitability. **Proshare's** research suggests that large banks would likely have ratios clustering around 0.50, while other banks would have ratios between 0.60 and 0.70. The higher the percentage, the more likely the bank would wander between tier 11 and tier 111 status.

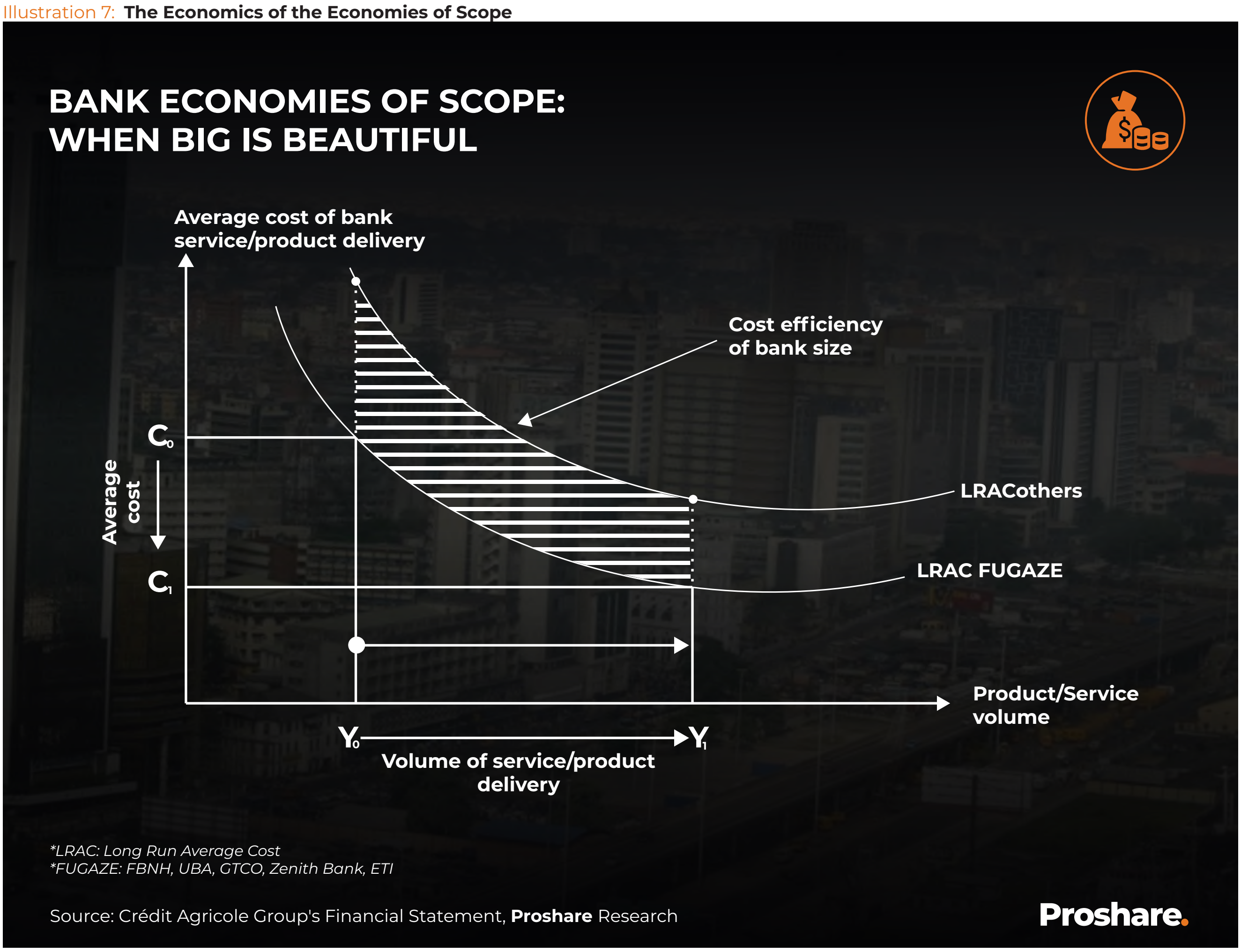
'Blue Oceaning' Tier 1

Improving economies of scope (lower CIRs) and higher economies of scale (larger LDRs) are just two matters of concern to tier 1 banks. Another major tier 1 bank issue is the creation of islands of uncontested or mildly contested competitive service or product advantage.

For Tier 1 banks to survive in the upper financial service delivery league, they must break away from the constraints of banking as a commodity to banking as a unique service delivery experience and a bespoke product delivery pipeline. Fighting in highly contested markets will thin down net interest margins and flatten bank profitability, harming corporate sustainability.

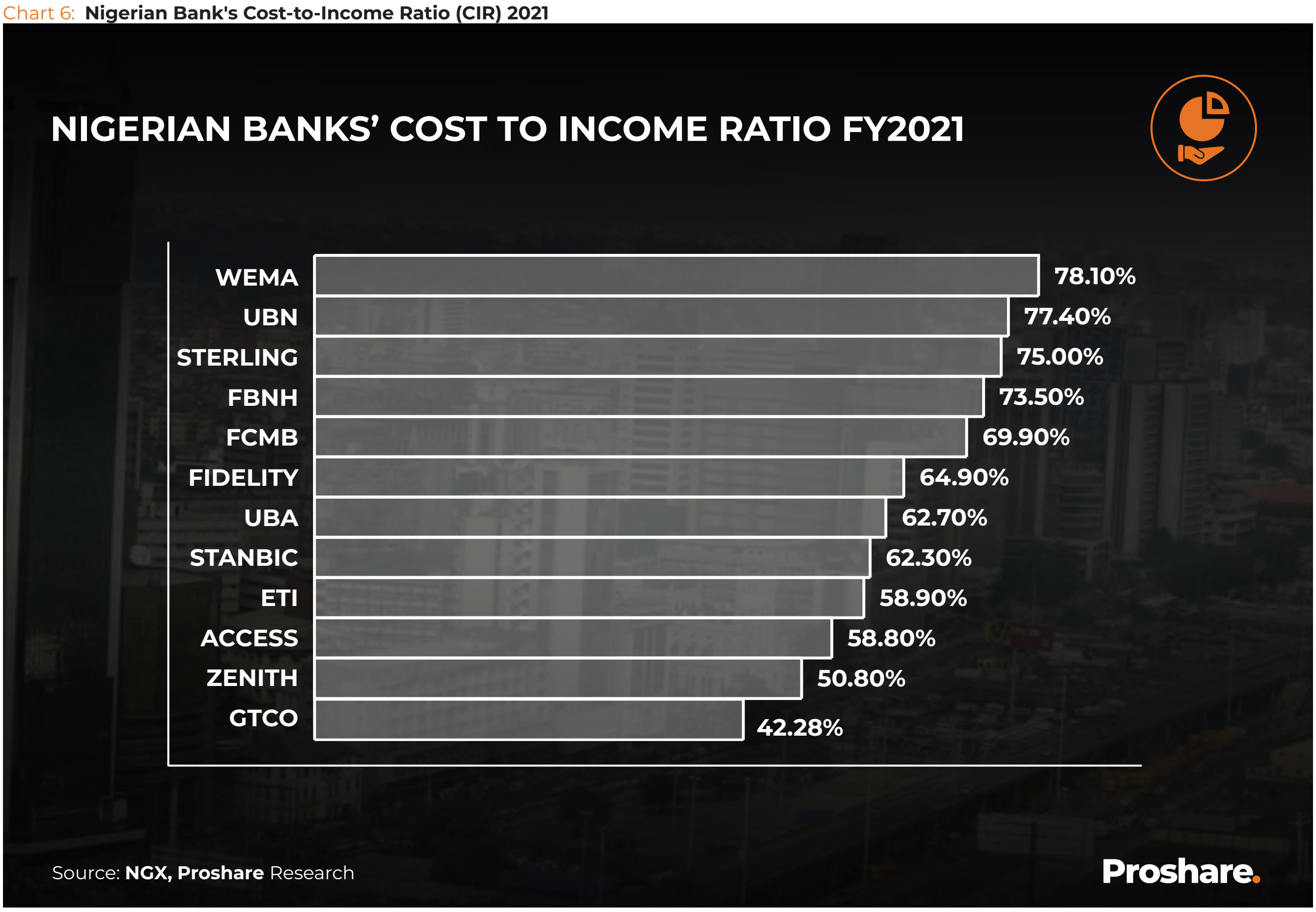
Analysts believe top-tier banks can think and act differently but must find inspiration, imagination, and execution. Differentiating between corporate service quality and product delivery standards will be the primary separator between banks that succeed and banks that do not, as decentralized ledger technology (Blockchain) becomes an industry disruptor. Big banks can use economies of scope to reduce short- and long-run average operating costs, but this is meaningful only if a rise in corporate earnings accompanies it. Proceeding into the emerging banking battlefield of the mid to late 2020s will be a struggle for dominance in self-created market opportunities. The so-called 'white spaces' created by banks with tier 1 status should keep their financing costs low and operating incomes competitive (*see illustration 7*).

Illustration 7: **The Economics of the Economies of Scope**



The long-run average cost curve (LRAC) of tier 1 banks traditionally lies below their smaller industry counterparts, giving them cost advantages at higher service quality or larger service volume. The lower costs could show up in lower bank cost-to-income ratios (CIRs) of the FUGAZE. However, the data evidence does not sit tidily with this assumption as some FUGAZE banks have higher CIRs than their smaller competitors (*see chart 6*).

Chart 6: **Nigerian Bank's Cost-to-Income Ratio (CIR) 2021**



Fidelity Bank Plc had, as of 9months 2021, a CIR of 66.40% (64.90% in FY2021), which was lower than FBNH's CIR of 73.50%. The higher a bank's CIR, the more likely it would fall into the tier 11 bank category.

Proshare researchers also discovered that generic strategies like product and process differentiation, product and process focus, and cost-containment are essential but not conclusive or exhaustive. The report's authors noted that the traditional competitive approaches need to be boosted by pre-empting customer journey experiences and providing solutions that rely more on machine learning and artificial intelligence (ML/AI) than on standard products and services in the average bank's brick-and-mortar toolbox.

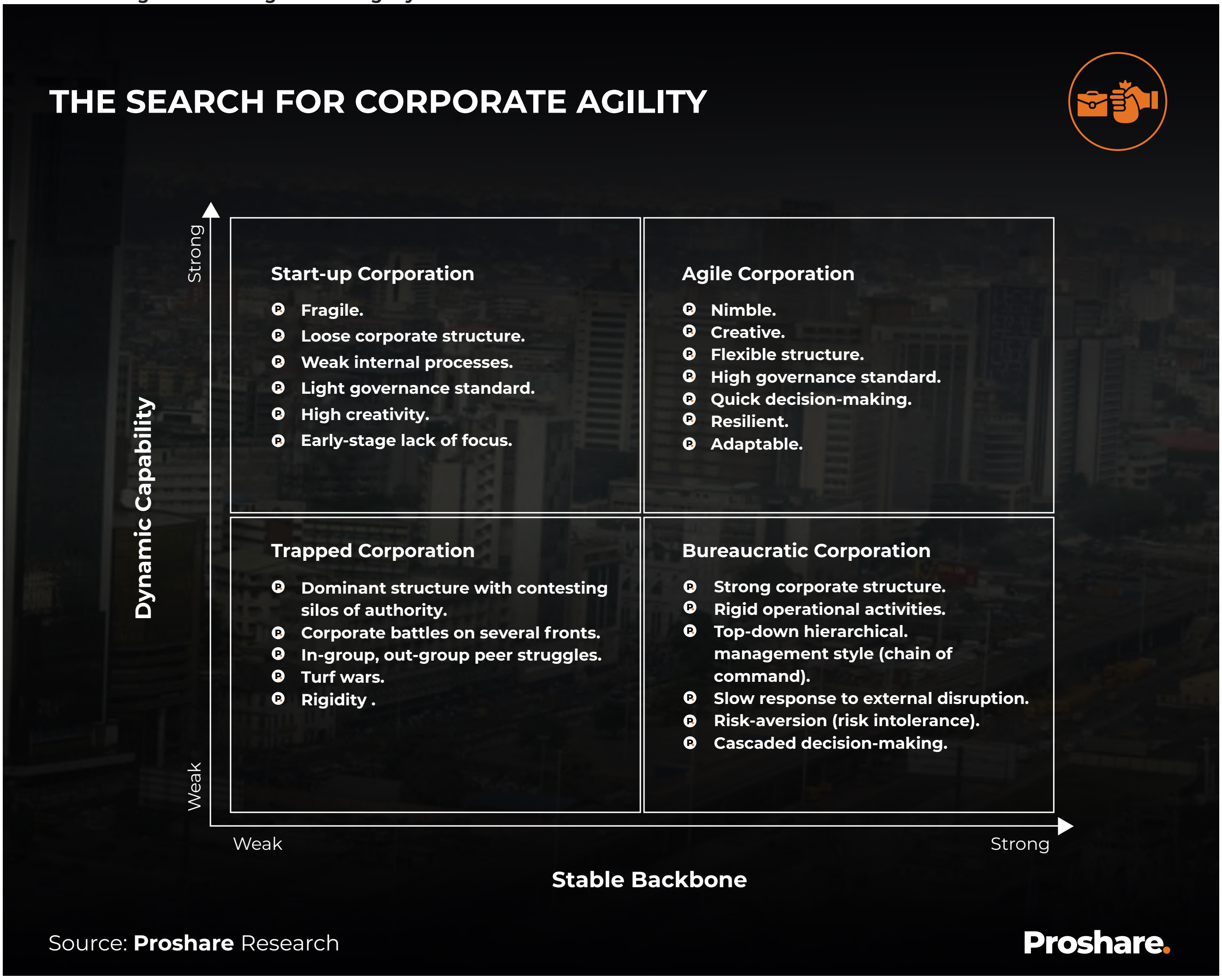
The writers noted that the banks need to stay ahead of individual and corporate needs and provide solutions that allow flexibility in either personal preferences or corporate aspirations. Bespoke structured finance facilities will become increasingly important as a service as corporate needs evolve. Banks would run head-to-head with the ascendancy of private and corporate banking as a service as organizations look for unique solutions that enable them to meet their customers' business objectives. In 2022 banks are expected to drive along specialized pathways more aggressively (*see illustration 8*).

Illustration 8: **Critical Trends to Look for in Nigeria's Banking Sector 2022**

For example, banks will need to service organizations with different characteristics, from start-ups to 'trapped' corporations, bureaucratic behemoths, and agile firms, large and small. The banks would need to assist companies in achieving their goals in an environment of volatility, uncertainty, complexity, and ambiguity (VUCA) (*see illustration 9*).

Illustration 9

Illustration 9: **Nigerian Banking Sector's Agility Matrix**



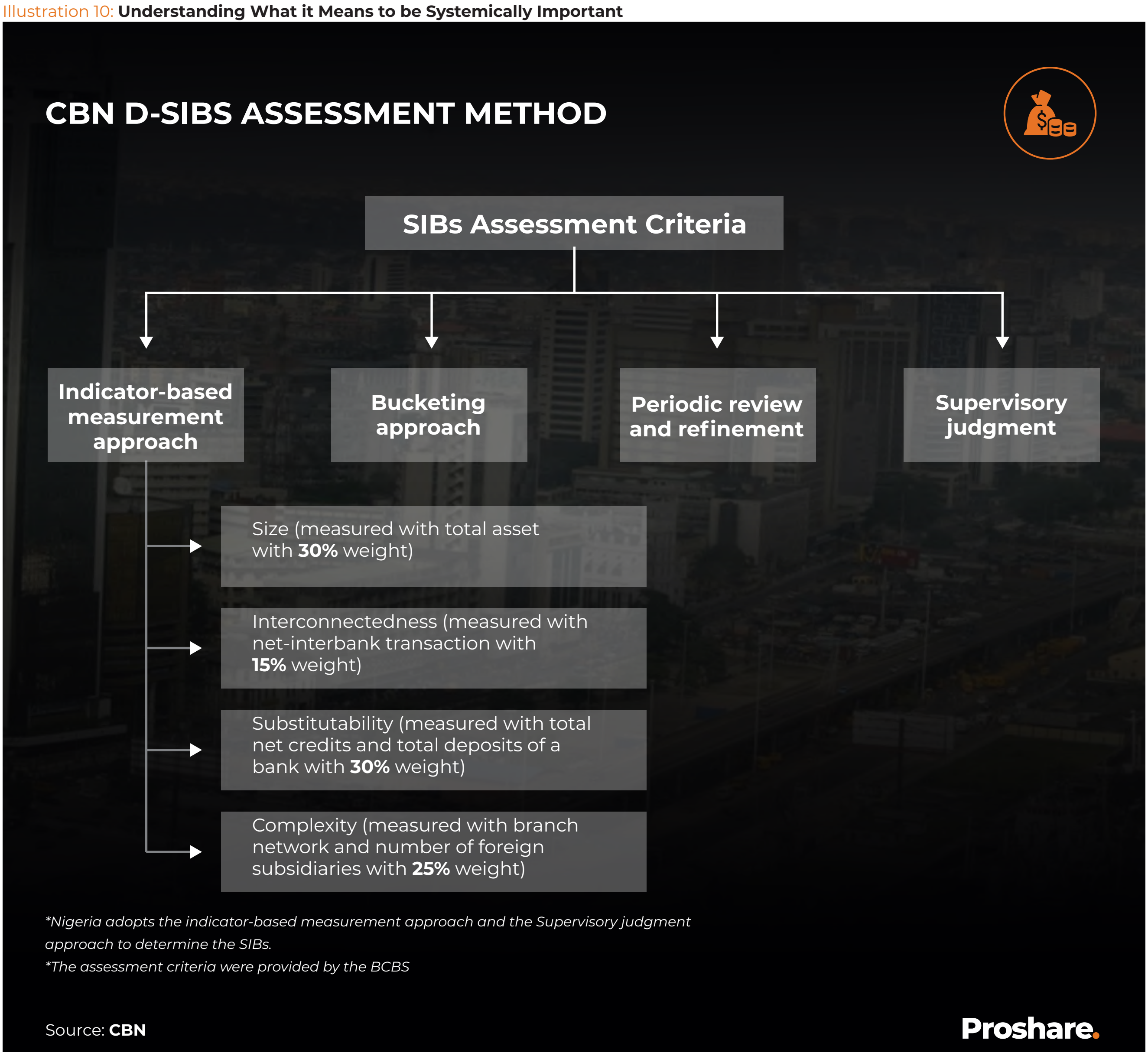
Big banks can easily cherry-pick customers as they assist them in developing the capacity to grow new competencies, stronger competitiveness, and tougher corporate governance frameworks. The large tier 1 bank also has access to international and domestic liquidity unavailable to banks in the lower tiers.

The researchers noted that tier 1 banks seem to provide more customer-specific and needs-driven products and services to solve problems than their smaller counterparts. They observed that economies of scope in the sector allow tier 1 lenders to offer solutions to intricate customer problems much easier than their lower-tiered competitors.

The analysts equally noted that there is no problem with the concept of a tier 1 bank but with its classification. The Central Bank of Nigeria (CBN) does not classify banks into tiers. The first time the concept of a tier 1 lending institution appeared in the local business lexicon was in a 2013 report of **Afrinvest**, an investment banking group previously run by Mr. Godwin Obaseki, the current governor of Edo State. The **Afrinvest framework** used four criteria to assess bank status. The criteria included asset size, capital adequacy ratio (CAR), liquidity, and non-performing loans (NPLs). Each criterion got a threshold metric with which banks were evaluated - above the threshold represented tier 1 and below tier 11.

In researching the objective criteria for bank tier 1 status, the analysts noted that the Nigerian banking regulator broadly classifies banks based on their scope of operation and systemic importance to the financial system. The well-known industry classification of banks into tier 1 and 2 is not a designation shared by the CBN but by market operators and the financial media. Notwithstanding, **Proshare** analysts' calibration of Nigerian banks using the CBN's assessment criteria revealed seven systemically important banks (SIBs). The SIBs were not necessarily first-tier banks, but all tier 1 banks were systemically important (*see illustration 10*).

Illustration 10: **Understanding What it Means to be Systemically Important**



Proshare's Bank Strength Index (PBSI) emerged from a pooled multiple regression analysis of bank operational indicators. The variables included total asset size, cost-to-income ratio (CIR), capital adequacy ratio (CAR), cost of risk ratio (CoR), and a few proxy management quality indicators, which set the framework for assessing which banks would fall into the different categories of tier 1, 2 and 3. The data for the Index comes from the year-ended December 2020 financial statements.

A fast and ready metric is the addition of the CIR, CoR, and NPLR, the higher the combined value, the lower a bank's rank. A bank with a combined score above 70.5% is classed as tier 11 and below 70.5% as tier 1. Applying the criteria and methodology to the NGX-listed banks in 2020, only six banks qualified as tier 1 banks; they were: GT Bank, StabicIBTC, Zenith Bank, UBA, Access Bank, and Fidelity Bank. Surprisingly, FBNH and ETI were out of the top tier category, and, therefore, the notion that all the FUGAZE banks' approximate tier 1 banks were called into question (*see table 5*).

Table 5: **The Fast and Ready Proshare Bank Strength Index (PBSI)**

THE FAST AND READY PROSHARE PBSI

Rank	Bank	CIR	COR	NPL	Score
1	GTB	38.24%	1.18%	6.39%	45.81%
2	Stanbic	47.40%		4.00%	51.40%
3	ZENITH	50.00%	1.50%	4.29%	55.79%
4	UBA	61.30%	0.90%	4.70%	66.90%
5	ACCESS	63.40%	1.80%	4.30%	69.50%
6	FIDELITY	65.10%	1.40%	3.80%	70.30%
7	FCMB	65.60%	1.78%	3.30%	70.68%
8	ETI	62.75%	1.85%	7.64%	72.24%
9	FBNH	68.60%	2.40%	7.70%	78.70%
10	UBN	75.40%		4.00%	79.40%
11	Sterling	77.40%	1.00%	1.90%	80.30%
12	WEMA	88.89%		4.70%	93.59%

Source: Result Presentation (2020), **Proshare** Research

Proshare.

Stanbic IBTC, UBN, and Wema Bank CoR data were unavailable during the report writing period but taking the median value of the CoR of banks listed on the NGX would ascribe a value of 1.5% to the three banks. By applying this adjustment, the positions of the top banks would be unchanged, but Sterling Bank would climb above UBN in ranking. UBN would drop to 11 while Sterling Bank would rise to 10. Using a 70.5 percentile would see the following banks fall into tier 1 territory: **GTCO, Stanbic IBTC, Zenith Bank, UBA, Access Bank**, and **Fidelity Bank** (*see table 6*).

Table 6: **The Modified Fast and Ready Proshare Bank Strength Index (PBSI)**

THE MODIFIED FAST AND READY PROSHARE PBSI

Rank	Bank	CIR	COR	NPL	Sum	Scores	Percentile	Tier
1	GTB	38.24%	1.18%	6.39%	45.81%	54.19%	100	1
2	Stanbic	47.40%	1.50%	4.00%	52.90%	47.10%	90.9	1
3	ZENITH	50.00%	1.50%	4.29%	55.79%	44.21%	81.8	1
4	UBA	61.30%	0.90%	4.70%	66.90%	33.10%	72.7	1
5	ACCESS	63.40%	1.80%	4.30%	69.50%	30.50%	63.6	1
6	FIDELITY	65.10%	1.40%	3.80%	70.30%	29.70%	54.5	1
7	FCMB	65.60%	1.78%	3.30%	70.68%	29.32%	45.4	2
8	ETI	62.75%	1.85%	7.64%	72.24%	27.76%	36.3	2
9	FBNH	68.60%	2.40%	7.70%	78.70%	21.30%	27.2	2
10	Sterling	77.40%	1.00%	1.90%	80.30%	19.70%	18.1	2
11	UBN	75.40%	1.50%	4.00%	80.90%	19.10%	9	2
12	WEMA	88.89%	1.50%	4.70%	95.09%	4.91%	0	2

**Banks' scores= 100 - sum of the ratios*
**Banks with scores in the 50th Percentile are regarded as Tier 1 banks.*

Source: Result Presentation (2020)

Proshare.

Section 1 of the report provides an understanding of the Global Banking Industry Structure and classification. The section also takes a helicopter view of the banking industry structure around the world, highlighting existing bank classifications, and their bases.

Section 2 looks at the evolution of the Nigerian banking ecosystem over the years and establishes the need for a regular review of the basis for tier-based bank classifications. The section reviews the need for strong banks and highlights their role in achieving financial inclusion and and supporting economic growth. The section also takes a look at the distinguishing features of the top Nigerian banks under the existing classification of banks. The section discusses the impact of technology in reshaping Nigeria's financial markets and how concepts such as "open banking" will become of major importance in the future.

Section 3 zeros in on the banking regulators classification and designation of banks, highlighting the major forms of classificating banks globally and domestically. It analyzes the CBN systemically important banks (SIBs) and looked at the context of their operations and the calibration of their primary performance data. It also looks at the new **Basel III** rules for a global perspective on bank capital classification.

Section 4 presents the Proshare Bank Strength Index PSBI as an intuitive and reasoned alternative to the existing tier-based classification The PSBI methodology is later used to analyze and rank Nigerian banks into tiers 1 and 2.

Section 5 concludes with a panoramic view of the report. It summarizes the research outcome and gives insight into the implications for the banking sector. The report calls for the review of the tier 1 categorization of domestic banks annually. It points out that changes could occur to fundamental indicators making some banks fall into the status while others fall out. According to the writers, using a fixed notion of tier 1 banks (FUGAZE) is inequitable and leads to poor resource allocation. Certain financing opportunities or access to funds depend on banks' categorization; the tier 1 institutions have options unavailable to lower-ranked institutions and, therefore, have a competitive funding advantage.

The section suggests that for fairness, equity, and financial resource efficiency, banks listed on the NGX should be categorized into tiers 1 and 2. The formalization of the bank category would clear up the uncertainty surrounding the use of the grouping by international institutions in determining their relationship with domestic Nigerian deposit-taking lenders.

The researchers observed that although a bank may be systemically important, it may not necessarily be a tier 1 bank. While the complexity of a bank's linkage may make it essential to the financial system, a bank with less integral associations may result in minor contagion in a crisis. In other words, a systemically important bank and a tier 1 bank may not necessarily mean the same thing.

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Introduction

The banking system stratification

Financial system stability has gone through several iterations. The CBN has adopted different banking models to grow the sector with minimal challenges to the quality of loan assets, overall liquidity and size of deposits.

From the universal banking framework adopted between 1999 and 2005, the bank decided to consolidate the industry and shrink the banking sector size from 89 deposit money institutions (DMBs) with a share capital of N2bn each to 25 institutions with a share capital of N25bn each. The goal was to create larger lenders that could fund big-ticket transactions like infrastructure, energy and the oil and gas sector. In 2005 no Nigerian bank was in Africa's top twenty (currently, no Nigerian bank appears in the top ten).

Before 1999 banks' classification was as follows:

- Commercial Banks.
- Merchant Banks.
- Mortgage Banks (S&Ls).
- Savings Banks.
- Specialized Banks.
- Finance Houses-Non-Bank Financial Institutions.
- Discount Houses- Non-Bank Financial Institutions.
- Bureau D'Changes - Non-Bank Financial Institutions.

In 1999/2000, banks collapsed into a universal banking structure. A single large bank carried out merchant and commercial banking activities with other businesses in retail financial services, real estate and foreign exchange markets.

By 2010/2015, the banking landscape changed again;
banks were restratified as follows:

- Commercial Banks
- Merchant Banks
- Digital Banks (Sun Trust, etc.)
- Specialized Banks (Bank of Industry, Bank of Agriculture, Infrastructure Bank, etc.)
- Payment Service Banks (MTN, Airtel Africa)
- Payment Service Vendors and Enablers (fintech: Firstmonie, Opay, Paystack, Jumia Pay,
- Flutterwave, etc.)
- Bureau D'Changes - Non-Bank Financial Institutions

Since 2015, the banking industry has mainly walked along the path of dominant commercial banks with a sprinkling of merchant and digital banks. Hanging to the coattails of commercial banks are payment solution enablers like flutterwave and paystack. In contrast, large banks like FBNH have pushed the frontiers of payment service delivery using point of sale (PoS) outlets in over 8000 locations nationwide. Unstructured Supplementary Service Data (USSD) use has also been a significant retail banking service delivery feature in the last decade.

Local banks have seen digital incomes as a significant proportion of net earnings rise in the last five years (*see table 7*).

Table 7: **Nigerian Banks 2021: Digital Income as a proportion of Gross Earnings**

E-BANKING: THE NEW CASH WALLET

Bank	Gross Earnings (N'bn)	E-Banking (N'bn)	Income From E-Banking As a % of Gross Earnings
FBNH	579.4	48.68	8.40%
Access	764.72	56.09	7.33%
UBA	620.4	44.25	7.13%
Unity Bank	42.71	2.64	6.18%
UBN	160.19	7.04	4.39%
FCMB	199.44	8.61	4.32%
Zenith	696.45	27.08	3.89%
Sterling	138.89	4.98	3.59%
ETI	841.14	29.45	3.50%
Wema	81.38	2.61	3.21%
GTB	455.23	11.77	2.59%
Fidelity	206.2	2.46	1.19%
Stanbic IBTC	234.45	2.74	1.17%

***Data as of FY2020**

Source: NGX, **Proshare** Research

Proshare.

Nigeria's banking stratification may not change much in the next decade. Still, the digital onslaught has begun, and digital service delivery channels to meet evolving customer service journeys will emerge as banks disappear, but banking grows into a metaverse of digital financial service satisfaction, or a digital payment, settlement, saving and credit hub.

Understanding Global Banking Industry Structure

The context of banking industry structure and classifications differ from country to country. Some countries classify banks according to their total assets, while others prefer to measure the size of loans and advances or high-quality liquid assets (HQLA). In some jurisdictions, banks classified as tiers 1 or 2 reflect the relative size of their tier 1 and 2 capital or tier 1 and 2 capitals as a proportion of their risk-weighted assets (RWA). For example, banks with tier 1 and 2 capitals of 8% of RWA are tier 1 banks, and those with tier 1 and 2 capitals to RWA less than 8% would be classified as tier 11. The Tier 1 banks would have tier 1 capital (cash and disclosed reserves) of at least 6% of RWA.

Banks have no tier or ranking beyond their capital size relative to RWA in countries outside Nigeria. The popular Nigerian characterization of tier 1 banks as FUGAZE (FBNH, UBA, GTCO, Access Holdings, Zenith Bank, and ETI) does not exist in other economies. Banks in Europe and the United States of America (USA) are classed as large or small based on the relative size of their assets and deposits and not a fuzzy notion of tier 1 and 2. The fact that other economies choose not to classify the tier their banks belong to does not make the concept wrong, but it calls for an industry-wide consensus on what a tier 1 and 2 bank means.

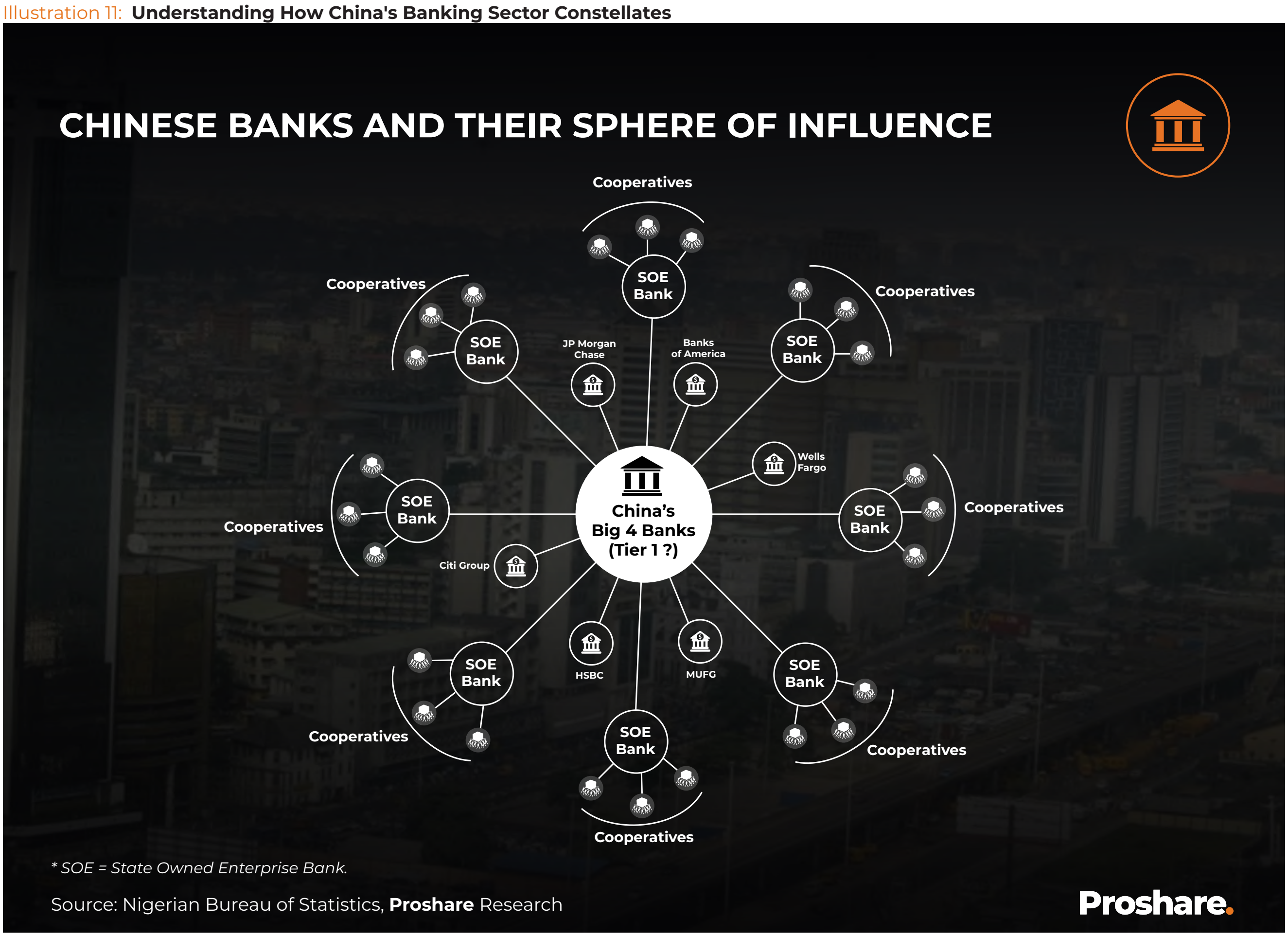
In the USA, banks have different charters, national and state. The respective charters outline the scope of banking activities and the locational dispersion of business activities ranging from within state borders to across state borders. However, since the Dodd-Frank legislation in 2010, these rigid lines have been blurred, and state banks can now have branches in other states but cannot use the words' national' or 'federal' in their name.

In China, banks are state-owned and considered state-owned enterprises (SOEs). China has had thousands of SOE banks in contemporary times, with many of them closed for mismanagement of loan portfolios and high non-performing credit assets. Rather than initiate a western-style loan recovery process, defaulting creditors in China (until recently) borrowed more money to replace loans that had gone bad. Today China has developed a financial system that revolves around four major banks, namely, the Bank of China (BOC), China Construction Bank (CCB), Industrial and Commercial Bank of China (ICBC), and Agricultural Bank of China (ABC).

These banks are 'tier 1' lending institutions surrounded by a cluster of smaller banks and cooperatives in rural communities. The four big banks are majority-owned by the state but run in-line with best global credit practices. The adoption of private sector management rules and governance oversight has helped the Chinese economy grow without the distraction of massive non-performing loans (NPLs), a vital feature of the Chinese financial sector until the mid-1990s. Loan losses have since escalated, but the bank managements have adopted aggressive loan recovery procedures and tightened their credit appraisal processes in recent years.

Since the early 2000s, foreign banks have found a second home in China, and a few of them have been considered foreign systemically important banks or FSIBs. These banks include JP Morgan Chase & Co. (JPM), Bank of America (BAC), Wells Fargo (WFC), Citi Group (Citi), HSBC, MUFG Bank. Within the present analysis, these banks would also be classified as tier 1 banks in China (*see illustration 11*).

Illustration 11: **Understanding How China's Banking Sector Constellates**



Countries around the world have banking structures that restrict the classification of banks to asset size, loan portfolio size, the size of customer deposit and the size of their capital stack with a sidebar consideration of the size of tier 1 capital as a proportion of the bank's total shareholders' funds.

Internationally, banks are moving from the traditional banking ecosystem to a universal arrangement by offering a more comprehensive range of services to their home and host countries (retail banking, investment banking, corporate banking, and wealth management to individual and corporate bodies).

Comparing their services to US banks, few of the banks happen to be universal, while many are still locked in a more restrictive traditional system.

KENYA: https://www.privacyshield.gov/article?id=Kenya-banking-systems#:~:text=Currently%20there%20are%2028%20domestic,the%20Post%20Office%20Savings%20Bank
AFRICA: https://assets.kpmg/content/dam/kpmg/ng/pdf/Africa-Banking-Industry.pdf
Europe: https://www.institutmontaigne.org/en/publications/reinventing-european-banking-sector
Ghana: https://www.scirp.org/journal/paperinformation.aspx?paperid=97053
USA: https://www.wisdomjobs.com/e-university/modern-banking-tutorial-372/bank-structure-and-regulation-in-the-usa-13301.html
https://www.researchgate.net/publication/5050557_The_role_of_retail_banking_in_the_US_banking_industry_risk_return_and_industry_structure

In Nigeria, the concept of tier 1 banks was a nomenclature initiated by an investment bank, Afrinvest, which decided to batch local banks into two principal categories reflecting the size of their assets and customer deposits. The classification stuck and became a convenient metric for bank comparison and decisions about business assessment.

The validity of the categorization and concerns about the static nature of banks considered to qualify as tier 1 and tier 11 (and even tier 111, which represent banks with negative shareholders' funds) formed the basis for detailed research on what a tier 1 and tier 11 bank means and who qualify to be part of each category.

The evolving narrative of the global financial service sector in the age of decentralized finance (defi) and open banking will add a spin to how capital intervenes in the marketplace of the future. With fintech, telcos and banks entering a phase of "co-opetition," the competitive global financial landscape will be a portrait in fifty shades of grey.

Global Banks in Terms of Balance Sheets Items

Asia

As Asia leads the world in growth, will its financial systems lead too?
-James P. Walsh

Four Asian banks led a global ranking of the top four banks by revenue, profit before tax (PBT), shareholders fund, asset size, and customer deposits as of June 2021, with total revenue of US$295.51bn. In 2021, the top three banks in Asia were the Industrial and Commercial Bank of China (ICBC), China Construction Bank, and Agricultural Bank of China. All three banks are domiciled in China and are state-owned.

The top five (5) largest banks by revenue in the world have combined revenue of US$325.16bn. The game is already stacked in favour of the Chinese banks as the Chinese government is heavily invested in these banks (*see chart 7*).

Illustration 11: **Understanding How China's Banking Sector Constellates**

Post COVID-19, the financial sector in Asia and throughout the world is facing new drivers of change. One that comes to mind is the need for the formation of new operating models, as well as the quick adaptation of distribution channels to a more digital environment. Customer behaviours vary per country, thus banks' responses to those environments must be tailored accordingly. In the new reality, banks' chances will vary by country, and those with operations in numerous nations will need to be flexible to succeed.

The overall profitability of the Asia Pacific banking sector slowed in 2020, primarily due to the compressed net interest margins and the rise in impairment charges. On average, the return on average assets (ROAA) was down from 0.73% in 2019 to 0.64% in 2020. Most banks maintained solid capital and liquidity positions despite the pandemic.

Industrial and Commercial Bank of China

The state-owned bank is listed both on the Shanghai Stock Exchange and The Stock Exchange of Hong Kong Limited with a credit rating of A and A1 by S & P and Moody respectively, the rating results are in the form of "long term foreign currency deposits rating". The market capitalization of the bank was US$254.43bn as of February 2022. The bank was ranked 1st place in the Global 2000 by Forbes and 1st place in the list of commercial banks of the Global 500 in Fortune for the eight consecutive years. In 2020, the Bank was able to manage the impact of the COVID-19 pandemic and changes in the external environment, net profit rose +1.4% in 2020 compared to the previous year. 9months 2021 figures also showed improvement both in profitability and asset quality. The non-Performing Loans ratio of the bank improved from 1.58% in 9months 2020 to 1.52% in 9months 2021. The operating income and profit before tax values were converted to US dollars using 6.32 CNY/US$.

Also, the bank is the largest bank globally by tier 1 capital which was US$495.58bn as of 9months 2021 recording a +9.03% rise from full year (FY) 2020 figures (*see table 8*)

Table 8: **ICBC Financial Highlights**

TOP 5 INTERNATIONAL BANKS BY NET REVENUE (US$'BN)

Profitability (%)	9M 2021	9M 2020	% Change
Return on average total assets	0.98	0.97	1.03%
Return on weighted average equity	11.81	11.65	1.37%
Cost-to-income ratio	22.23	21.81	1.93%
Operating Income (US$'m)	101,882	94,976	7.27%
Profit Before Tax	50,082	44,957	11.40%
Asset Quality (%)			
NPLs ratio	1.52	1.58	-3.80%
Allowance to NPLs	196.8	180.68	8.92%

Profitability (%)	9M 2021	9M 2020	% Change
Capital Adequacy (%)			
Core Tier 1 Capital Adequacy Ratio	13.14	13.18	-0.30%
Capital Adequacy Ratio	17.45	16.88	3.38%
US$'m	9M 2021	FY 2020	
Net core tier 1 capital	443,431	419,778	5.63%
Net tier 1 capital	495,584	454,555	9.03%
Net capital base	588,927	537,371	9.59%

Source: ICBC's Financial Statement, **Proshare** Research

China Construction Bank Corporation

China Construction Bank Corporation (CCB) is headquartered in Beijing and listed both on the Hong Kong Stock Exchange and Shanghai Stock Exchange with a market capitalization of US$186.14bn as of February 2022. The Construction bank operates in 15 countries including London and New York City and has an A, A1, and A long-term rating and a Stable outlook from S & P, Moody, and Fitch respectively. Its asset size reached US$4.45trn (CNY28.13trn) as stated in its 9months 2021 financial statement. The 9months 2021 result also reveals that while the bank's bottom-line earnings and asset quality improved, the cost-to-income ratio also edged up in the period (*see table 9*).

Table 9: **CCBC's Financial Highlights**

CCBC 9M 2021: FINANCIAL HIGHLIGHTS

Profitability (%)	9M 2021	9M 2020	% Change
Annualised return on average assets	1.07	1.03	3.88%
Annualised return on average equity	13.15	12.53	4.95%
Cost-to-income ratio	23.09	22.33	3.40%
Operating Income (US$'m)	90,592	84,803	6.83%
Profit Before Tax	46,329	39,540	17.17%
Asset Quality (%)			
NPLs ratio	1.51	1.53	-1.31%
Allowance to NPLs	228.55	217.52	5.07%

Capital Adequacy (%)			
Core Tier 1 Capital Adequacy Ratio	13.96	13.86	0.72%
Capital Adequacy Ratio	17.25	16.88	2.19%
US$'m	**9M 2021**	**FY 2020**	
Common Equity Tier 1 capital after regulatory adjustments	381,313	357,824	6.56%
Tier 1 capital after regulatory adjustments	397,146	373,658	6.29%
Total capital after regulatory adjustments	490,831	448,209	9.51%
Risk-weighted assets	2,845,467	,627,309	8.30%

Source: CCBC's Financial Statement, **Proshare** Research

Agricultural Bank of China

The Chinese-based commercial bank, formerly known as AgBank is one of the "Big Four" owned by the state. The Bank has over 300m retail customers and 2.7m corporate clients, the bank went public in 2010 and had the world's biggest-ever initial public offering at the time, listed on both the Shanghai Stock Exchange and the Hong Kong Stock Exchange. The Bank operates mainly through four business segments, the Corporate Finance segment, the Personal Finance segment, the Treasury segment, and the Asset Management segment.

As of February 2022, the Bank had a market capitalization of US$165.85bn, its total asset for 9months 2021 result stood at US$4.59trn (CNY28.99trn). The Agricultural Bank also improved its asset quality in the period to 1.48% and the cost-to-income ratio fell by -1.43% to 25.58% (*see table 10*).

Table 10: **AgBank's 9M 2021: Financial Highlights**

AgBANK 9M 2021: FINANCIAL HIGHLIGHTS

Profitability (%)	9M 2021	9M 2020	% Change
Return on weighted average net assets	12.17	11.81	3.05%
Cost-to-income ratio	25.58	25.95	-1.43%
Operating Income (US$'m)	86,374	78,989	9.35%
Profit Before Tax	36,597	31,617	15.75%
Asset Quality (%)			
NPLs ratio	1.48	1.52	-2.63%

Profitability (%)	9M 2021	9M 2020	% Change
Allowance to NPLs	288.04	272.44	5.73%
Capital Adequacy (%)			
Core Tier 1 Capital Adequacy Ratio	12.98	12.76	1.72%
Capital Adequacy Ratio	16.70	16.54	0.97%
US$'m	9M 2021	FY 2020	
Tier 1 capital, net	365,067	339,104	7.66%
Total capital, net	469,554	439,637	6.80%

Source: AgBank's Financial Statement, **Proshare** Research

Proshare.

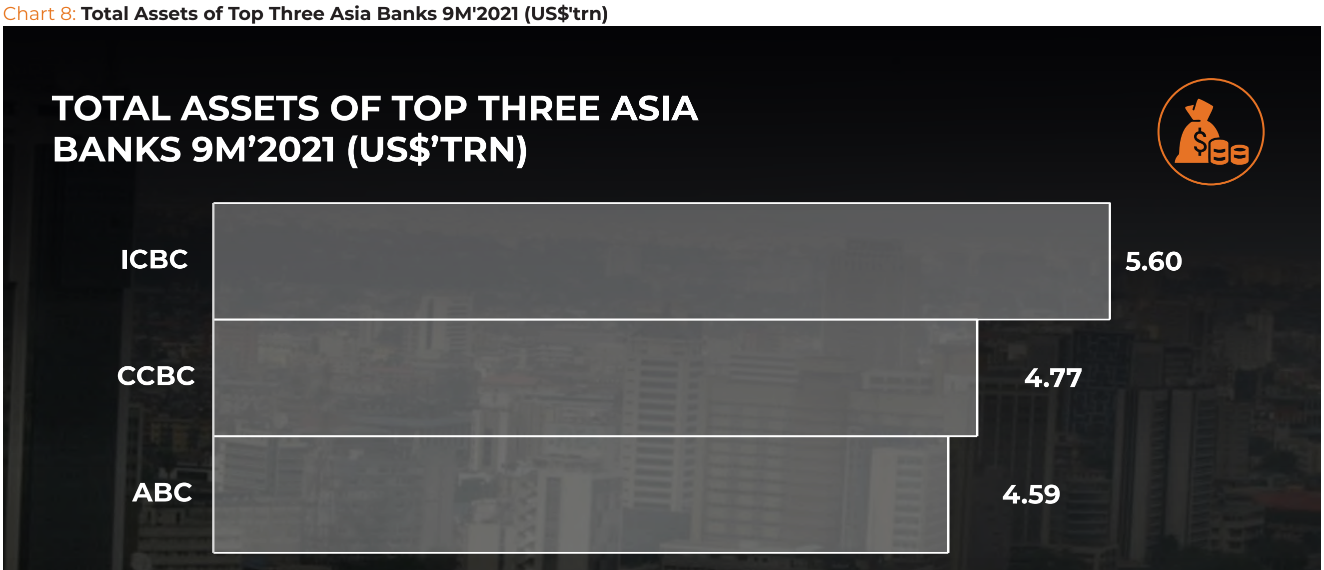
The Financial Position

Total Assets

The total asset of the three top banks in the Asia economy grew considerably in 2021. With an average growth rate of +6.67%. The Industrial and Commercial Bank of China had the largest value in the two periods (2020 and 2021) with a smaller growth rate of +5.86% among its peers. The marginal growth was because of a -33.74% decrease in dues from bank and other financial institutions, -30.01% fall in derivatives assets, and -18.90% decline in the reverse purchase agreement.

China Construction Bank the largest bank in the world by assets size had a growth rate of +6.71% in its total assets in the period. The total asset of the bank grew from US$4.47trn to US$4.77trn. Agricultural Bank of China ranked third in total assets with a growth rate of +6.50% (*see chart 8*).

Chart 8: **Total Assets of Top Three Asia Banks 9M'2021 (US$'trn)**



Source: Bank's Financial Statement, **Proshare** Research

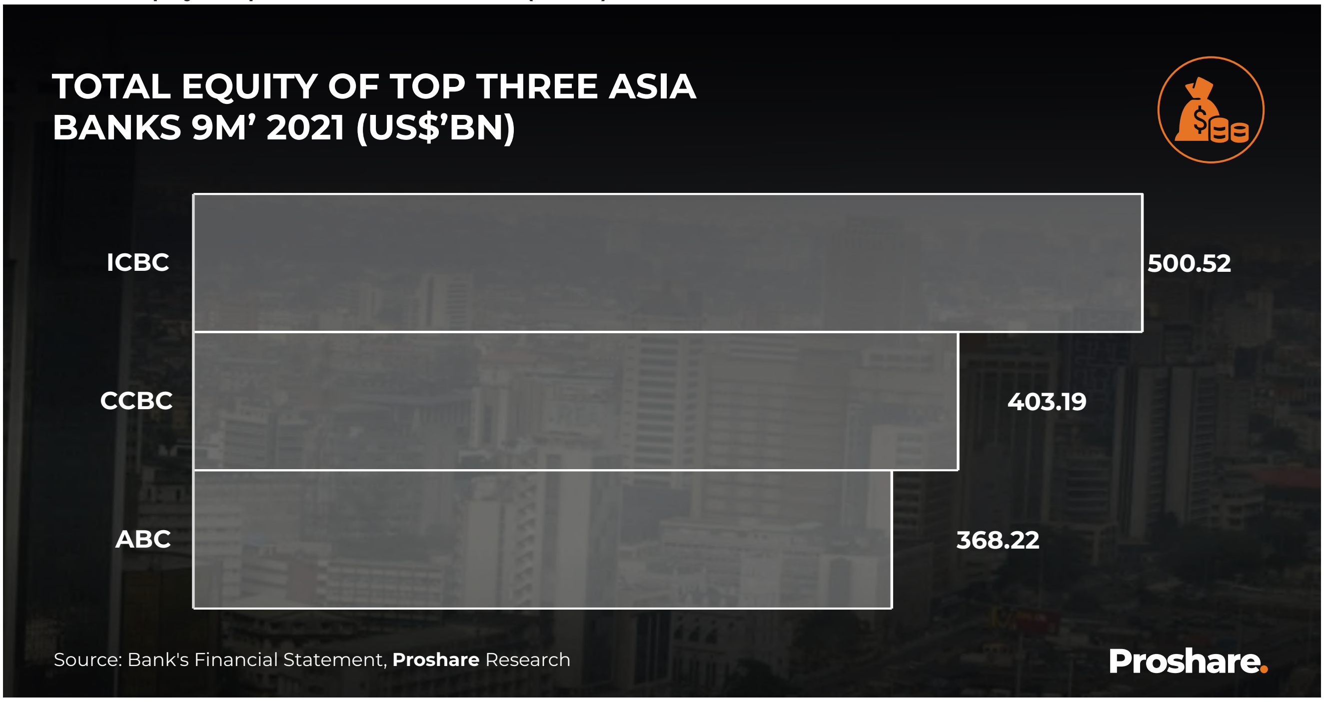
Proshare.

Shareholders Fund

With a growth rate of +12.09%, The Industrial and Commercial Bank of China had the highest shareholder fund of US$500.52bn in 9month 2021 compared to US$446.53bn recorded in the previous year. The increase was a result of +10.90% growth in retained earnings, +10.13% change in reserves, and a +45.64% rise in other equity instruments.

China construction bank ranked second both in value and percentage growth. The bank Shareholders' funds stood at US$ 403.19bn in 9month 2021 with a percentage change of +6.65%. Agricultural Bank of China which ranked third in shareholders fund had the second-highest growth rate +7.52% in the period (*see chart 9*).

Chart 9: **Total Equity of Top Three Asia Banks 9M' 2021 (US$'bn)**

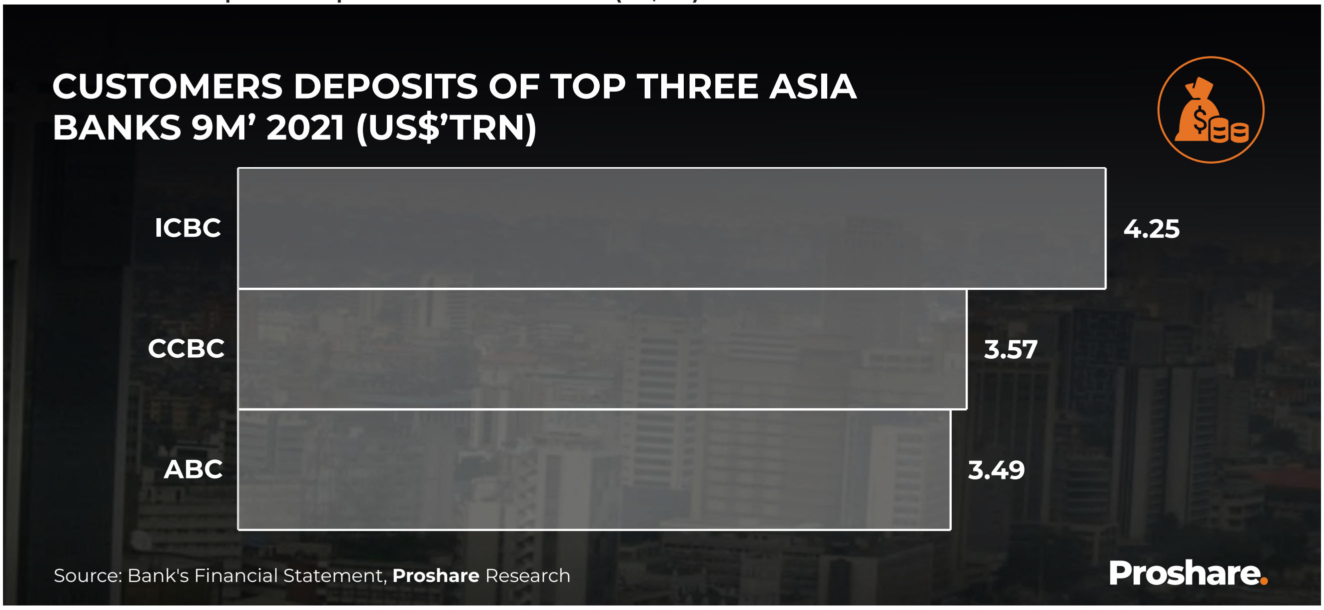


Customers Deposits

Industrial and Commercial Bank of China also had the highest customer deposit of US$4.25trn in 9month 2021 and grew by +5.02%. While China Construction Bank had the highest growth rate of +7.85% and was the second-largest bank by customers' deposit. Agricultural Bank drew in US$3.49trn as customers deposit with a growth rate of +6.40% (*see chart 10*).

Chart 10

Chart 10: **Customers Deposits of Top Three Asia Banks 9M' 2021 (US$'trn)**

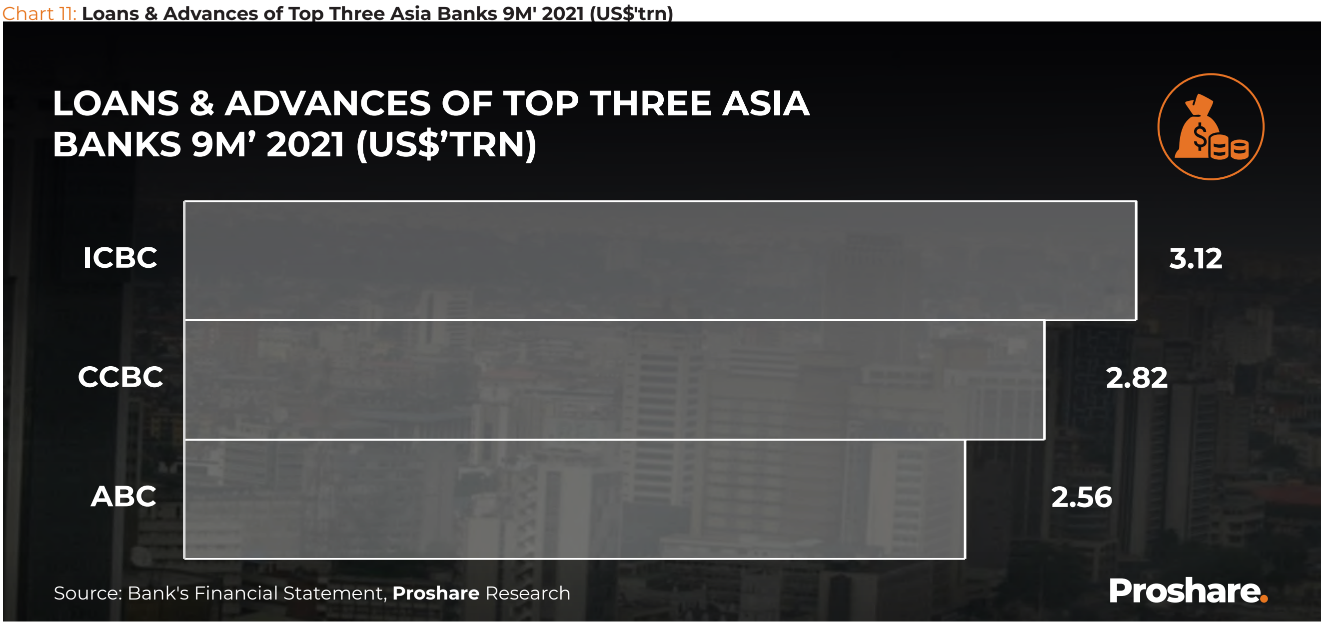


Loans And Advances

Agricultural Bank of China is the third-largest bank in the world by loans and advances and recorded the highest growth rate of +12.78% amongst its peers, with a value of US$ 2.56bn in 9month 2021. China Construction Bank's had the second-highest growth rate in loans and advances, which was up by +10.59%.

The industrial and commercial bank of China with the highest loans and advances had the lowest growth rate of +9.86% in 9month 2021 (*see chart 11*).

Chart 11: **Loans & Advances of Top Three Asia Banks 9M' 2021 (US$'trn)**



Europe

"Banking is very good business if you don't do anything dumb" – ***Warren Buffett***

European banks have been in a perplexing predicament since the Great Financial and Sovereign Debt Crisis. Because banking is a unique industry, this paradox presents a problem not only for financial institutions but also for Europe's economic and political standing. To address this challenge and chart a path to long-term growth, banks will have to reinvent themselves, and policymakers will have to take decisive action.

Although the industry was severely destabilized by the financial and sovereign debt crises, European banks have cleaned up their balance sheets, aided by new international prudential rules implemented in Basel. They're better capitalized, more solvent, and have greater liquidity presently. According to data, European banks' equity increased by 65% between 2008 and 2020.
For large banks, the balance sheet total and quality of the asset is a crucial indicators of how well a bank is doing. The Analyst looks at both the financial position and statement of performance of the top three banks in Europe, BNP Paribas SA, France, HSBC Holding, UK, and Crédit Agricole Group, France ranked the largest bank in the continent.

BNP Paribas

Banque Nationale de Paris (BNP) and Paribas is a French international banking group and a top-tier bank in Europe. The bank became one of the largest banks in the Eurozone following the 2008 financial crisis. It is considered a systematically important bank by the Financial Stability Board. The French bank is listed on the Paris Stock Exchange with a market capitalization of US$73.00bn as of February 2021. BNP Paribas holds key positions in three operating divisions, Commercial, Personal Banking and Services, Investment and Protection Services, and Corporate & Institutional Banking.

The full-year 2021 results show that the Bank recorded a total asset of US$2.37trn which rose by +5.87% from 2020 levels (*see table 11*). In 2021, BNP Paribas had a dividend payout ratio of 60%, 50% in cash, and 10% in share buyback.

Table 11: **BNP Paribas Financial Highlights**

BNP PARIBAS FY2021: FINANCIAL HIGHLIGHTS

Profitability (%)	9M 2021	9M 2020	% Change
Revenue	39,425	37,639	4.75%
Operating Income	10,203	7,098	43.74%
Net Income	8,901	6,680	33.25%
Total Assets	2,373,373	2,241,884	5.87%
Total Equity	110,367	105,720	4.40%
%			

Profitability (%)	9M 2021	9M 2020	% Change
Total Capital Ratio	16.40%	16.40%	0.00%
Tier 1 Ratio	14.00%	14.20%	-1.41%
Common Equity Tier 1 Ratio	12.90%	12.80%	0.78%
ROE	8.90%	6.70%	32.84%

Source: BNP Paribas' Financial Statement, **Proshare** Research

HSBC Holdings Plc

HSBC Holdings is a British multinational financial services company and the second-largest bank in Europe, present in over 64 countries. the bank is listed both on the Hong Kong Stock Exchange and the London Stock Exchange. It has secondary listings on the New York Stock Exchange and the Bermuda Stock Exchange. As of February, the market cap of the Holdings was US$134.67bn and its total assets at the end of 2021 stood at US$2.96trn.

The financial statement of the result as of 2021 shows significant improvement as the COVID-19 pandemic had a severe impact on the performance of the bank in 2020. Profit before tax rose year-on-year (Y-on-Y) by +112.98% and the return on equity of residual owners of the bank rose Y-on-Y by +208.70% to 7.1% from 2.3% in 2020. The equity side of the capital structure of the company at all levels reduced during the period with tier 1 capital recording the largest decline of -11.36% to US$21.49bn (*see table 12*).

Table 12: **HSBC Holdings FY2021: Financial Highlights**

HSBC HOLDING PLC FY2021: FINANCIAL HIGHLIGHTS

Profitability (%)	2021	2020	% Change
Return on average tangible equity	8.3	3.1	167.74%
Return on average ordinary shareholders equity	7.1	2.3	208.70%
Cost Efficiency Ratio	69.9	68.30	2.34%
Net Interest Margin	1.2	1.32	-9.09%
Operating Income (US$'m)	63,940	63,074	1.37%
Profit Before Tax	18,906	8,877	112.98%
Capital Adequacy (%)			
Tier 1 Capital Adequacy Ratio	15.80	15.9	-0.63%

Profitability (%)	2021	2020	% Change
Total Capital Ratio	21.20	21.5	-1.40%
US$'m	2021	2020	
Common Equity Tier 1 Capital	132,565	136,050	-2.56%
Additional Tier Capital	23,727	24,123	-1.64%
Tier 2 Capital	21,494	24,250	-11.36%
Total Regulatory Capital	177,786	184,423	-3.60%

Source: HSBC Holdings' Financial Statement, **Proshare** Research

Crédit Agricole Group

Sometimes called the Green Bank due to its historical ties to farming, the group consists of 39 regional banks and is listed through Credit Agricole S.A, an intermediate holding company on Euronext Paris. With a market capitalization of US$35.87bn, the bank has about 51 million customers in France and over 11,000 branches worldwide. The bank is considered a systematically important bank by the Financial Stability Board.

Revenues for 2021 were up Y-on-Y by +7.92% while gross operating income rose Y-on-Y +12.26%. The cost of risk and cost-to-income ratio improved in the period by 49.36% and 2.57% respectively (*see table 13*).

Table 13: **Crédit Agricole Group FY2021: Financial Highlights**

CRÉDIT AGRICOLE GROUP FY2021: FINANCIAL HIGHLIGHTS

US$'m	2021	2020	% Change
Revenues	39,924	36,995	7.92%
Gross operating income	15,013	13,374	12.26%
Cost of risk	2,010	3,968	-49.36%
Income before tax	13,410	9,816	36.61%
Cost/Income ratio	60.60%	62.20%	-2.57%
NPL	2.00%		

Source: Crédit Agricole Group's Financial Statement, **Proshare** Research

Financial Position

Total Assets

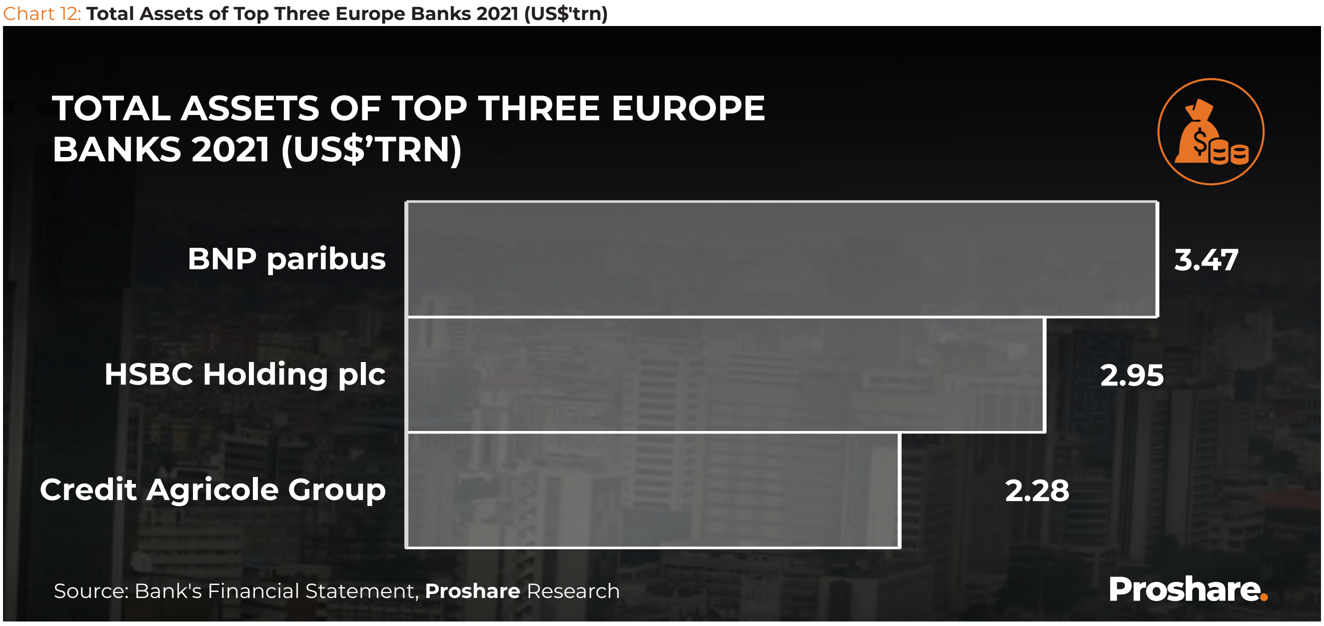
The three top banks in Europe recorded an average growth rate of +3.78% in 2021. BNP Paribus Bank had the largest total asset with the highest percentage growth rate of +6.12%. The bank had a total asset of US$ 3.4trn. HSBC Holding PLC came second with a US$2.95trn as total assets, while Credit Agricole Bank Group ranked as the third-largest bank with US$2.28trn in total asset.

BNP Paribus Bank recorded the highest growth rate of +6.12%. the growth was supported by a +12.69% in cash and balances with the central bank, +14.42% increase in Securities, and +5.81% growth in financial investment in insurance activities.

The growth in Credit Agricole Bank was a result of +22.39% in cash and cash balance with the central bank, +37.21 increase in current and deferred tax assets, and +8.23% increase in loans and receivables due from credit institutions.

While -36.02% decline in derivatives resulted in to -1.01% decrease in the total assets of HSBC Holding Bank (*see chart 12*).

Chart 12: **Total Assets of Top Three Europe Banks 2021 (US$'trn)**

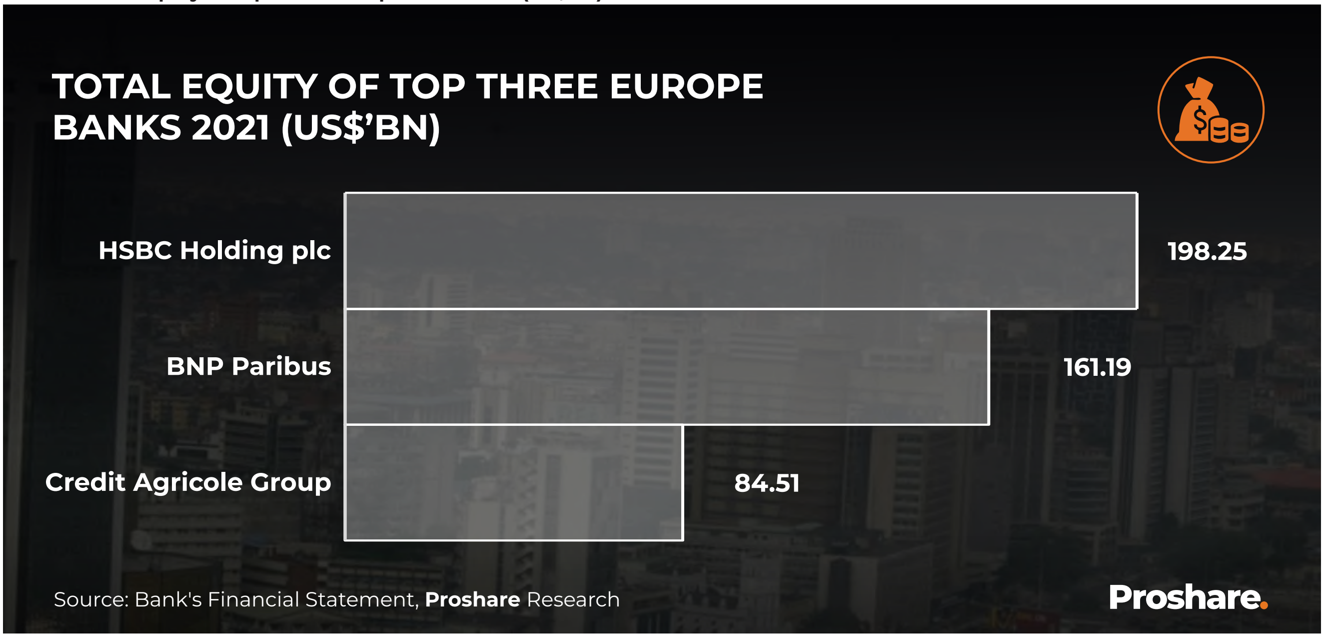


Shareholders Fund

With an average growth rate of +3.30% shareholders' fund, HSBC Holding PLC had the largest shareholder fund in the two periods. 2021, the bank shareholders fund grew at a margin of +0.92% to US$198.25bn. BNP Paribus Bank shareholders fund grew by +4.39% to 161.19bn; the growth was supported by a +3.86% rise in retained earnings and net income and a +1.56% increase in minority shareholders' interest.

With the lowest value of US$84.51bn in shareholders fund, Credit Agricole Group reported the highest growth rate of +4.59% (*see chart 13*).

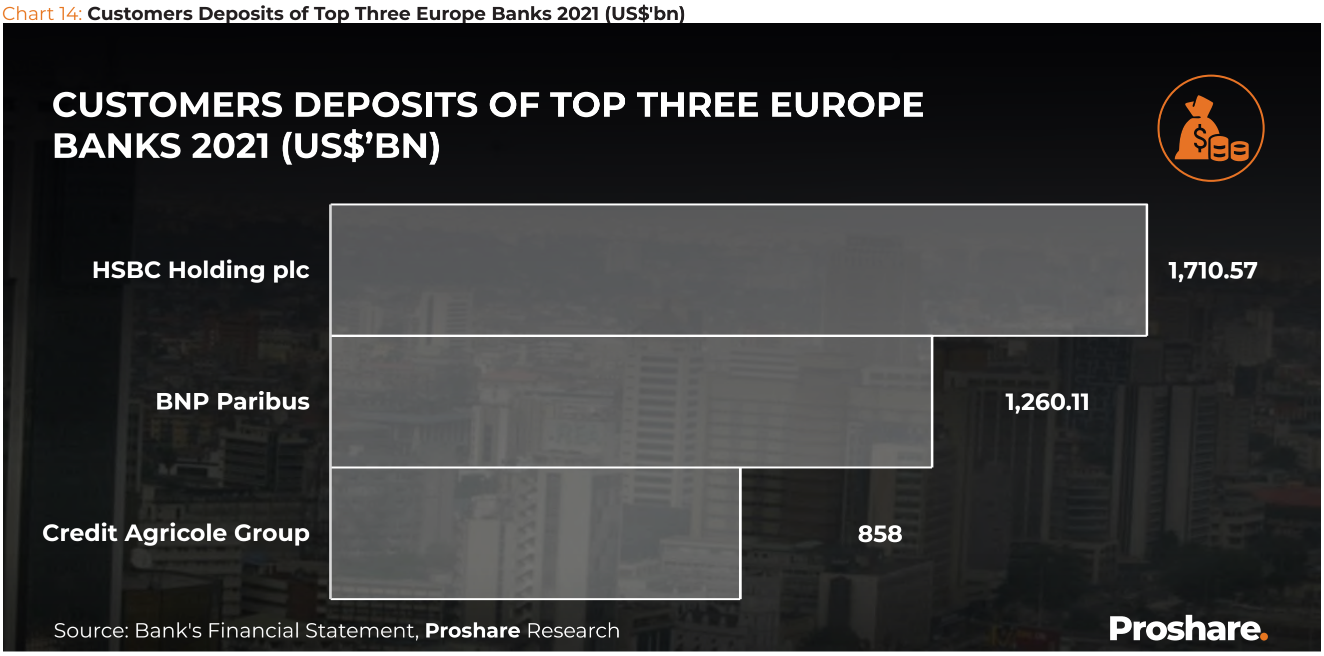
Chart 13: **Total Equity of Top Three Europe Banks 2021 (US$'bn).**



Customers Deposits

Credit Agricole bank which had the lowest value of US$858bn in customers deposit attained the highest growth of +8.47%, HSBC Holding PLC came second with a percentage growth of +4.13% and a value of US$1.7trn in customers deposit, BNP Paribus appeared third on the percentage growth list stating a growth rate of +1.77% and a value of US$1.26trn in customers deposit (*see chart 14*).

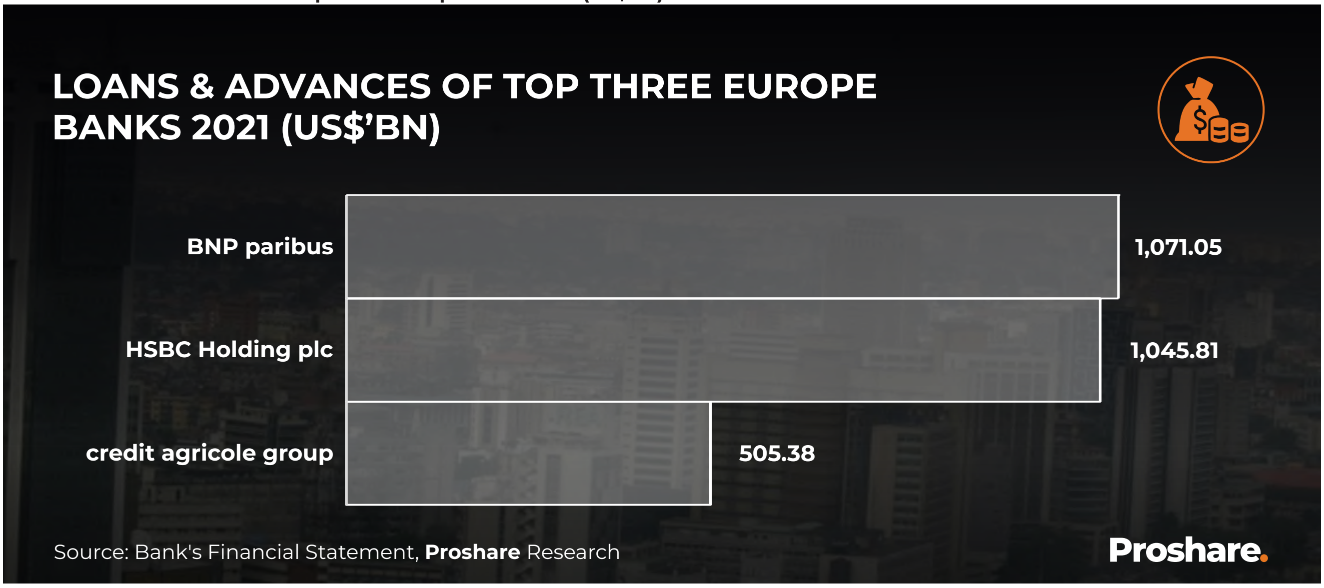
Chart 14: **Customers Deposits of Top Three Europe Banks 2021 (US$'bn)**



Loans And Advances

BNP Paribus Bank had the highest value of loans and advances in the two-period with the lowest growth rate of +0.55%, HSBC Holding Plc, then came second both in value and the percentage growth of +0.75% resulting in US$1.04trn. Credit Agricole Group recorded the highest growth of +13.30% with the lowest value of US$505.38bn in loans and advances (*see chart 15*).

Chart 15: **Loans & Advances of Top Three Europe Banks 2021 (US$'bn)**



United States of America

"Progress is cumulative in science and engineering, but cyclical in finance"- ***James Grant***

The United States banking industry was in the depths of the global financial crisis more than a decade ago. Following the injection of billions of dollars in new capital, US banks have returned to a more sustainable path and increased liquidity. After another systemic shock caused by the COVID-19 pandemic, banks saw no extraordinary losses, major capital calls, or 'white knight' acquisitions this time. Although the pandemic did not have the expected negative financial consequences for the global banking industry, it did have numerous other consequences. Digital banking accelerated, cash use decreased, savings increased, remote working became a part of life, and customers and regulators are more concerned about the environment and sustainability. Now, banks are adapting, adopting, and thinking more about ecosystem expansion.

The U.S is dominated by four large banks, JPMorgan Chase, Bank of America, Wells Fargo, and Citigroup. These banks are not only leading banks on a domestic scale but are also among the largest banks in the world, with JPMorgan Chase being the fifth-largest bank by customer deposit, total assets, and shareholder's funds in the world.

JPMorgan Chase

Considered to be a universal bank and a custodian bank, it is a major provider of various investment banking and financial services. The bank is majorly exposed to the fossil fuel industry, and it is considered the largest lender to the industry. JPMorgan Chase is listed on the New York Stock Exchange with a market capitalization of US$391.68bn and as of fourth-quarter 2021, the bank recorded a US$3.74trn in total assets (*see table 14*).

Table 14: **JPMorgan Chase Financial Highlights**

JPMORGAN CHASE Q42021: FINANCIAL HIGHLIGHTS

Profitability (%)	2021	2020	% Change
ROTCE	19%	24%	-20.83%
Return on Equity	16%	19%	-15.79%
Credit Cost	-9.30	17.5	-153.14%
Revenue (US$'bn)	29.26	29.34	-0.27%
Net Income (US$'bn)	10.39	12.14	-14.42%
Capital Adequacy (%)			
Common Equity Tier 1 Capital Ratio - Standardized	13.0%	13.10%	-0.76%
US$'bn	2021	2020	
Common Equity Tier 1	214	205	4.39%
Common Equity Tier 1 Capital Ratio - Advanced	13.8	13.8	0.00%

Source: JPMorgan Chase Q4 Financial Statement, **Proshare** Research

Proshare.

Bank of America Corporation

With an asset size of US$3.17trn as of Q4 2021, the bank ranks as the second-largest bank in the US. According to Data by the Bank, it serves at least 10.7% of all American deposits, its core financial activities revolve around commercial banking, wealth management, and investment banking. Bank of America is listed on the New York Stock Exchange and has a market capitalization of US$334.85bn as of 15th March 2022.

The latest result of the bank show improvement in bottom-line earnings and investors' returns. However, the core capital of the bank fell in the quarter both in value and ratio (*see table 15*).

Table 15: **Bank of America Financial Highlights**

BANK OF AMERICA Q42021: FINANCIAL HIGHLIGHTS

	Q4 2021	Q4 2020	% Change
Net income (US$'bn)	7.00	5.50	27.27%
Return on average assets	0.88%	0.78%	12.82%
Return on average common shareholders' equity	10.90	8.40	29.76%

	Q4 2021	Q4 2020	% Change
Return on average tangible common shareholders' equity	15.20	11.70	29.91%
Efficiency ratio	67.00	69.00	-2.90%
Capital & Liquidity			
Common equity ratio	7.70%	8.80%	-12.50%
Common shareholders' equity (US$'bn)	245.0	248.0	-1.21%
Tangible common equity ratio	5.60%	6.50%	-13.85%
Tangible common shareholders' equity	175.0	178.0	-1.69%
CET1 ratio	12.30%	12.90%	-4.65%
Common equity tier 1 capital (CET1)	172.0	177.0	-2.82%

Source: Bank of America Q4 Financial Statement, **Proshare** Research

Proshare.

Wells Fargo

Wells Fargo operates in 35 countries with over 70 million customers globally and is considered a systematically important financial institution by the Financial Stability Board. The bank is listed on the New York Stock Exchange with a market CAP of US$189.92bn and total assets at US$1.96trn in 2021.

The bank's Q4 2021 result shows that total revenue rose by +10.78%, net income had a more percentage growth, and it increased by +86.08% against Q4 2020 figures. Return on equity improved by +93.94% on the back of the significant growth in net income (*see table 16*).

Table 16: **Wells Fargo Q42021: Financial Highlights**

WELLS FARGO Q42021: FINANCIAL HIGHLIGHTS

	Q4 2021	Q4 2020	% Change
Total revenue (US$'bn)	20.86	18.83	10.78%
Provision for credit losses (US$'bn)	-452	-179	152.51%
Net income (US$'bn)	5.75	3.09	86.08%
Return on equity (ROE)	12.80%	6.60%	93.94%
Return on average tangible common equity (ROTCE)	15.30%	8%	91.25%
Efficiency ratio	63%	80%	-21.25%

	Q4 2021	Q4 2020	% Change
Capital & Liquidity			
Common Equity Tier 1 (US$'bn)	140.60	138.30	1.66%
CET1 Ratio	11.40%	11.60%	-1.72%
Liquidity Coverage Ratio	118.00%	133%	-11.28%
Total Loss Absorbing Capacity	23.00%		

Source: Wells Fargo Q4 Financial Statement, **Proshare** Research

The Financial Position

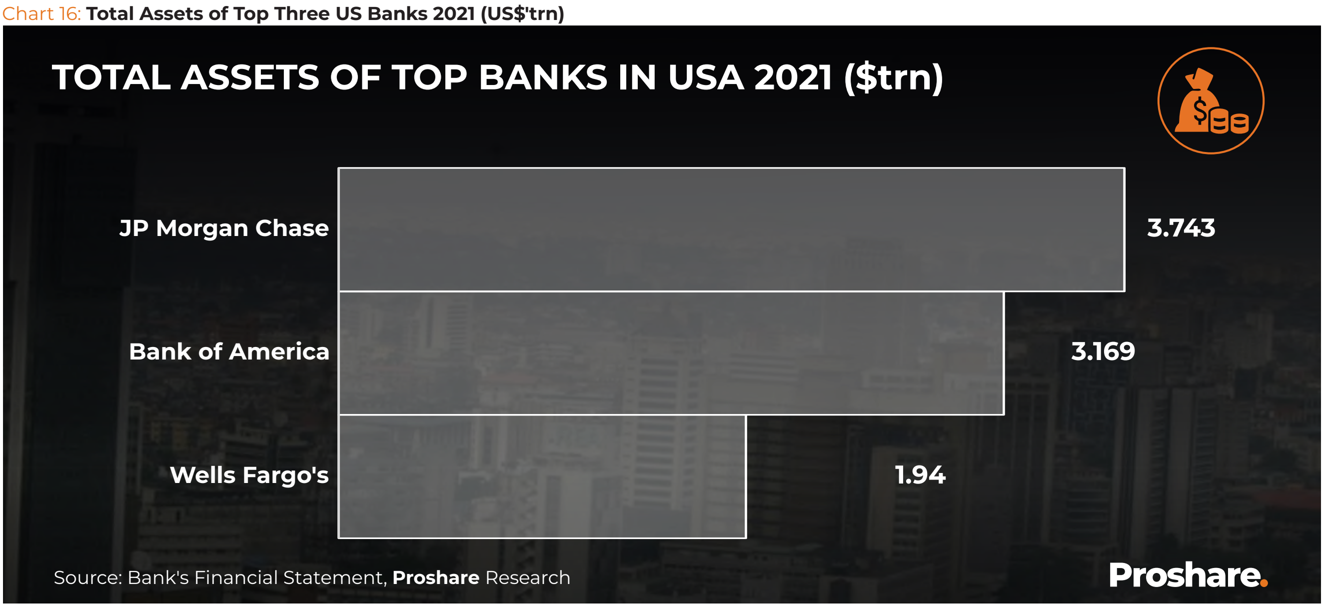
Total Assets

In 2021, the total assets of the three top banks in the United States recorded an average growth rate of +7.57% in assets. JP Morgan Chase was the largest bank by total assets in the two periods (2020 & 2021) under review. The Bank had total assets of US$3.74trn, Bank of America came in second place with US$3.17trn in total assets while Wells Fargo ranked the third-largest large bank by total assets in the United States in 2021.

Bank of America had the highest growth rate of +12.41%, which came on the back of a +43.48% increase in debt securities and a +6.34% rise in Loans and net allowance.
JPMorgan's +10.56% growth in total assets was on the back of growth of +80.21% in securities Held-to-Maturity, +42.10% increase in deposits held with other banks, and +2.25% rise in cash and due from banks.

While a decline of -11.48% in cash and cash equivalent dragged Wells Fargo's total asset to US$1.94trn in 2021 (*see chart 16*).

Chart 16: **Total Assets of Top Three US Banks 2021 (US$'trn)**

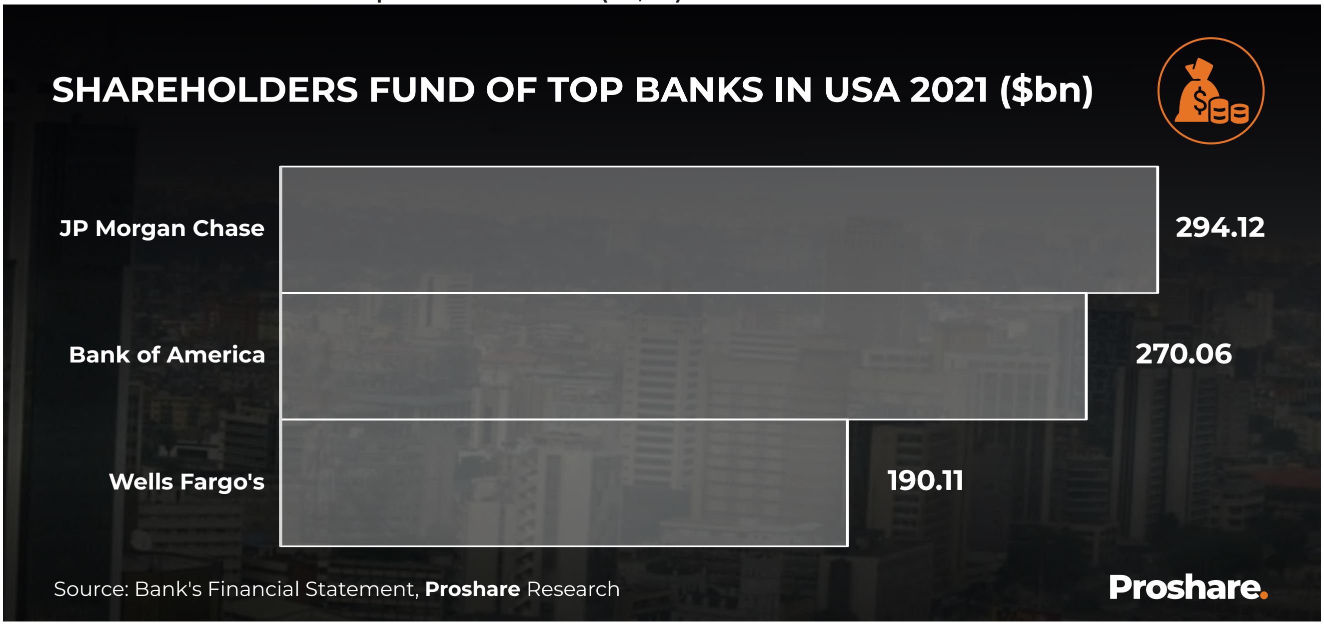


Shareholders Fund

In terms of shareholders' funds, the ranking remained the same with ranking by total assets. JP Morgan Chase shareholders' fund was up by +5.29% to $294.12bn in 2021. the improvement was largely driven by a +15.88% increase in preferred stocks and +14.89% growth in retained earnings, positioning the institution as the bank with the largest shareholders fund in the US.

Bank of America had s shareholders' fund of US$270.07bn which fell slightly by -1.05%, supported by a +208.21% in the accumulated comprehensive loss and -27.43% decline in common stock.
Wells Fargo, which has the lowest shareholders fund attained the second position with a growth rate of +2.37% and $190.11b in value (*see chart 17*).

Chart 17: **Total Shareholders Fund of Top Three US Banks 2021 (US$'bn)**



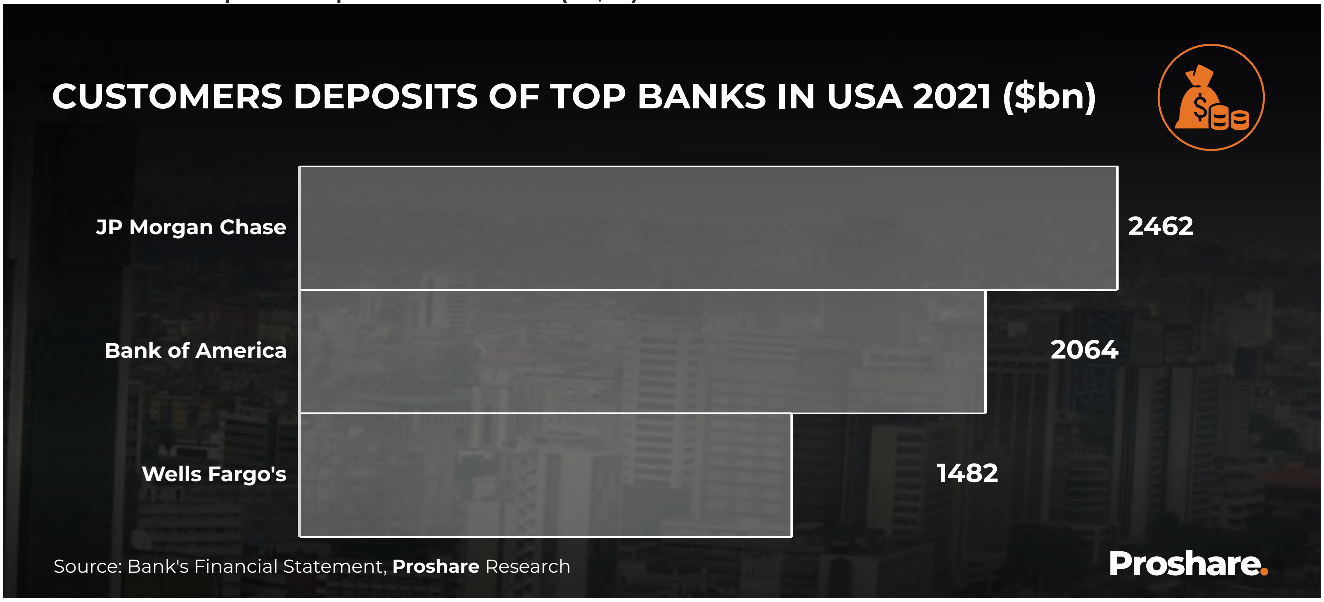
Customers Deposits

The top three banks reported a remarkable growth in customers deposit with an average growth rate of +11.79%. Bank of America recorded the highest percentage growth in customer deposits, it grew by +14.98% to $2.06trn which was supported by a +55.14% increase in deposits from non-US offices and +12.29% rise in interest-bearing deposits.

Wells Fargo recorded a slight increase in deposits, resulting in +5.56% growth Y-on-Y from $1.40trn to $1.48trn (*see chart 18*).

Chart 18

Chart 18: **Customers Deposits of Top Three US Banks 2021 (US$bn)**



Loans And Advances

JP Morgan Chase had the highest loans and advances in two consecutive years, with an increase of +7.80% in 2021. While Bank of America ranked second both in value and the percentage growth of +6.34%, Wells Fargo ranked third position in value and the percentage growth of +1.59%, the marginal increase was on the back of a -32.54% decrease in allowance allocated for loan loses (*see chart 19*).

The African Continent

South African banks dominated the African region's top banking rankings. In general, South African banks have strong tier 1 capital and liquidity positions, which are directly tied to risk management. Although the banking system varies across the continent, some economic facts cut across regions. The banking sector's outlook is largely positive; however, SMEs will continue to encounter liquidity issues when seeking funding as a result of the high cost of funds and the private sector's crowding effect following the COVID-19 shock. Most African economies have budget deficits, which will lead to greater borrowing in these regions, putting corporates at risk of rising borrowing prices. Credit constraints are loosely linked to the development of the financial sector, and the weak economic performance has fed an increase in non-performing loans (NPLs) in most markets. Although NPLs appear to be coming under control in most banking groups, especially in the Nigerian Banking Sector, it is still on the rise in other markets.

Standard Bank Group, FirstRand, and Absa group ranked the top three banks in the continent, and are all incorporated in South Africa. According to data released by Statista, the aggregate tier 1 capital from the South African banks was over US$35bn as of 2020, this amount is roughly the total values from leading banks from Egypt, Morocco, Nigeria, and Kenya

Standard Bank Group

Africa's largest lender by asset and tier 1 capital operates in over 20 countries and has over 560 branches. The bank has a dual listing, listed both on the Johannesburg and Namibian Stock Exchanges. The Industrial and Commercial Bank of China is a 20% shareholder of the Group. With a credit rating of BB+ (Long term) and a stable outlook by Fitch, the bank's total assets stood at

US$181.48bn as of 2021 which rose Y-on-Y by +7.61%.

The financial performance of the company improved in 2021 as total income which represents the consolidated revenue of the Group was up by +7.53% and net income rose over +90%. The credit loss ratio and cost-to-income ratio improved during the period (*see table 17*).

Table 17: **Standard Bank Group Financial Highlights**

STANDARD BANK GROUP: 2021 FINANCIAL HIGHLIGHTS

	FY 2021	FY 2020	% Change
Total income (US$'bn)	8.85	8.23	7.53%
Net Income	1.87	0.966	93.58%
Cost-to-Income Ratio	57.9%	58.2%	-0.52%
Credit Loss Ratio (bps)	73	151	-51.66%
Return on Equity	13.50%	8.90%	51.69%
Capital & Liquidity			
CET 1 capital (US$'bn)	11.61	10.33	12.39%
Tier 1 capital (US$'bn)	12.42	10.92	13.74%
Tier II capital (US$'bn)	1.98	1.73	14.45%
Total regulatory capital (US$'bn)	14.4	12.64	13.92%
Capital Adequacy Ratio	13.80%	13.20%	4.55%

Source: Standard Bank Group Financial Statement, **Proshare** Research

Proshare.

FirstRand Group

The Group which ranks as the second-highest lender in terms of assets and market capitalization is also listed on the Johannesburg Stock Exchange and Namibian Stock Exchange. The bank operates in eight African countries and branches in London, Guernsey, and India.

FirstRand has a market capitalization of US$26.57bn and the institution had US$125.59bn in total assets as of 2021. The bank also showed improved performance in its 2021 results, with a +54.72% rise in profit before tax and a decline in cost-to-income ratio and credit loss ratio (*see table 18*).

Table 18

Table 18: **FirstRand Group Financial Highlights**

FIRSTRAND GROUP: 2021 FINANCIAL HIGHLIGHTS

	FY 2021	FY 2020	% Change
Income from Operations (US$'bn)	6.38	5.39	18.37%
Profit after Tax (US$'bn)	1.87	1.28	46.09%
Cost-to-Income Ratio	52.40%	52.90%	-0.95%
Credit Loss Ratio	1.06%	1.91%	-44.50%
Return on Equity	18.40%	12.90%	42.64%
Return on Assets	1.39%	0.96%	44.79%
NPLs as % of advances	4.76%	4.37%	8.92%
Capital & Liquidity			
CET 1 capital	13.50%	11.50%	17.39%
Tier 1 ratio	14.10%	12.10%	16.53%
Capital Adequacy Ratio	16.30%	14.50%	12.41%

Source: FirstRand Group Financial Statement, **Proshare** Research

Proshare.

Absa Group

Amalgamated Banks of South Africa (ABSA) is one of Africa's largest diversified financial services groups with a presence in 14 countries. The group owns majority stakes in Botswana, Kenya, Ghana, and seven (7) other African countries. In 2021, the group's total assets rose Y-on-Y by +0.34% to US$101.94bn.

The year 2021 was a year of recovery for the top banks in Africa, as Absa Group also saw improved earnings and reduction in credit loss ratio and CIR just as Standard Bank Group and FirstRand performed in the period (*see table 19*).

Table 19: **Absa Group Financial Highlights**

ABSA GROUP: 2021 FINANCIAL HIGHLIGHTS

	FY 2021	FY 2020	% Change
Total Income (US$'bn)	5.72	5.43	5.34%
Profit After Tax (US$'bn)	1.29	0.48	168.75%
Cost-to-Income Ratio	56.60%	59.00%	-4.07%

	FY 2021	FY 2020	% Change
Credit Loss Ratio	0.77%	1.92%	-59.90%
Return on Equity	14.60%	5.20%	180.77%
Return on Assets	1.13%	0.40%	182.50%
Capital & Liquidity			
CET 1 capital	12.80%	11.20%	14.29%
Capital Adequacy Ratio	17.00%	15.00%	13.33%

Source: Absa Group Financial Statement, **Proshare** Research

The Financial Position

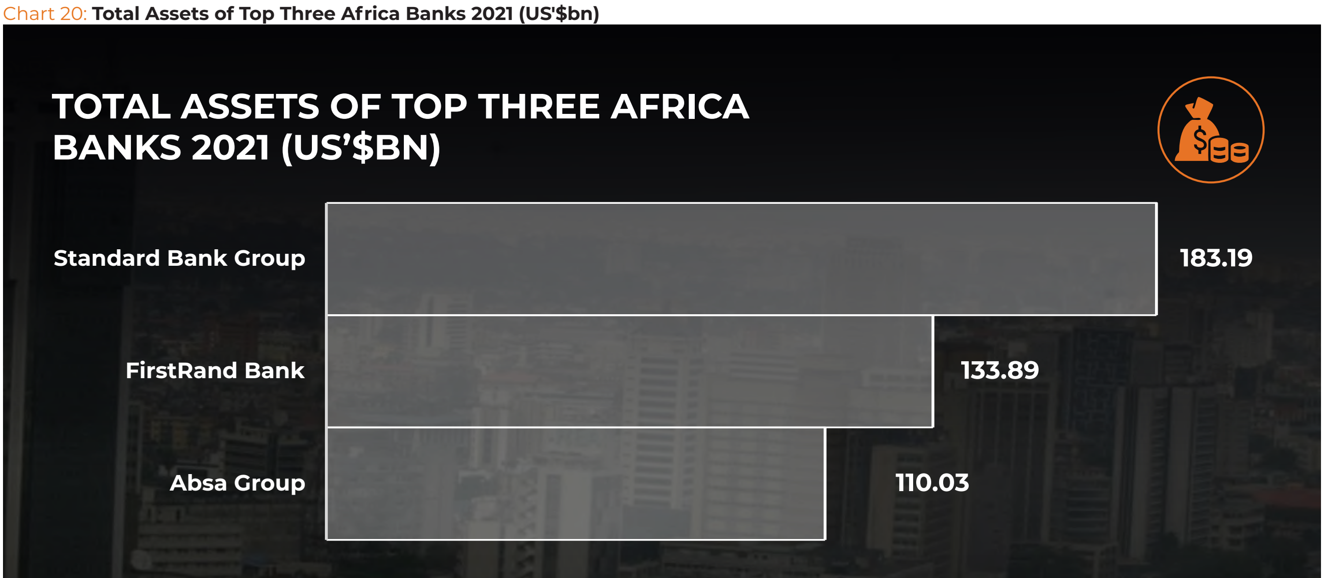
Total Assets

At the end of the financial period in 2021, The three top banks in Africa recorded an average growth of +0.80% in total assets. Standard Bank Group had the largest total asset in the two-period (2020 and 2021) with a percentage growth rate of +7.62%. The bank total assets grew to US$183.19 in 2021, which was driven by a +27.96% increase in net and loan advance to banks and a +3.34% rise in other assets of the bank.

First Rand Bank was positioned second in the value of assets owned in the same period. The bank's total assets grew by +2.18% to US$133.89bn in 2021.

Absa Group Ltd came third with US$110.o3bn as total assets with a growth rate of +7.29% Year-on-Year. The growth was supported by a +38.87% increase in deferred tax assets, +23.06% growth in investment securities, and +8.83% growth in cash and cash balances with the central bank (*see chart 20*).

Chart 20: **Total Assets of Top Three Africa Banks 2021 (US'$bn)**



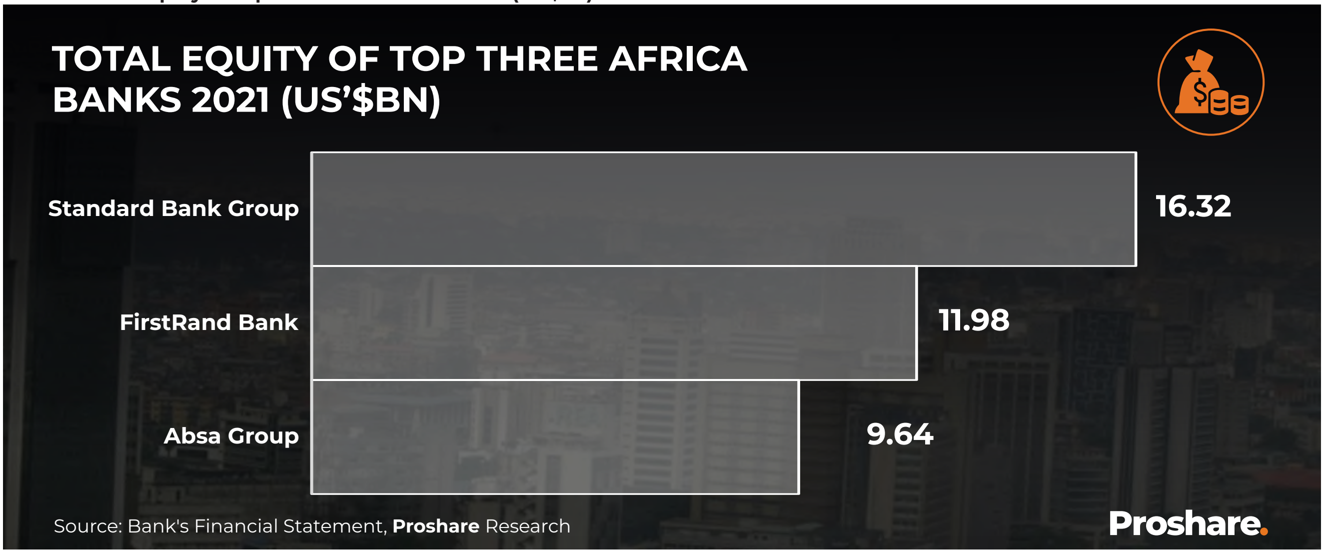
Source: Bank's Financial Statement, **Proshare** Research

Shareholders Fund

In terms of value, Standard Bank Group had the highest value of US$16.32 in 2021 shareholders' funds with a percentage increase of +12.79%. First Rand Bank came second with a value of US$11.98bn with a growth rate of +10.41%.

While Absa Group Ltd ranked third in value of US$9.64bn with the highest growth rate of +12.49% (*see chart 21*).

Chart 21: **Total Equity of Top Three Africa Banks 2021 (US'$bn)**

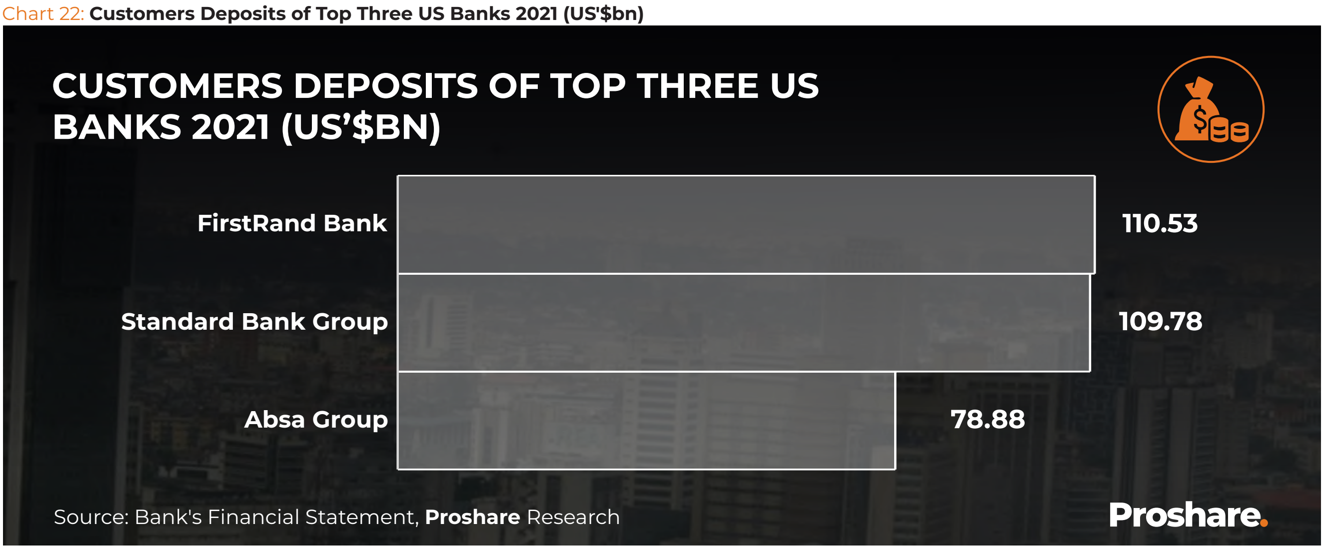


Customers Deposits

The three top banks reported a significant growth in customer deposits. First Rand Bank attained the highest value of US$110.53bn with an increase of +5.64%. Standard Bank Group ranked second with the second-highest percentage growth rate of +9.50% to US$109.78bn.

While, Absa Group Ltd which had the highest growth rate of +12.49% came third, stating US$78.88bn as customers deposit (*see chart 22*).

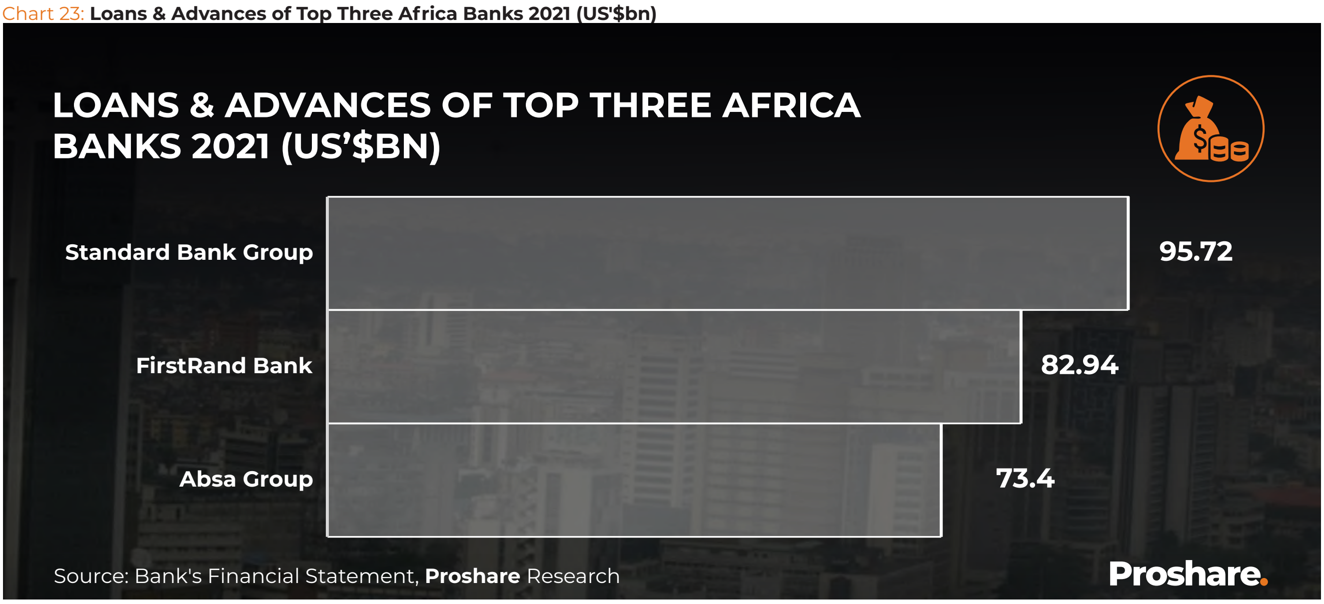
Chart 22: **Customers Deposits of Top Three US Banks 2021 (US'$bn)**



Loans And Advances

with the average growth of +8.93% in Loans and Advances, Standard bank Group attained the highest value of US$95.72bn in the period; with an increase of +12.04%. First Rand Bank reported the second-highest value of US$82.94bn. Absa Group Ltd came third in the value of US$73.4bn in loans and advances with a growth rate of +8.93% (*see chart 23*).

Chart 23: **Loans & Advances of Top Three Africa Banks 2021 (US'$bn)**



Nigeria's Banking **Ecosystem.**

Nigerian Banking Industry- The Evolution

"If banks cannot truly be customer intimate, they are doomed to be just dumb commodities, acting behind the scenes, like utilities." ***-JP Nicols, bank innovation expert***

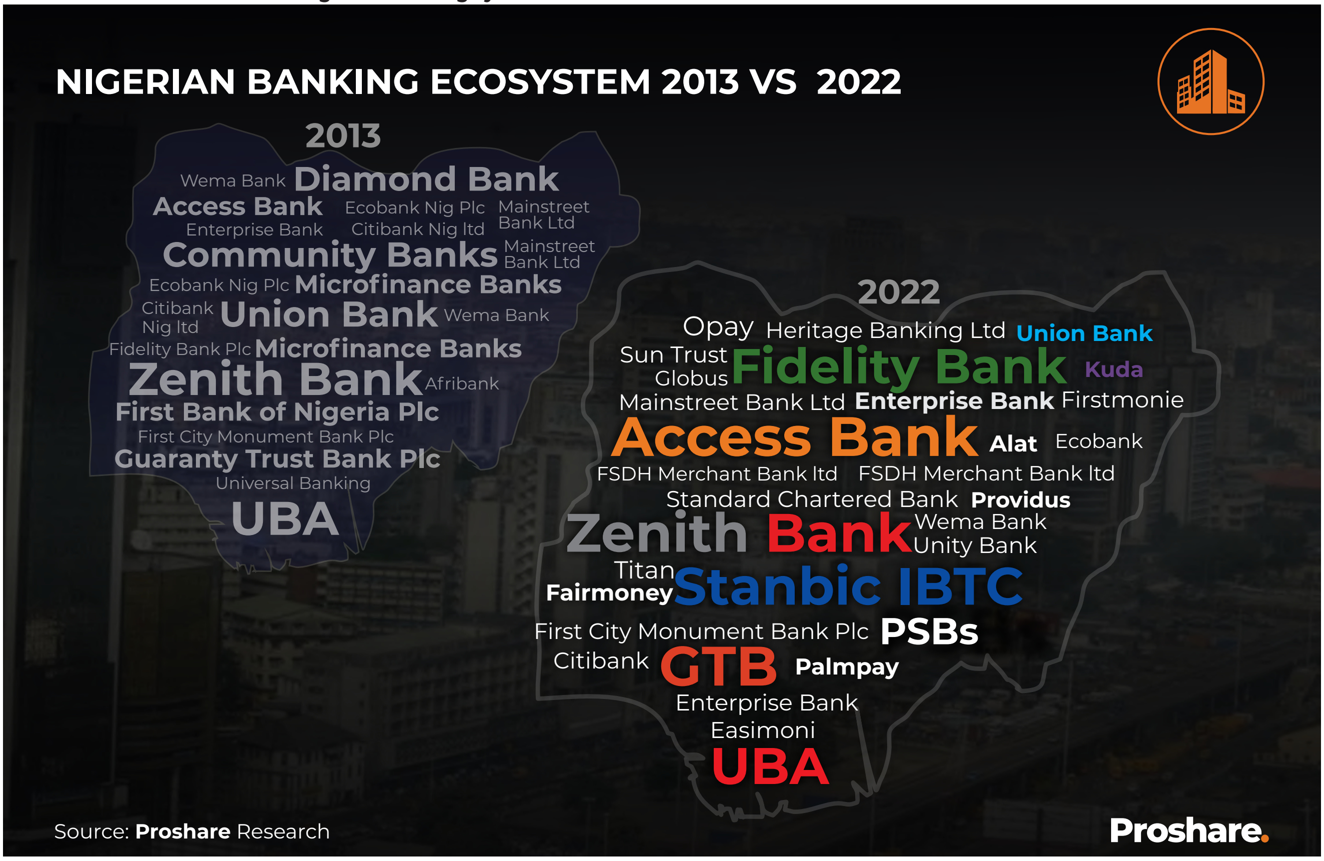
Nigeria's banking system has undergone various transitions, especially over the last 22 years, from 89 banks before 1999 to the universal banking regime that commenced in earnest in 2000 and then onto the consolidation of 2005. Between 2005 and 2010, the number of banks collapsed to 25 larger institutions with a stronger capacity to support big-ticket domestic transactions and support manufacturing and service sector growth. The period was disruptive but progressive. In 2010 another round of consolidation took place, creating even larger banks. The "great consolidations" were expected to develop a few of Africa's largest banking franchises, but this is yet to happen. The steady depreciation of the Naira and the rising non-performing loans as banks became bigger hobbled their growth.

The Tier 1 bank classification as defined by Afrinvest in its 2013 special Banking report was made within a context. So much has changed ever since. At the time, the Nigerian banking ecosystem was characterized by several features. The changes it has seen have been far-reaching, affecting not just the regulators, operators but also customers. Back in 2013, when the Afrinvest model was formulated, even the largest Nigerian Banks in Asset size could not boast of Assets worth N5tr. As of 2021 about half of the quoted banks have assets in excess of 5tr.

Another current reality that marks a major difference between the banking industry today and what was obtained in 2013 is the fact that back then there was a finite number of operators, today's banking industry has an elastic and almost infinite universe of banks. Whereas in 2013, Banks identified as such, today's banks are increasingly less identifiable by their titles and so non-traditional banking institutions holding the requisite license abound. The rise of Digital Banks like Kuda, Opay, Palmpay, Fairmoney and a host of others has redefined the banking landscape. Likewise, Payment Service Banks (PSBs), Telecoms companies like MTN and Airtel have also recently obtained full approval from the regulator to operate as payment banks. Microfinance Banks and community banks led the financial inclusion agenda of the government a decade ago whereas, PSBs approvals have become a major driver of financial inclusion (*see illustration 12*).

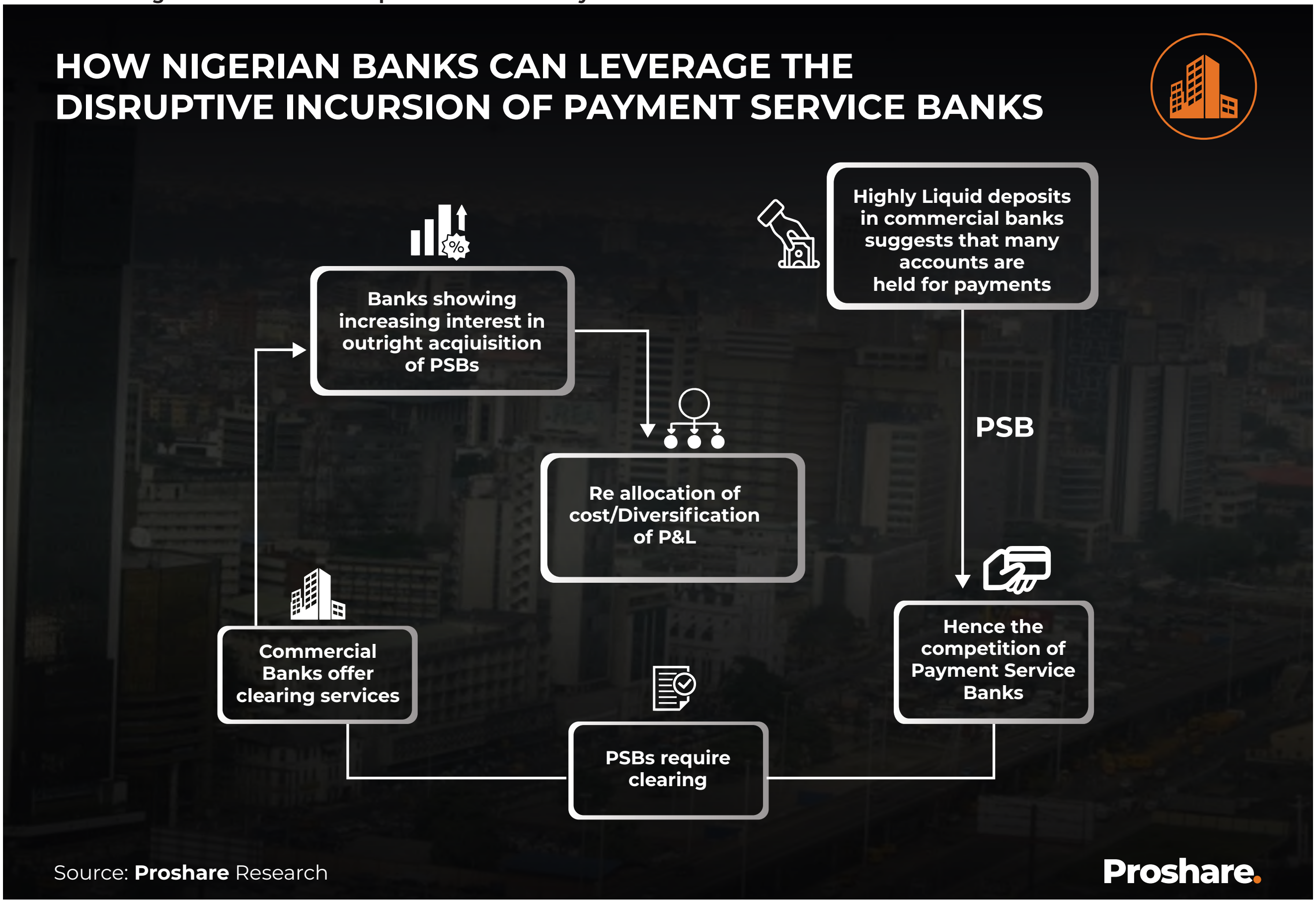
Illustration 12

Illustration 12: **The Evolution of Nigerian Banking system**



The incursion of PSBs has generated mixed reactions from traditional banks. While some banks have regarded the rise of PSBs as a threat to their operations and earnings others seem to have however identified opportunities. Such banks are showing increasing interest in owning, partnering, or even acquiring PSBs. Whereas the fact that most Nigerians prefer to keep their savings in checking accounts suggests that such accounts are actually meant for payments. Payments Banks recognizing this have therefore chosen to create an alternative that is less costly but as efficient as conventional banks. Conventional commercial banks however can capitalize on the rise of PSBs not just by providing clearing services for the PSBs (since they are not licensed to do so) but as has been the case banks can set up PSBs altogether. So, while the banks may generally hold lower deposits, they can earn commissions on clearing for the PSBs thereby diversifying their P&Ls (*see illustration 13*).

Illustration 13: **Nigerian Banks and Disruptive Incursion of Payment Banks**



Source: **Proshare** Research

As noted later in the report, Nigerian banks are still significantly smaller than their South African and Egyptian counterparts. It would be difficult to urge bank recapitalization in a difficult economic situation. Still, at some point, the ***financialization*** of assets would be called upon to enhance the capital size of domestic banking institutions.

Nigeria's banking sector rotates around two circles of bank types called tier 1 and 2. Before now, the Tier 1 banks had the largest loan assets and deposits, showed the strongest levels of operational efficiency and highest returns on shareholders' funds. The second-tier banks were contextually less strong than their tier-one counterparts, but this may not be true for every aspect of their businesses. For example, a few tier 11 banks have shown greater skill and agility in growing their digital banking income relative to gross earnings (*see table 20*).

Table 20: **The Digital Income Wars in Numbers**

E-BANKING: THE NEW CASH WALLET (N'bn)

Bank	Gross Earning	E-banking Income	E-Banking as a proportion of Gross Earnings
FCMB	212.01	26.10	12.31%
FBNH	427.00	42.02	9.84%
UBA	660.20	64.60	9.78%
ACCESS	971.89	66.28	6.82%
UNITY	48.97	3.04	6.21%
UBN	177.27	8.87	5.00%
ZENITH	765.56	37.47	4.89%
STERLING	142.32	6.75	4.74%
GTB	447.81	21.08	4.71%
WEMA	93.63	2.64	2.82%
FIDELITY	250.78	5.29	2.11%
STANBIC	206.64	3.69	1.79%

** FBNH is 9M data*

Source: NGX, **Proshare** Research

While it is true that in absolute numbers, bigger banks have larger digital earnings when viewed as a ratio of income from electronic banking to gross earnings, tier 11 banks are no laggards.

Interestingly, second-tier banks also seem to find it easier to convert deposits to loans as their loan to deposit ratios are in a few cases higher than that of their tier 1 rivals. Besides GTCO and Stanbic IBTC, which posted outlier returns on assets (ROA), tier 11 banks walked in lockstep with their higher-tiered competitors.

However, return on equity (ROE) told a different story. Larger banks seem to achieve higher equity returns (*see table 21*).

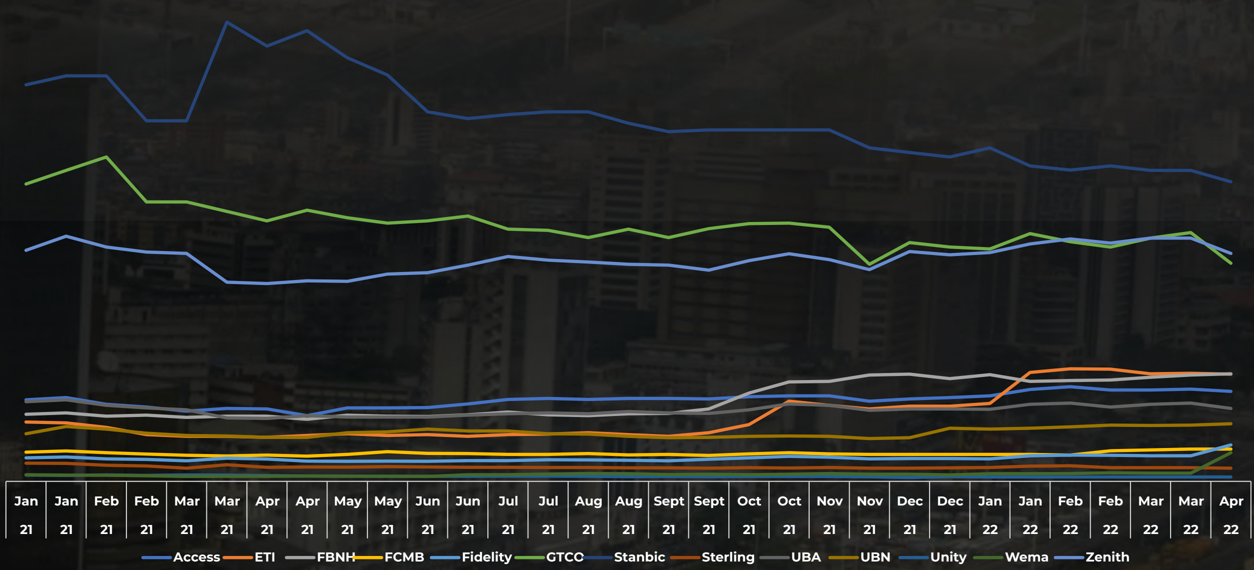
Table 21

Table 21: **Snapshot of Nigerian Banks Performance 2021**

SNAPSHOT OF NIGERIAN BANKING PERFORMANCE 2021

	PAT	TOTAL ASSET	GROSS EARNING	EPS	NPL	CIR	CAR	COR	LIQUIDITY RATIO	ROE	ROA	LDR
	N'bn	N'trn	N'bn	N	%	%	%	%	%	%	%	%
FBNH	40.85	8.51	427.03	1.12	7.30	73.50	15.50	1.50	-----	7.20	0.70	52.80
UBA	118.68	8.54	660.20	3.39	3.60	63.00	24.90	0.35	47.46	15.60	1.50	40.36
GTCO	174.84	5.44	447.81	6.14	4.85	42.26	23.83	0.47	38.26	20.06	3.37	42.08
ACCESS	160.22	11.73	971.89	4.51	4.0	58.80	24.50	2.0	51.00	17.80	-----	50.80
ZENITH	244.56	9.45	765.56	7.78	4.19	50.80	21.00	1.90	71.60	20.40	2.70	54.10
ETI	146.33	11.69	956.39	7.79	6.20	58.90	14.80	1.69		19.00	1.30	51.90
FIDELITY	35.58	3.29	250.77	1.23	2.90	64.90	20.10	0.50	40.40	12.50	-----	85.56
STERLING	13.52	1.63	142.32	0.47	0.70	75.00	14.82	1.00	37.90	9.70	1.00	58.50
STANBIC	56.97	2.74	205.79	4.40	2.10	62.30	21.10	-0.10	-----	14.70	2.10	78.02
FCMB	20.92	2.49	212.01	1.05	4.10	69.90	16.20	1.00	34.80	8.90	0.90	54.80
UBN	19.37	2.59	177.27	0.67	4.30	79.20	14.60	......	35	7.30	0.90	66.00
UNITY	2.47	0.53	50.38	21.14	0.04	88.27	-86.18	1.20	.....	......	-----	-----
WEMA	8.93	1.18	93.63	23.10	4.88	78.10	15.4	......	30	17.80	1.20	45.16

Share Price Movement Jan 2021 -Apr 18, 2022



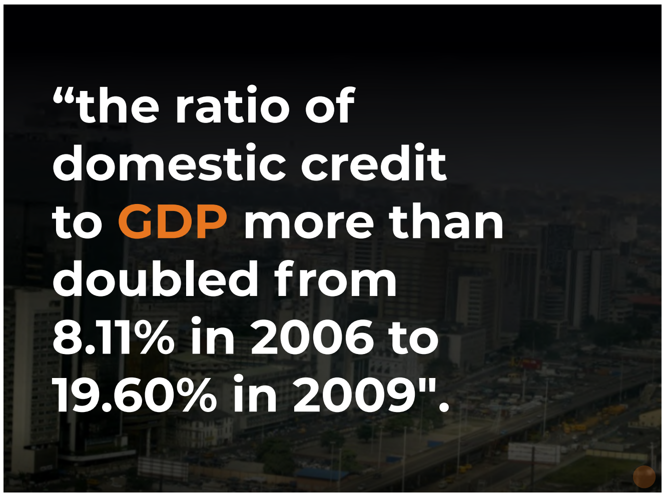
SOURCE: NGX, **Proshare** Research.

The share price movements of Nigerian banks listed on the Nigerian Exchange Group (NGX) trading floor huddle around a narrow price band. But higher-priced banks like Zenith Bank, GTCO, and Access Bank have seen more distinct patterns, which recently have moved within a bearish trading channel with Access Holdings and GTCO engaged in arm-wrestling for price dominance.

As JP Nicols noted, the business of banking is becoming less about a place as it is about space, the digital space. The dominance of a digital service delivery platform that touches bank customers at their pain points will separate the strong from the weak. The size of bank headquarters and branches would be meaningless when meeting customer needs as customers will increasingly decide that banks are what people do rather than places people go.

Nigeria's old banking playbooks become shredded as battling institutions become more ***customer-centric*** by applying big data to build artificial intelligence (AI) and machine learning (ML) architectures. The new architectures will enable customers to travel more smoothly across their service journey experiences.

In relief, Nigeria's banking landscape is a Roman Coliseum with gladiators of all sizes using preferred weapons of warfare to stay in the financial arena with minimal loss of blood.

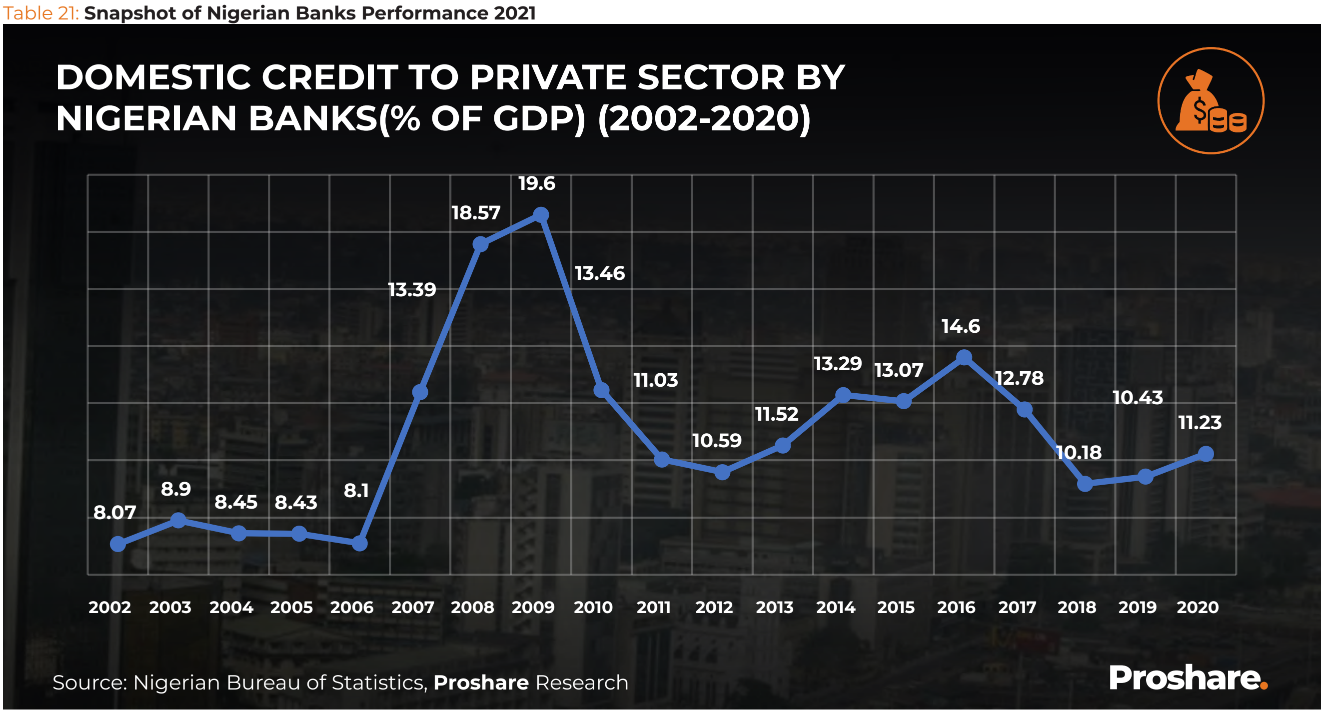


Emerging Roles of Tier 1 Banks in Economic Growth and Sector Development

Commercial banks play a key role in the process of capital formation which itself is a major catalyst for economic growth. By intermediating between economic units with excess liquidity and those in deficit, deposit money banks do not only serve the purpose of efficient allocation of economic resources but also create credit through the instrumentality of the money multiplier. The role of banks transcends the safekeeping of depositor's assets, when banks fail and there is a run, the entire economy risks a collapse as was experienced during the 2008/2009 global financial crisis. The need for a strong and efficient financial system, capable of spurring sustainable economic growth brought about the consolidation of the banking sector in Nigeria in 2005. At the time, the Nigerian banking industry comprised many banks, a good number of which had unanswered questions about their soundness but perhaps more importantly about their capacity to support the economy with credit. As of June 2004, prior to the Nigerian banking sector consolidation, as many as 89 money deposit banks were operating in Nigeria, curiously, however, many of these banks had capital of less than US$10mn.

The Nigerian banking sector was fragmented and could barely support any bold developmental plans. Prior to the consolidation, a certain South African Bank was as large as all 89 Nigerian banks. The Charles Chukwuma Soludo-led CBN supervised several mergers and acquisitions a process that required banks to raise their capital base to N25bn. At the end of the process, there were a total of 25 banks believed to be larger and better capacitated to support the real sector. While a larger capital base enhances the lending capacity of banks and reduces the risk of a bank failure, there were now fears that lending to small businesses lending could suffer as commercial banks grow. The fear did not materialize in the Nigerian case. Following the consolidation of the banking industry in 2005, IMF data shows that Domestic credit to the Private sector rocketed, and the ratio of domestic credit to GDP more than doubled from 8.11% in 2006 to 19.60% in 2009. The downward trend that started afterward and was sustained till 2012 is attributable to the Global Financial Crisis (*see chart 24*)

Table 21: **Snapshot of Nigerian Banks Performance 2021**



Despite the success of the consolidation programme which saw the emergence of new generation banks such as Access Bank, Guaranty Trust Bank and Zenith Bank as major forces to reckon with, Nigerian banks still did not rank in terms of size anywhere near some of their counterparts on the continent. For instance, as of 2011, no Nigerian bank made a list of 15 top African banks (based on Assets). As of the time, the top four on the list were all South African Banks, namely: Standard Bank Group, Absa Group, First Rand, and Nedbank Group. Collectively they held assets worth $456bn. First Bank of Nigeria was the highest-ranked Nigerian bank in the 16th position with assets worth $17.39bn.
In 2009, the Nigerian Banking Industry once again witnessed a major intervention from the regulator, this time, it was as a result of the regulator's concern about the risk management practices of some banks, a situation which saw the ratio of Non-Performing Loans Ratios (NPLR) rise to as high as about 37.25% this development, as well as the global financial crisis, had begun to cause foreign portfolio withdrawal, this led to the AMCON Act and later on the establishment of the Asset Management Corporation of Nigeria (AMCON)- a body that will prevent the looming financial sector collapse in the country. At the time of inception, introduced a total of ₦736 billion liquidity to buy up the toxic assets of up to 10 banks, of these number only Keystone Bank, Mainstreet Bank, and Enterprise Bank were eventually acquired by AMCON and subsequently referred to as the Bridged Banks.

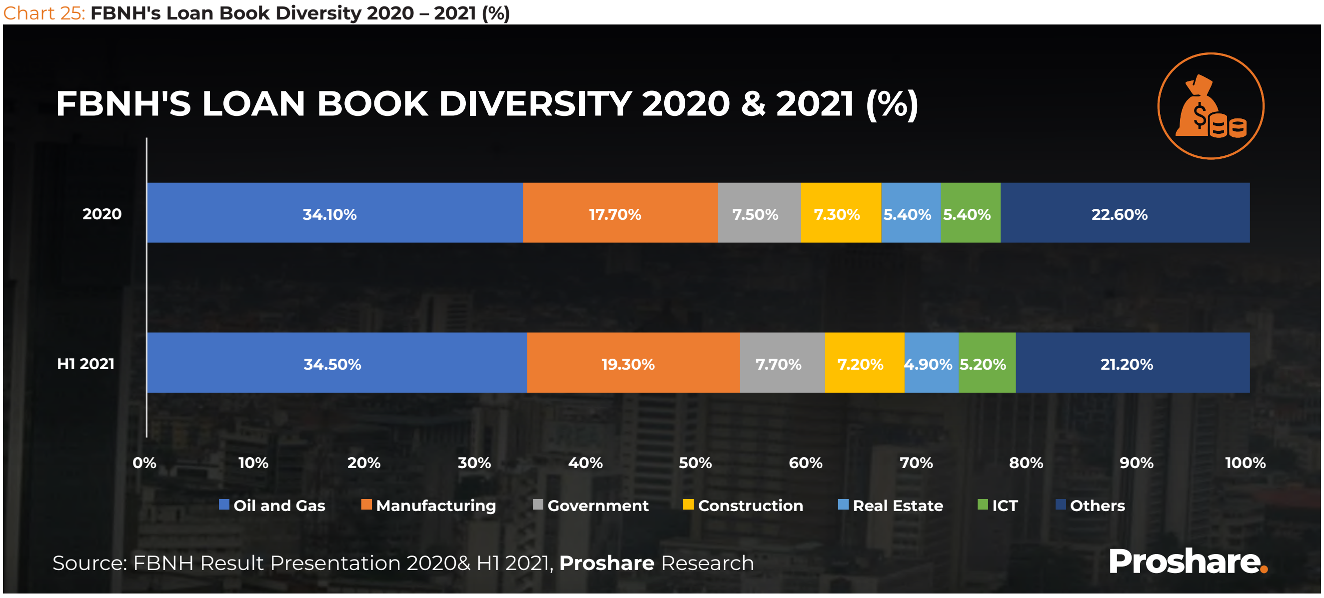
Current Areas of Lending Priority: Loans and Advances by Sector

The 5 largest banks in Nigeria have a major role to play in further diversifying the Nigerian economy. Even though we recognize the fact that commercial banks are in the business of lending to make a profit and maximize shareholders' wealth, they occupy such a vital position within the economy that makes it necessary for their appreciation of the long-term potential of the Nigerian economy. The fact that banks also engage in and make a lot of earnings from other businesses asides from lending raises a lot of questions. The same deep involvement of banks in foreign exchange trading and investment in government treasury bills is unhealthy and unhelpful to the economy.
A look at the loan books of the largest banks in asset size shows that most of the lending is directed to the Upstream and Downstream sectors of the Nigerian economy. This poses a peculiar challenge given that the Oil and Gas Sector has on average only accounted for 5% -7% of the country's GDP, more so the Oil and Gas Sector has contracted in the last seven quarters.

FBNH

FBNH in 2020 channeled 17.7% of total loans and advances to the Manufacturing sector. The Oil and Gas sector was provided with 25% of the loans and advances of the bank. When further analyzed, the upstream oil and gas sector got 17.3% of total loans while the downstream sector obtained 9% of the total loans. The ICT sector obtained about 5% of total loans. The lender's loans to the Manufacturing sector rose from 17.7% of total loans and advances in 2020 to 19.30% in H1 2021. Nevertheless, as of H1 2021, the oil and gas sector remained the sector with the largest funding with 34.5% of FBNH's loans (*see chart 25*).

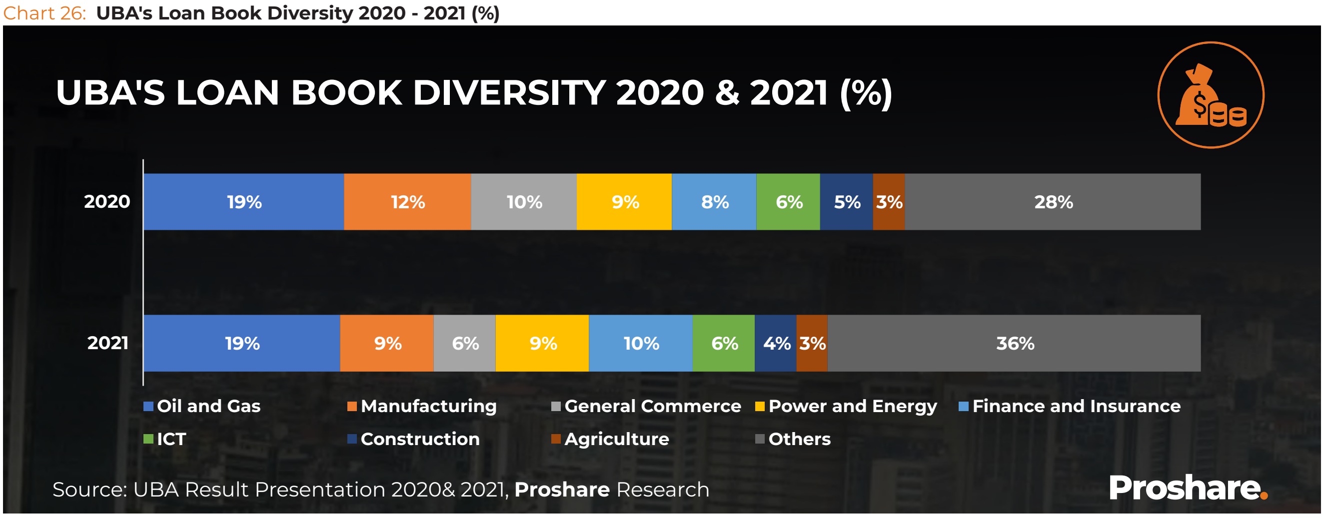
Chart 25: **FBNH's Loan Book Diversity 2020 – 2021 (%)**



UBA

In 2020, UBA advanced 19% of its loans to the Oil and Gas sector. ICT, a fast-growing sector only managed to obtain 6% of the lender's loans and advances. Meanwhile, 12% of the bank's lending in the period was directed to Manufacturers. By 2021, UBA's loan book had the same proportion (19%) committed to funding the Oil and Gas sector, while loan exposure to the Manufacturing sector reduced from 12% to 9% of total loans (*see chart 26*).

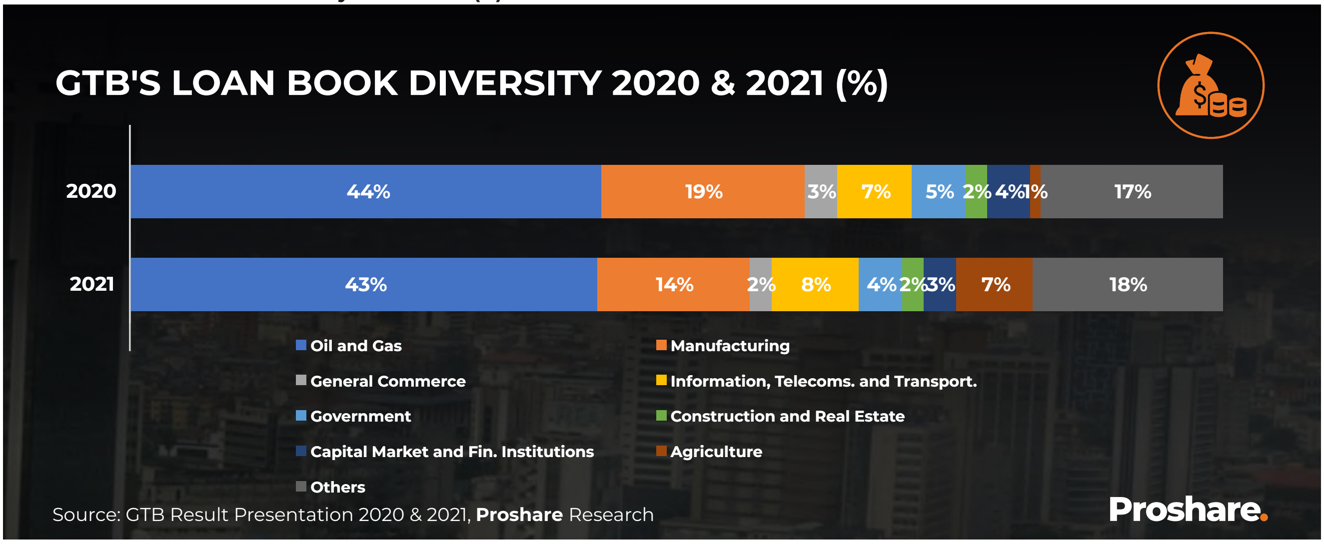
Chart 26: **UBA's Loan Book Diversity 2020 - 2021 (%)**



GTCO

Like other top banks, 30% of GTB's loan book in 2020 was committed to funding business in the Oil and Gas sector. This proportion fell marginally to 28% in 2021, while the portion of total loans and advances to the high-growth Information, Telecoms and Transport sectors increased from 1% in 2020 to 7% in 2021. The lender's advances to the Manufacturing sector however decreased in the period from 19% in 2020 to 14% in 2021 (*see chart 27*).

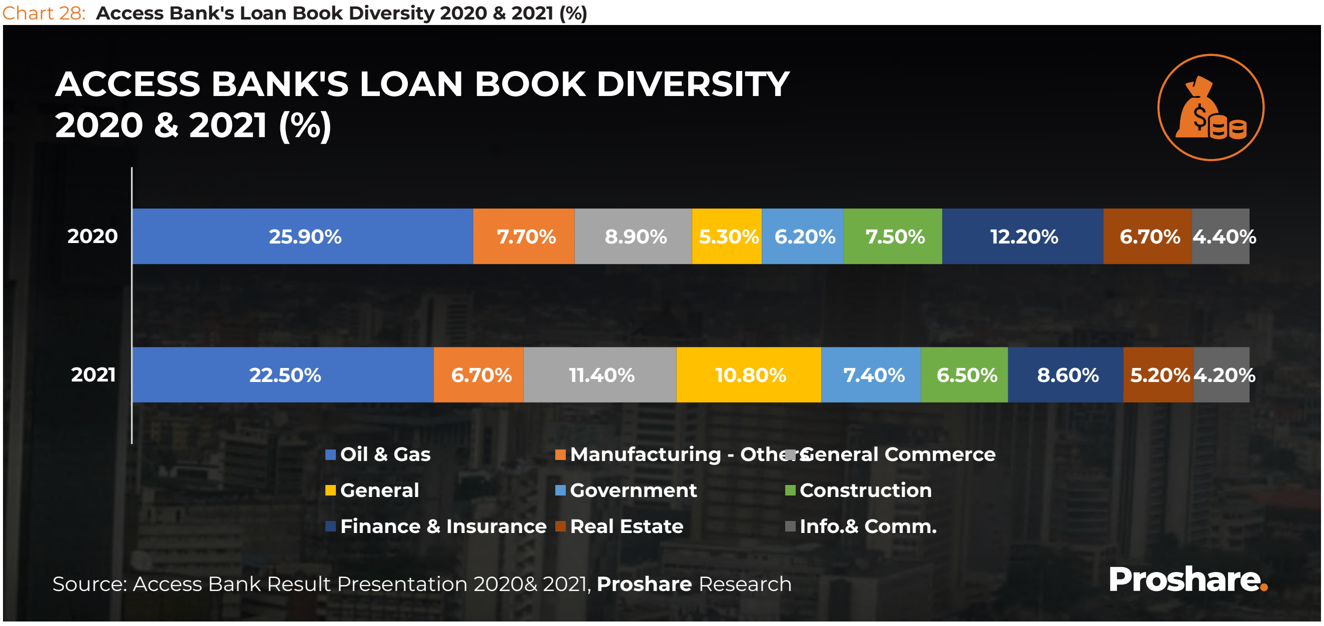
Chart 27: **GTB's Loan Book Diversity 2020 & 2021 (%)**



Access Bank

Over 25% of Access bank's lending as of FY2020 was to the Oil and Gas sector, while the Manufacturing sector only got 7.7% of total loans. A look at the loan book at the end of 2021 reveals that the exposure to the Oil and Gas sector had moderated slightly to about 23% while the proportion of total lending to Manufacturing also dropped to 6.7% (*see chart 28*).

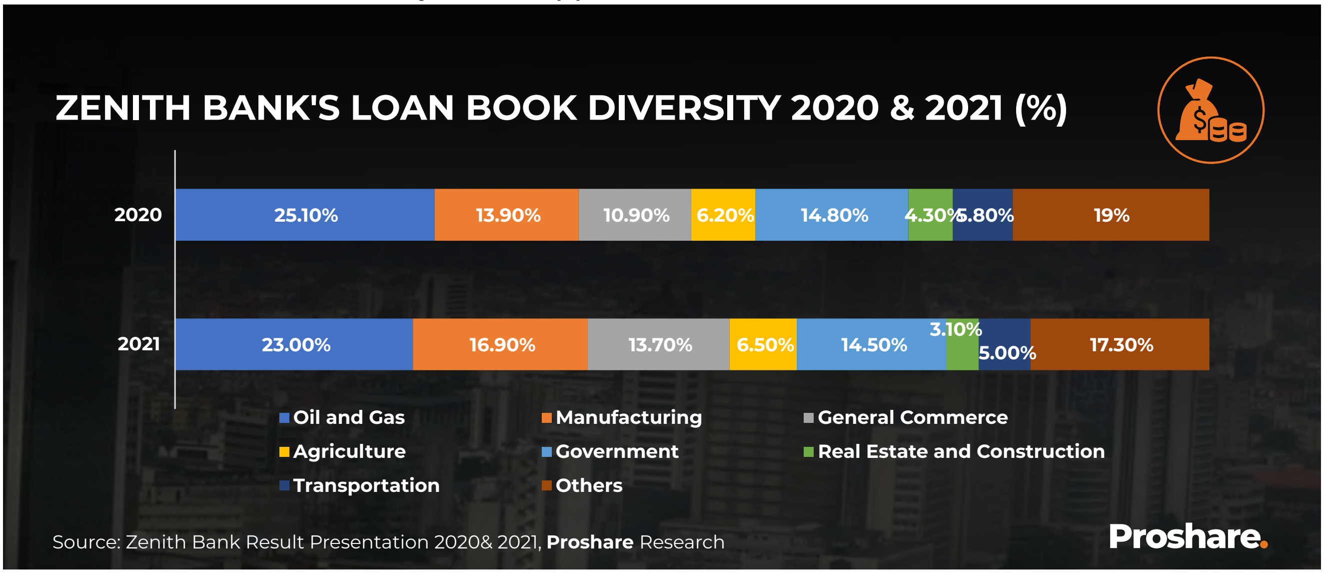
Chart 28: **Access Bank's Loan Book Diversity 2020 & 2021 (%)**



Zenith

A quarter of Zenith Bank's loan exposure in 2020 was to the Oil and Gas Sector, Manufacturing sector obtained about 14% of the total loans advanced as of the end of 2020. Meanwhile, 6.2% of the bank's lending was directed to the Agricultural sector. At the end of 2021, the Bank's loan book shows that the bank had reduced its exposure to the Oil and Gas Sector to 23% while increasing lending to the Manufacturing sector to close to 17% of the bank's loan book. Lending to Agriculture also rose to 6.5% (*see chart 29*).

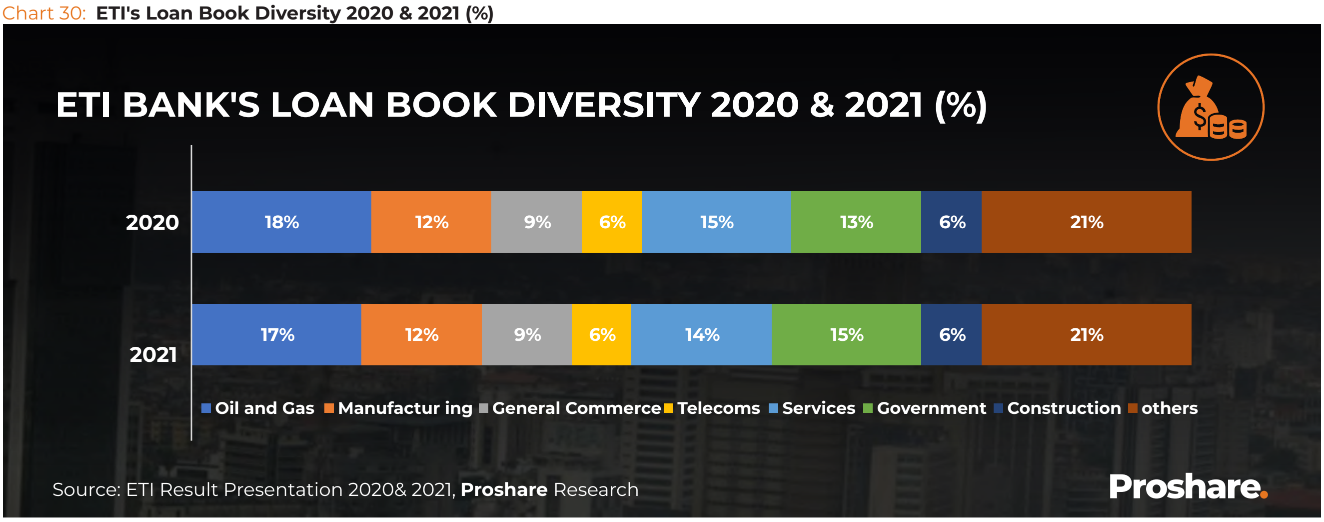
Chart 29: **Zenith Bank's Loan Book Diversity 2020 & 2021 (%)**



ETI

A look at the loan book of ETI in 2020 reveals that up to 18% of the bank's lending exposure was to the Oil and Gas Sector, in terms of size of exposure, the next highest lending was to the Manufacturing sector (12%). About 9% of the bank's lending was channeled to General commerce. The lending pattern remained the same in 2021, with the exposure to the Oil and Gas sector only reducing slightly to 17% while the proportion of lending to Manufacturing and Agriculture remained the same (*see chart 30*).

Chart 30: **ETI's Loan Book Diversity 2020 & 2021 (%)**



Finding The Compass Bearing for Nigerian Tier 1 Banks

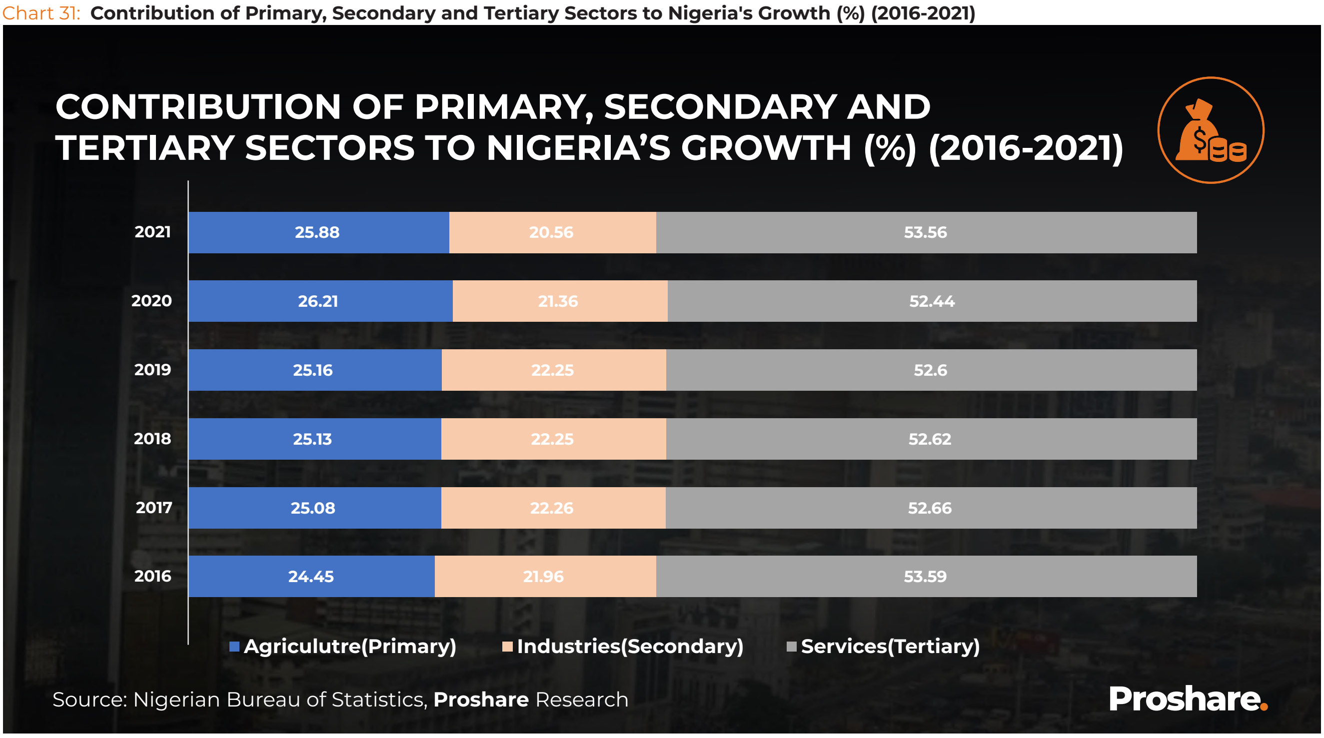
Structure & Macroeconomic indicators

According to the World Bank, Nigeria is a lower-Middle Income country and although the non-oil sector contributes about 90% of the country's GDP, the oil and gas sector, accounts for over 95% of export earnings and nearly 85% of government income. As is the case with developing economies, Nigeria's Manufacturing sector contributes a meagre fraction of the country's GDP, making it largely import-dependent on manufactured items including refined oil and other petroleum products.

Meanwhile, the services sector has on average contributed over 50% to the country's annual GDP. Contrary to the common but inaccurate idea that the economy is monolithic, the Nigerian economy is indeed diversified. It can be argued, however, that Nigeria has leap-frogged the traditional growth pattern which orders growth in three phases namely: Primary sector growth, Secondary and Tertiary growth, but experts identify a similar trend in the case of some low-income countries like Malawi, Ethiopia, Senegal, and Tanzania where major growth stimulating structural changes have led to a transition from low-productivity agricultural activities to higher-productivity activities in terms of services as against Industrial activities.

As of 2016, the industrial sector in Nigeria accounted for 21.96% of total economic activity, the Services sector contributed 53.59% while Agriculture contributed 24.45% to GDP. The contribution of the Industrial sector has shrunk progressively over the five years between 2016 and 2021, from 21.96% in 2016 to 20.56% in 2021. This is despite the fact that Nigeria's long-term economic transformation plan at the time, namely Nigeria Vision 20: 2020, emphasizes industrialization (*see chart 31*).

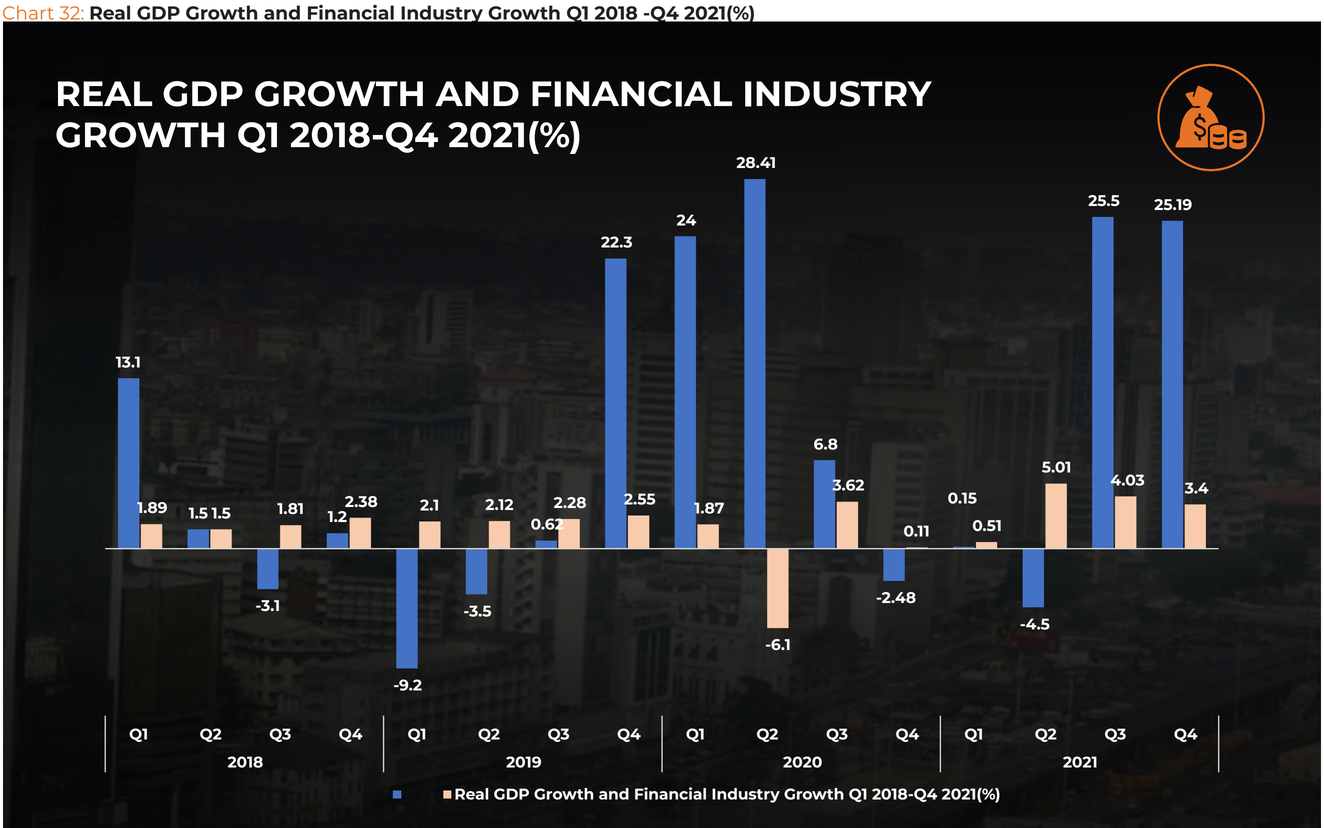
Chart 31: **Contribution of Primary, Secondary and Tertiary Sectors to Nigeria's Growth (%) (2016-2021)**



Progress in both Industrial and Service sector activity, would open up the Nigerian economy, reduce the excess absorptive capacity of the Nigerian economy as well as reduce poverty and unemployment. Nigeria's trade balance would and service activity, the industrialization plan strives to improve worldwide competitiveness in the production of processed and manufactured goods.

Overall, the Nigerian economy has witnessed moderate positive real GDP growth in several quarters since 2015, with the exception of 2016 and 2020 when the economy experienced recessions owing in the first case to a slump in crude oil price whereas the latter was due to the Covid-19 pandemic. In the last quarter of 2020, Nigeria exited the recession and in subsequent quarters consolidated its recovery. In 2021, the Nigerian economy grew by 3.4%, with an increase in government spending, money supply growth, removal of lockdowns, and a base effect. Growth in the Nigerian economy has been independent of the financial sector. For instance, while real GDP growth in the overall economy remained fairly stable at around 2% between Q1 2019 and Q1 2020, the financial industry grew by 22.33% in Q4 2019 and 24% in Q1 2020. This further shows that there is a disconnect between the financial market and the real sector In Nigeria (*see chart 32*).

Chart 32: **Real GDP Growth and Financial Industry Growth Q1 2018 -Q4 2021(%)**



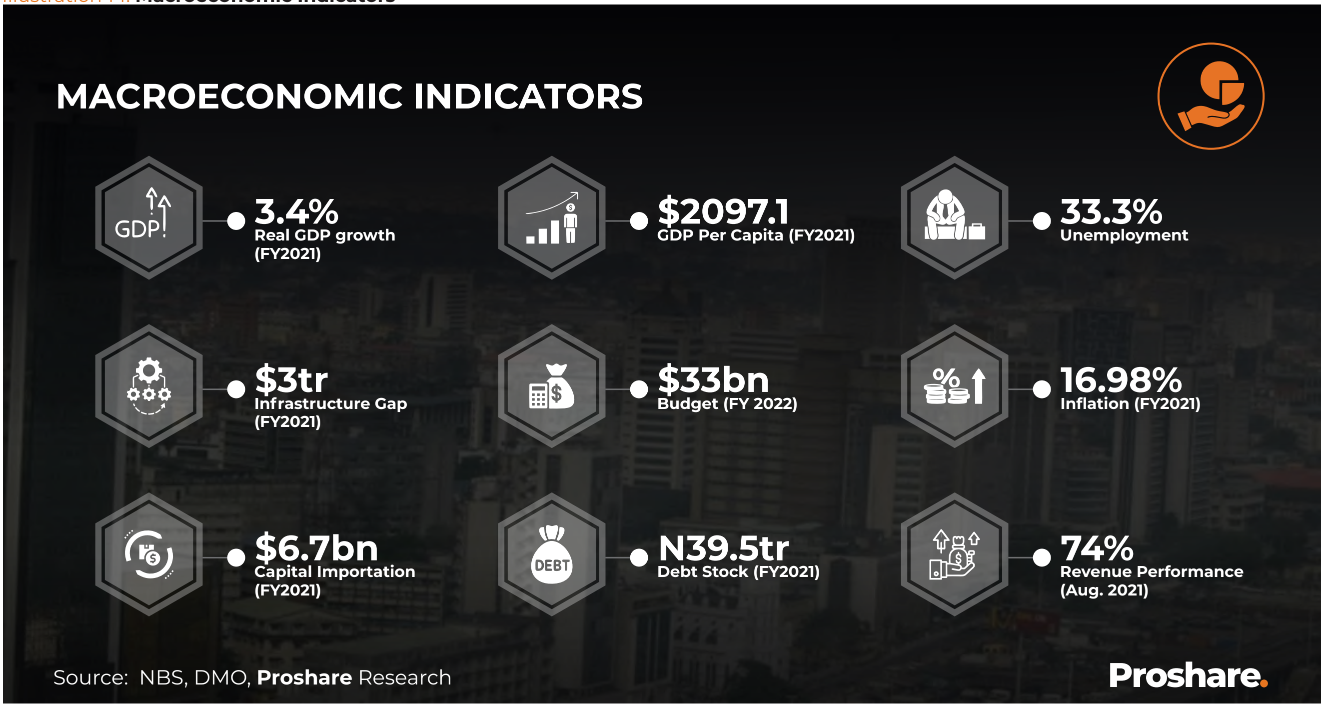
Source: Nigerian Bureau of Statistics, **Proshare** Research

Policy Environment

In Nigeria, the heterodox monetary policy which the CBN has employed since September 2020 when it adopted the accommodative monetary policy stance it maintains to date. So, while it held the monetary policy rate at 11.5%, Cash Reserve Ratio CRR at 27.5%, and Statutory Liquidity Ratio at 30%; the monetary authority has continued to manage excess liquidity through Open Market Operations. Meanwhile, the Money supply has continued to rise, with Money supply (M3) hitting N44.581tr in January 2022, at the same time in 2021, Money in circulation was N38.9tr, the CBN has attributed the rise in Net Domestic Assets (NDA). Nigeria's foreign reserves gained from the $4bn Eurobond issuance and $3.35bn Special Drawing Rights (SDR) awarded by the IMF in 2021. International reserves closed in 2021 at $40.5bn but have subsequently dipped to $39.55bn in February 2022 this is despite the rise in crude oil prices.

On the Fiscal side, having contended with a year-long revenue drag, fiscal deficits widened, and government debt rose to N38.005tr at the end of 2021. The debt profile however does not take the ways and means finances offered by the Central Bank to the Federal government into consideration (*see illustration 14*).

Illustration 14: **Macroeconomic Indicators**



Emerging Priorities of Deposit Money Banks

National Development Plan

Nigeria's National Development Plan is a medium-term economic programme that replaces the 2017 Economic Recovery and Growth Plan which ended in 2020. The NDP has its main objectives. The 6 broad objectives of the Plan are:

- Economic Diversification
- Investment in Infrastructure
- Security and good governance
- Educated and healthy population
- Poverty Alleviation
- Economic and Social development across states.

Importantly the NDP has a financing target of N348.1tr with the public sector expected to provide N49.7tr, Private sector would be providing the critical mass of the funding required(N298.3tr). The plan sets out an average budget deficit of 1.68% of GDP and a surplus of 1.35% by 2025. The NDP noted that over the years several industrialization projects have been delayed owing to underfunding infrastructure. Nigerian banks would be critical to the success of the NDP as analysts have noted syndicated loans.

Aviation & Rail Transportation

In the Aviation sector, there are ongoing PPP initiatives relating to four international terminals – Lagos, Abuja, Kano, and Port-Harcourt. The Lagos Terminal was recently commissioned by President Muhammadu Buhari. Other PPP initiatives in the sector include the set-up of a Maintenance Repairs and Overhaul (MRO) Facility, the establishment of a National Carrier, and the development of the Aviation Leasing Company (ALC). In terms of Railway transport, the government is eyeing the rehabilitation of the Western and Eastern narrow-gauge rail lines, as well as the construction of new rail lines linking agricultural hubs, solid mineral sites, and major industrial centers.

Electricity Infrastructure, Energy transition, and Alternative Energy

The electricity value chain comprises 23 generating plants with a capacity of 12.5MW. Despite the privatization of that section, power generation suffers from maintenance and repair requirements. Although the country's huge gas production serves 85% of the plants on the national grid, poor gas pipeline and processing infrastructure often result in insufficient gas supplies. Investment in gas supply infrastructure has over the years been considered unviable due to the low domestic gas prices. The Transmission stage on the other hand suffers from underinvestment in building new infrastructure and a lack of appropriate maintenance of the current infrastructure.
The transition from production and consumption energy systems that are high in greenhouse gas (GHG) to those that are renewable with net-zero emissions requires banks to commit to cleaner energy by extending credit accordingly while also helping to originate bonds and re-package existing green loans into securitized structures.

Tech

Nigerian Banks are quickly adopting technology, some own tech foundries, many have expressed their strategic intent of morphing into complete digital banks. This would mean that Nigerian banks would set out to rival such tech companies as Flutter wave. In this wise, the future of banking rests heavily on the ability of banks to adapt to new technology. Enormous opportunities abound in the disruptive innovations of Fintech start-ups and labs and while some banks have chosen to prevent their industry from being taken over and actually compete with fintech others have been passive. Banks need to position themselves by removing bureaucracy and attracting young talents to promote innovation and growth. According to the 2016 issue of McKinsey's Cutting through the noise around financial technology report, only 11% of fintech start-ups provide large corporate banking services. This presents an opportunity for Nigerian Tier 1 banks.

Infraco
The banking business across the globe is becoming more dynamic and the major drivers of the transformation are technological innovation, financial globalization, Energy transition and trade agreements, and diplomatic ties and conflicts. Banking in Nigeria like in other emerging economies has been a highly regulated industry. The N15tr infrastructure company is expected to attract investment to bridge the country's large infrastructure funding gap. Public Infrastructure companies in other climes tend to raise capital through public equity markets.

New growth sectors
A glance at the growth rates of specific sectors in the Nigerian economy shows that in the period between 2016 and 2021, the Water Supply sector recorded an average growth of 11.42%. This is the best performance by any sector over the period. The ICT sector comes in second place having grown by +7.6%, the Electricity sector which recorded a -2.24% contraction in 2016 has since then grown on average by +6.88%. In 2021, the sector recorded a growth of +27.57% - the highest increase in the economy. Other sectors that have recorded decent growth over the period include Transport (+6.35%) and Financials (+5.92%) (*see chart 33*).

Chart 33: **High Growth Sectors in the Nigerian Economy 2016-2021**

Source: Nigerian Bureau of Statistics, **Proshare** Research

What Made FUGAZE Top of the Banking Pile:
The Afrinvest Paradigm

Bank tiers are a system for classifying banks based on their size to the entire balance sheet. The size ranges for each bank tier vary by region. While certain banks specialize in certain areas, the Analyst evaluates institutions based on a variety of parameters. Financial institutions that survived the 2008 global financial crisis went back to work, a conflagration that started in banks and spectacularly ended many of them. They built capital, mended fences with regulators, and invested in digitalization to build relationships with customers and wrest more efficiencies from their back-office processes.

The COVID-19 pandemic's impact on banking both at the global level and the domestic level was mild compared with that of the 2008 financial crisis. The performance and financial position of Nigerian banks were more impacted in the second and third quarters of 2020, the rebound in earnings happened immediately.

Top tier banks are considered systemic important banks as one of the fallouts of the 2007 financial crisis was a call for measures to deal with systemically important financial institutions, seeing the failure of large and complex financial institutions led to severe undesirable contagion effects that included the disruption of the financial system and real economy. The classification of top-tier or tier 1 banks as systemically important banks (SIB) is not far-fetched as SIBs are based on size, interconnectedness, substitutability, cross-jurisdictional activity, and complexity. At the domestic level, some of the FUGAZE (an acronym for FBNH, UBA, GTCO, Access Bank, Zenith Bank, and ETI) can be considered SIBs in terms of asset size, cross-jurisdictional activity, and complexity.

FUGAZE – Top of the Pile

Gross Earnings

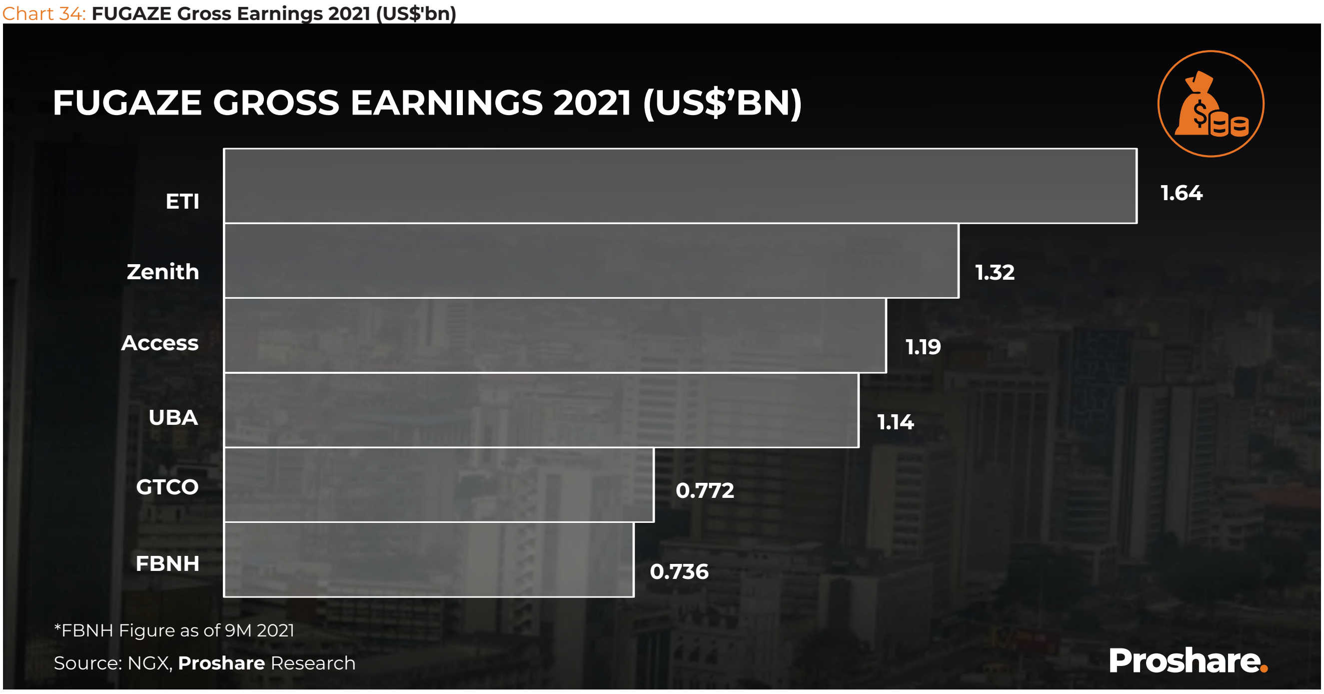
Ecobank Transnational Incorporated (ETI) maintained its 2020 position as the largest bank by gross earnings in 2021. Gross earnings for ETI stood at US$1.64bn (N952.95bn) which rose Y-on-Y by +13.10% from US$1.45bn (N841.14bn) in 2020.

Surprising First Bank Holdings (FBNH), the oldest bank in Nigeria ranked the least in gross earnings US$736.26m (N427.03bn) in 2021, the bank recorded a decline in gross earnings, it fell by -26.33% from US$999m (N579.43bn) in 2020.

The Pan African nature of ETI can be said to have aided its performance in gross earnings, however, that argument isn't the same with UBA which also operates as a pan African financial institution (*see chart 34*).

Chart 34

Chart 34: **FUGAZE Gross Earnings 2021 (US$'bn)**

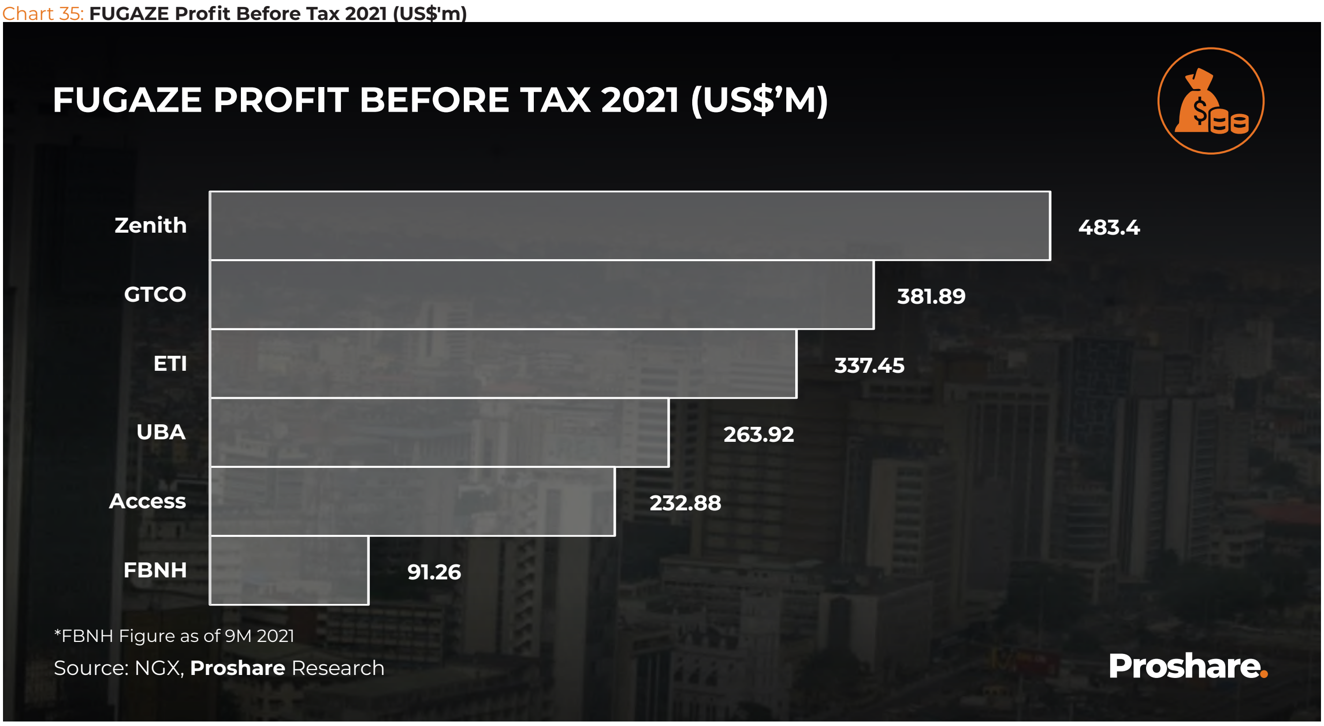


Profit Before Tax

Zenith bank the largest bank by shareholders fund in Naira terms also ranked as the most profitable listed bank on the Nigerian Exchange (NGX), though, the listed banks are also the largest in the industry. Zenith Bank's profit before tax (PBT) was US$483.4m in 2021 which rose by +9.58% against 2020 figures.

FBNH also recorded the least PBT in the charts, which declined by -36.76% to US$91.26m from US$144.32m in 2020 (*see chart 35*).

Chart 35: **FUGAZE Profit Before Tax 2021 (US$'m)**



The Financial Position

Total Assets

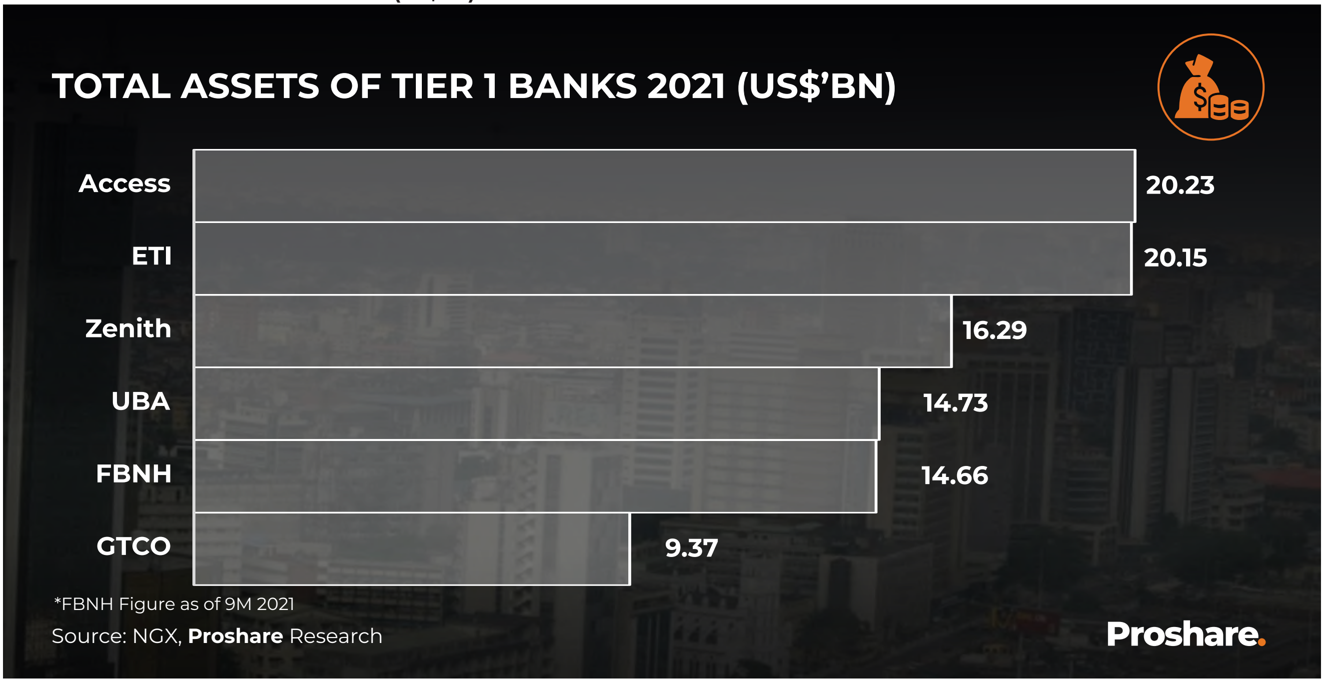
The FUGAZE had a double-digit value with an average growth rate of +16.04%. Access Bank was perceived to be the bank with the largest total asset in 2021. The total asset of the bank grew by +35.16% to US$20.23bn (N11.73trn), moving ETI which had the largest total assets in 2020 to the second position of US$20.15bn (N11.69trn) and Zenith Bank came third with US$16.28bn (N9.45trn).

The improvement in Access Bank's total assets was the result of a +3.29% increase in non-pledged trading assets, +105.51% in cash and balances with the central bank, +29.77% increase in investment securities, and +10.23% in the restricted deposit of the bank.

A decrease of -48.48% in pledged assets pulled ETI to the third position of +12.15% percentage growth and second position in total assets of the bank.

despite the +25.22% increase in cash and cash balances, GTCO had the lowest value of US$9.34bn (N5.44trn) in total assets and a percentage growth of +9.94% (*see chart 36*).

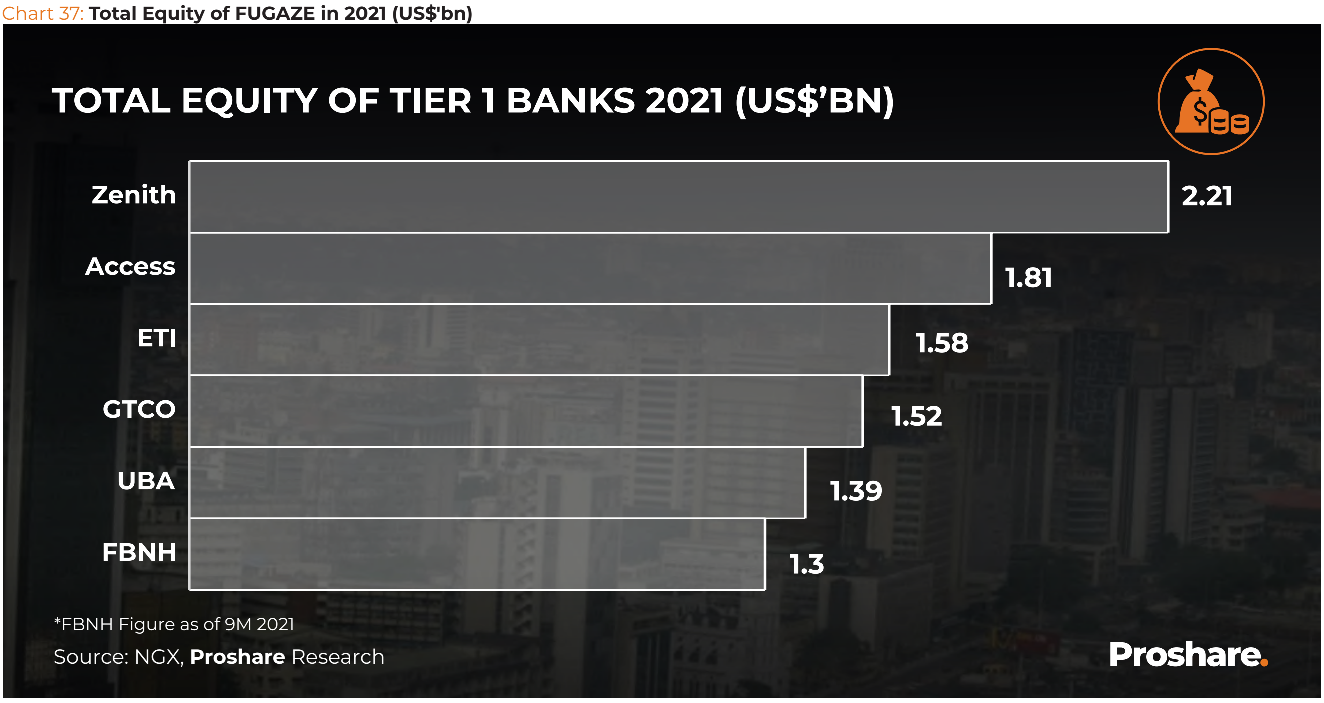
Chart 36: **Total Assets of FUGAZE in 2021 (US$'bn)**



Shareholders Fund

In terms of shareholders fund, Zenith Bank had the largest shareholders fund in two consecutive years. shareholders fund of the bank grew by +14.51% to US$2.21bn (N1.28trn) in 2021. The growth was on the back of +16.48% in retained earnings and a +23.46% increase in other reserves of the bank.
Access Bank ranked as the second-largest bank by US$1.81bn (N1.05trn) shareholders fund with the highest percentage growth rate of +39.81%. while FBNH had the lowest value both in shareholders fund and a growth rate of +5.83% (*see chart 37*).

Chart 37: **Total Equity of FUGAZE in 2021 (US$'bn)**

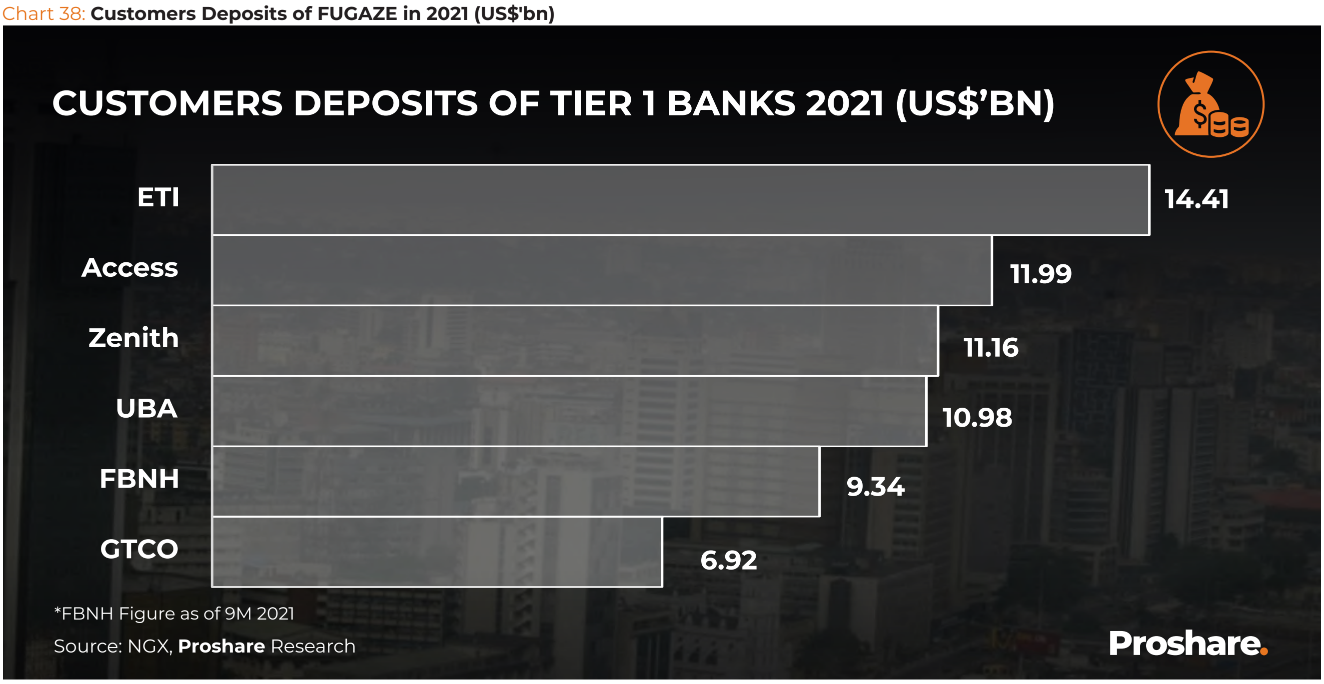


Customers Deposits

customers deposit of the FUGAZE grew considerably as two of these banks had a percentage growth above the +17.05% average growth rate of the banks. Access Bank appeared as the bank with the highest percentage growth rate of +24.47% with the second-highest value of US$11.99bn (N6.95trn) in customers' deposits. Zenith Bank came second with a growth rate of +21.20% and US$11.16bn (N6.47trn). FBNH ranked third, the bank had a growth rate of +16.97%.

While ETI which had the highest value of US14.41bn (N8.36trn) in customers deposit came fifth with a growth rate of +14.14% (*see chart 38*).

Chart 38: **Customers Deposits of FUGAZE in 2021 (US$'bn)**

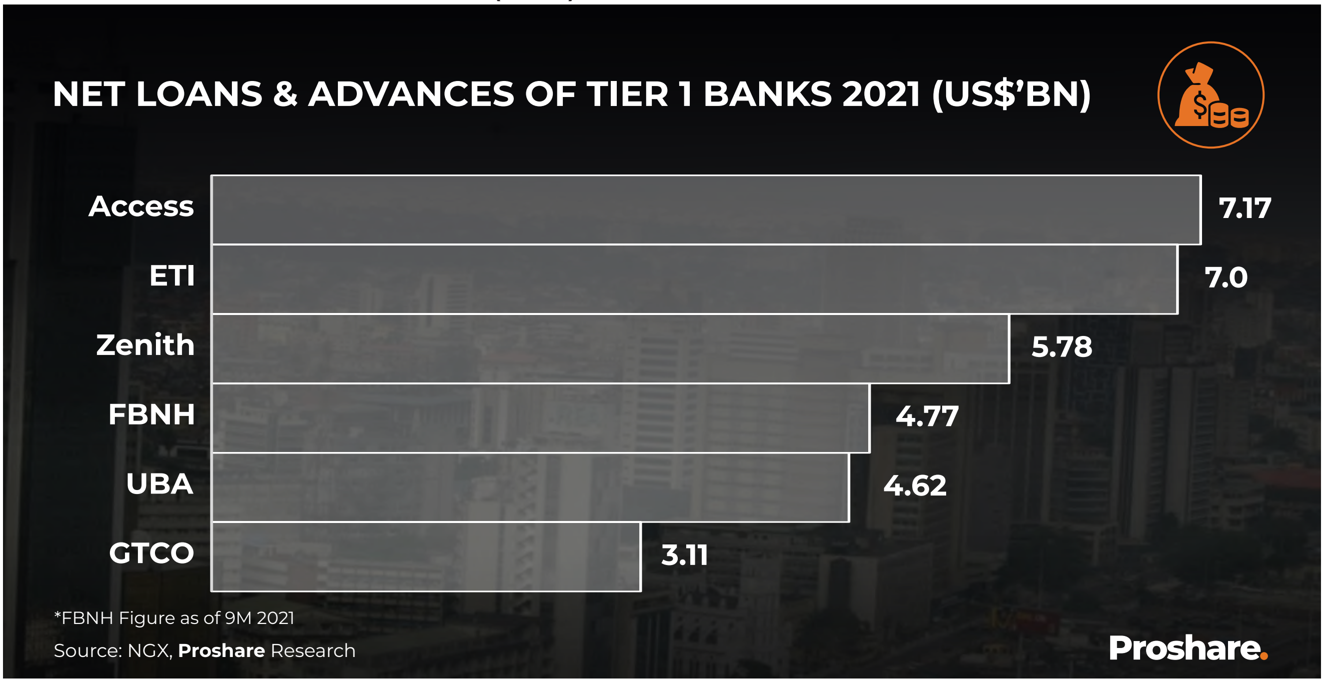


Net Loans and Advances

Access Bank which came second after ETI in 2020 had the highest value of US$7.17trn (N4.16trn) as loans and advances to customers. The bank had the second-highest growth rate of +29.31% in 2021. a percentage growth rate of with a growth rate of +29.31%. ETI came second with a value of US$7.0bn (N4.06trn) in 2021 and a growth rate of +9.93%. Zenith Bank ranked third both in loans and advances with a percentage growth of +20.75%.

while GTCO appeared to be the bank with the lowest value of US$3.11bn (N1.80trn) with a growth rate of +8.41% (*see chart 39*).

Chart 39: **Net Loans & Advances of FUGAZE in 2021 (US$'bn)**



Tier 1 Banks in the Context of Disruption and Technology - Decentralized Banking

"We live in an era of disruption in which powerful global forces are changing how we live and work. The rise of China, India, and other emerging economies; the rapid spread of digital technologies; the growing challenges to globalization; and, in some countries, the splintering of long-held social contracts are all roiling business, the economy, and society. These and other global trends offer considerable new opportunities to companies, sectors, countries, and individuals that embrace them successfully—but the downside for those who cannot keep up has also grown disproportionately. For business leaders, policymakers, and individuals, figuring out how to navigate these skewed times may require some radical rethinking." ***- Executive Briefing, McKinsey January 2019***

In the future, banks that win the competitive contact sport called business will rely on their ability to adapt technology to fit evolving customer journey experiences. As consumers become mobile and more flexible in their work culture, they would expect the following service standards:

- Speed
- Clarity

- Consistency
- Interactiveness (adaptability)
- Best governance practice

The younger bank customers would also expect to see environmental friendliness and social sensitivity. The digital age of banking would break old barriers by bringing in more customers at cheaper costs and improving market access to rural and urban small to medium-sized enterprises. Technology would also be a boon to microentrepreneurs wanting to service a larger customer base using digital platforms. The ease of merchant payments and settlements using Unstructured Supplementary Service Data (USSD) exemplifies how improved technology can support business growth. Platforms like Facebook, Twitter and Instagram are being used as marketing platforms where merchants and individuals sell in space rather than in a place.

Fintechs have started to grant loans and provide commercial payment platforms, but many are beginning to realize their folly at brazenly barging into the risk asset business. Be that as it may, banks cannot be indifferent to the challenge that Fintechs bring in making loans more accessible to customers. While Fintechs lack the credit evaluation competencies of deposit money banks (DMBs), they have the technical capacity to ensure payments and settlements quickly and safely. The evolution of the fintech onslaught into banking-type services would be greater digital oversight by the regulatory authorities and tighter controls over lending activities such as setting reserve requirements and minimum tier 1 capital base for digital mobile lending platforms.

Banking is changing. Banks, and their customers, are riding a wave of innovation, reimagination, and reinvention, thereby intensifying retail competition and how customers are serviced. Technology 'cancelled' routine teller functions, but it has also placed less repetitive jobs in the crosshairs of software developers aiming at automating lending and loan recovery decisions as financial service operators increasingly use big data to hedge loan risks and guide loan selection. The AI of banking is not on its way; it is here.

Market analysts note that the anonymous customer no longer exists and growing digital footprints have given Nigerian lenders an insight into the psychology of borrowers and the potential buying habits of customers. The character of customers can be gleaned from the pile of data buried in their income statements, spending habits, investment choices, and saving cycles. These digital footprints apply to both corporate and individual customers.

Indeed, access to massive data on individuals and corporations means that unlike in the past, when knowing the customer was a hit-or-miss affair, the new data age of machine learning (ML) and artificial intelligence (AI) unpacks the customers' lifestyle. However, what might still prove difficult is determining a customer's character, but this is not entirely impossible, or at least it could be made less random by using AI and ML as guardrails for assessing behavioural patterns and customer reliability.

With more data about individuals and corporations becoming available to lenders daily, the once far-fetched concept of 'open' banking is moving from fringe speculation to mainstream implementation. Local banks are accessing customer transaction data to build financial solutions that meet customers at their points of pain and are opening up wider opportunities to properly appraise services such as temporary overdrafts to meet short-term cash flow deficiencies based on such things as salary expectations. Loan repayment cycles could establish a digital footprint of a customer's ability and willingness to repay loans to form a 'character map.'

Such character mapping has improved rural financial inclusion and greater female economic participation in places like East Africa, but not everybody has caught the bug.

The Nays Have Their Say

In October 2015, the European Parliament approved a new Payment Services Directive, called PSD2. The new rules were intended to promote the development of innovative mobile online payments through 'open' banking.

However, some financial reviewers were unconvinced that this was the way to go. Mr. Mick McAteer of the UK's Financial Inclusion Centre thought that only digital natives would benefit from the development. He said that open banking was "a daft idea" that could worsen lower-income individuals' financial exclusion. McAteer argued that it was naïve for regulators to expect customers to take ownership of their data and negotiate good deals with the banks. He noted that banks could exploit customers based on the higher cost of sundry new products such as payday loans and the misuse of data and personal information that customers could inadvertently make public.

The pushback against open banking has not gained broader market support as fintech companies and banks have continued filling the 'white spaces' between customers and financial service providers. The gaps in service delivery in banking are being addressed by institutions that have taken advantage of the spread of telecommunications and the increased penetration of mobile telephony in frontier economies to meet customer service needs.

As good as AI applications and open banking appear to be on the surface, they could create significant challenges to individual data privacy. In trying to understand the customer's service experience, banks could face the morality of customer data mining and the selective bias of customer profiling. Highly priced services could be offloaded onto undiscerning customers who find themselves paying premium prices for services they could either ignore or perhaps defer (predatory lending).

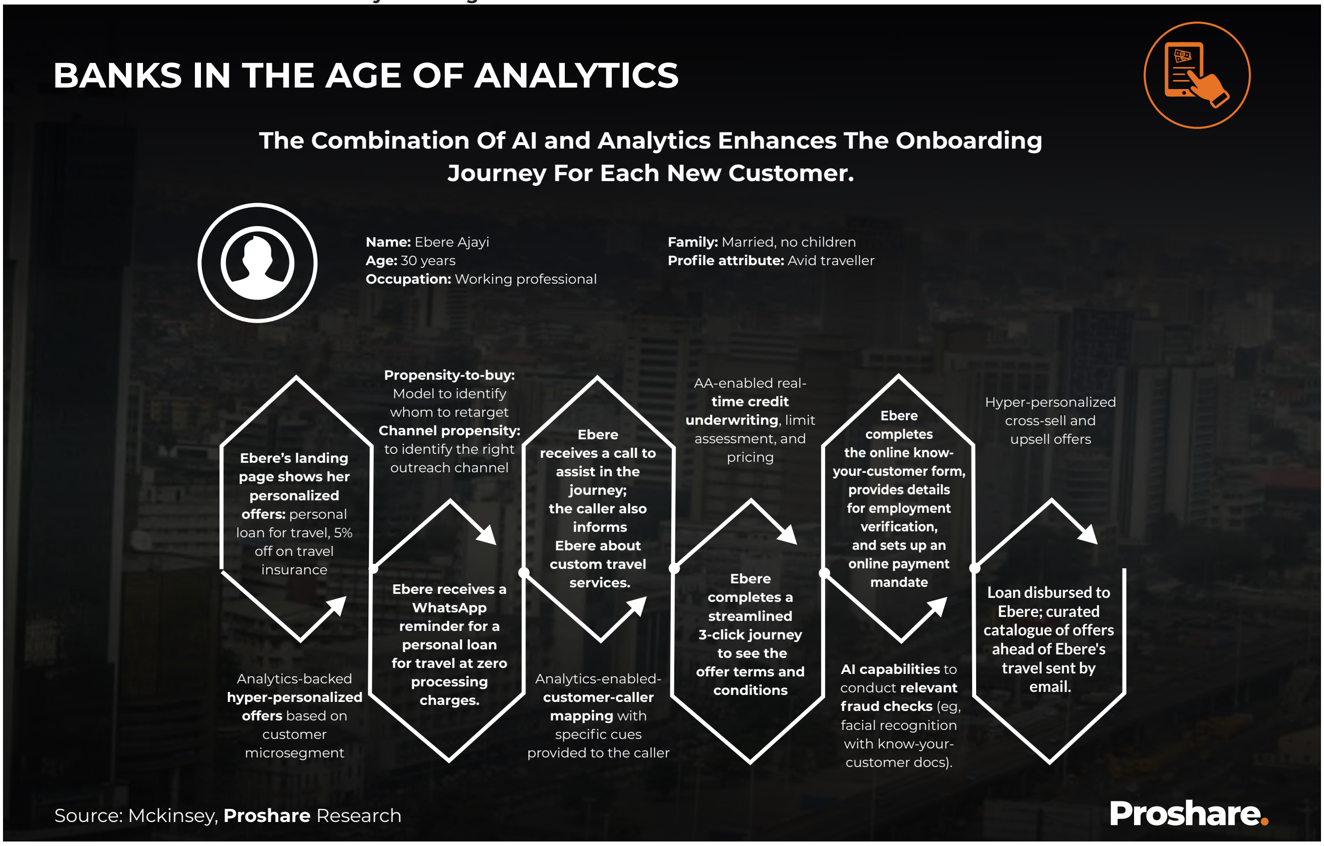
This issue is raised and debated in a March 2021 article in the International Monetary Fund's (IMF's) magazine Finance and Development. The writer Nikita Aggarwal, a researcher at the University of Oxford, England, notes a need for a balance between the rise in digital lending and consumer protection. This issue is yet to be resolved satisfactorily in the new digital marketplace.

She observed that 'datafication' of debt was used in increasing loans to poorer customers. Still, she noted that this comes at the cost of predatory pricing of services by banks and the loss of data privacy. Analysts have observed that the loss of data privacy may be accompanied by an improvement in the ability of lenders to assess whether a loan will go bad or not; in other words, loan delinquencies would fall as NPLs decline. There is still much debate on how customers' data is compromised by open banking. Still, Nigeria's Federal Competition and Consumer Protection Council (FCCPC) has more than a few months of work to figure out how to protect financial service customers using digital financial platforms.

But what is clear is that the age of AI and ML is here. Financial service delivery going forward will be more preemptive than reactive, and service providers will be more aware of customers' service expectations and experiences than they were in the past (*see illustration 15*).

Illustration 15

Illustration 15: **Financial Service Delivery in the Age of AI**



Nigeria's e-Banking: The Hookup

But while the FCCPC gathers its thoughts on the pricing of digital financial services, the lending train appears to be moving along. Local banks have continued to push the digital payment and lending services hard and fast as e-banking revenues rise as a proportion of gross bank earnings.

For example, in the financial year 2021, FCMB recorded gross earnings of N212bn, of which N26bn or 12% came from its e-banking activities. FBNH came second on the chart with gross earnings of N427bn of which N42bn or 9.84% from its e-banking activities while UBA made gross earnings of N660.2bn with N64.6bn or 9.78% attributable to electronic banking activities of the bank. Access Bank came fourth in the e-banking-to-gross earnings log, with the bank posting gross earnings of N971.9bn and an e-banking income of N66.28bn or 6.82%.

At the other end of the table, Stanbic IBTC had the lowest e-banking income with 1.79% gross earnings of N206.64bn and e-banking income of N3.69bn at FY 2021. Second, from the bottom was Fidelity Bank, with gross earnings of N250.78bn and an e-banking income of N5.29bn or an e-banking income as a proportion of gross earnings of 2.11%. What analysts found a bit surprising was that GT Bank, despite steady growth in its retail banking operations in the last few years, saw its e-banking income as a proportion of its gross earnings crawl at a relatively slow 4.71%, with e-banking income of N21.08bn over gross earnings of N447.8bn in FY 2021 (*see table 22*).

Table 22: **The Nigerian e-Banking Logbook in 2021**

E-BANKING: THE NEW CASH WALLET (N'bn)

Bank	Gross Earning	E-banking Income	E-Banking as a proportion of Gross Earnings
FCMB	212.01	26.10	12.31%
FBNH	427.00	42.02	9.84%
UBA	660.20	64.60	9.78%
ACCESS	971.89	66.28	6.82%
UNITY	48.97	3.04	6.21%
UBN	177.27	8.87	5.00%
ZENITH	765.56	37.47	4.89%
STERLING	142.32	6.75	4.74%
GTB	447.81	21.08	4.71%
WEMA	93.63	2.64	2.82%
FIDELITY	250.78	5.29	2.11%
STANBIC	206.64	3.69	1.79%

** FBNH is 9M data*

Source: NGX, **Proshare** Research

Proshare.

Analysts have noted that the 9M 2021 data of FBNH, despite the drama around the sacking of its Board of Directors and its hitherto unknown forbearance status with the Central Bank of Nigeria (CBN), was able to pull off an impressive e-banking revenue coup as one of the highest e-banking revenue to gross earnings ratios for the banks listed on the NGX, this may be explained by the Holdco's large and expanding agency banking network of over 86,000 agents across the country.

FBNH's agency banking operations appear to have been the hub of a fast-moving and aggressive service delivery wheel. Indeed, looking into the future, analysts believe that the holding company could strategically position itself to use its massive market data to provide open banking services that would increase its market penetration, broaden its gender inclusion, and refine its user experience and customer interaction (UX/UI) across new market segments. Analysts believe that increased adoption and deployment of artificial intelligence (AI) and machine learning (ML) could help the lender to derisk its loans and improve its non-performing lending assets (NPLs) as its loans-to-deposit ratio (LDR) rises. Of the thirteen (13) banks listed on the local stock market (NGX), the top tier banks had the lowest loans to deposit ratios in 2021, implying that they would likely have incurred large CBN penalties debited against their cash reserve ratios (CRR) for the year (*see table 23*).

Table 23: **A Quick Look at Nigerian Banks 2021 NPLs and LDRs**

A QUICK LOOK AT NIGERIAN BANKS 2021 NPLS AND LDRS

Bank	NPL	LDR
ACCESS	4.00%	50.80%
ETI	6.25%	51.88%
FBNH	7.30%	52.80%
FCMB	3.20%	66.40%
FIDELITY	2.90%	85.56%
GTB	6.04%	42.08%
STANBIC	2.10%	78.02%
STERLING	0.70%	58.50%
UBA	3.60%	40.36%
UBN	4.70%	62.60%
UNITY	0.03%	83.24%
WEMA	4.88%	45.16%
ZENITH	4.20%	54.10%

** FBNH, FCMB, and UBN are 9M 2021 data while Unity is 2020 data*

Source: Earning Presentation, **Proshare** Research

Proshare.

Bridging the Present, Past, and Future

The old days of banking without sophisticated analytical tools had their strengths in that they required the development of individuals into behavioural analysts, accounting experts and subject matter industry specialists.

However, human beings with their foibles provide less reliable interpretation of data and are potentially influenced by sentiments and personal biases making the outcome of their decision-making less dependable. With artificial intelligence, machine learning and big data, the basis of preempting customers' needs and meeting their expectations becomes less arbitrary. Financial lenders in contemporary times can break down customer data into a series of reports that onion slice the needs of each customer given the constraints of the business environment and the future outlook of an industry. At an individual level, AI and ML will produce reports that would enable lenders to build services around the customer's experience journey and aspirations.

The new Nigerian financial lender is a cyborg with machines running complex and critical calculations to complement the banker's deep industry knowledge and unique customer insights. Today's financial service manager or banker will metamorphose further as data becomes broader and deeper and machines develop better analytical capabilities.

The new AI game will produce winners and losers.

The winners will include:

Winners will include lenders that are flexible and agile. These institutions will loop digital sandboxes into product and service pipelines with short lead times. Customers of banks and other financial service providers would meet service delivery requirements tailored to suit individuals with high levels of personalization. Programmers will have a field day reimagining services and products and going wild within limits.

Ancillary industries that manufacture computer hardware and provide cloud storage, data mining services and data analytics will be on an upward swing. Telephone manufacturers with phones that enable consumers to achieve greater engagement with markets and financiers will see rising revenues.

Digital content providers in raw commodities, business and financial markets will witness rising patronage as more individuals use their mobile devices for as much business as pleasure. New customer and partner ecosystems that will forge alliances to support improved mobile customer service experiences (*see illustration 16*)

Illustration 16: **The New Digital Ecosystem**

Source: **Proshare** Research

The Losers will include:

Financial service providers are slow on the uptake of customers' need for agile response, flexible service structures and customer journey sensitivity. Crusty deposit money institutions (DMIs) will increasingly see deposits and earnings flatten.

Institutions that allow customer data go 'dead.' Corporations that do not use customer data to refine products and services will find themselves cheering from behind with no medals and no glory Corporations that fail to feed into AI and ML ecosystems will find that they would be 'cancelled' by millennials and generation Y and Z customers impatient with the slowness of service delivery and the tackiness of user experience and interface (UX/UI). With the majority of Nigeria's population being between the ages of 0 and 34 and with a bulge between the ages of 18 and 40, service providers need artificial intelligence and machine learning to model consumption patterns and consumer preferences to design products and services that speak to these demographics.

Old economy companies will give way to newly reimagined businesses in entertainment, hospitality, healthcare, financial services, and air travel. Even surface transportation such as buses and trains will have to reimagine their futures, emphasizing less carbon emission and improved commuter leisure at lower average costs. Conversations are ongoing using compressed natural gas (CNG) buses for urban commutes and electric trains for light intracity mass transit movement. Regarding upper-end urban housing, families rely on private solar-powered energy rather than the gas-fired or hydro-powered public alternatives.

Technology disruption is not a fad but a fact. The adoption of mobile digital platforms will be woven into the consumer's transaction journeys and underline how people work, play, and communicate in 2021 and beyond. Companies outside the digital loop will stumble, shrink, and disappear. The winners will adapt to the financial services sector while the losers will delay and be zapped (*see illustration 17*).

Illustration 17: **Eyes on New Technologies**

The Future of Now

Technology has taken a swing at old-world economics and is establishing new paradigms of how people interrelate and collaborate. The emerging trends establish that payment transactions will become faster, more flexible, and broader by penetrating hitherto tricky locations to reach.

Indeed, the ability to dimension a borrower's spending and saving habits suggests that micro-lending, micro-insurance, and micro-leasing will increase and proliferate as lending institutions prepare themselves with the right amount of data and the enormous power of analytics to establish risk profiles and make carefully measured lending decisions.

Another shift in the evolving lending architecture would be adopting digital records of borrowers with a permanent register of delinquent loan-takers. The profiles of hardcore debtors would be on a referable digital register that would allow lenders easy access to information across lending platforms and institutions. A platform that has taken a headstart in providing such an archived and searchable digital database is Debtors. Africa.

In a report published in 2019, the delinquent debtor digital database managers noted that "If there is one characteristic that will define the success of winners and losers in the new loan ecosystem, it is transparency, banks hiding delinquency behind a stump of grass will soon discover that their nakedness is as clear as that of a day-old baby. The only way for banks and their borrowers to create a sustainable credit environment is to stand digitally undressed, with the delinquent borrower's character open to the world to see and make judgment calls" (www.debtorsafrica.com).

“In God we trust; everybody else must bring data."

Data is the hemoglobin of the financial payment and loan systems. The customer and lender's journey touchpoints in 2022 will be anchored on the amount of shared data within the credit and payment ecosystem. The more data that exists and is shared, the better the system becomes and the easier it would be to create retail loan assets with minimal default risk. This should see deposit money banks comfortably raising their LDRs and reducing their NPLs. Of course, the high Central Bank of Nigeria (CBN) cash reserve ratio (CRR) of 27.5% would rein back lending growth, but the pull would be less severe with lower lending risks.

The rise of the data age will intensify technology applications in financial markets and increase transaction speed, data-induced resource distribution, investment allocation, and loan creation. Analysts generally agree that the future of data is here.

With the Nigerian economy (GDP) growing at 0.51% in Q1 2021 and inflation towering at 15.7% (February 2022), fiscal and monetary authorities have found themselves in a sticky place with policy choices requiring fiscal and monetary policy expansion to pull the growth rate up. Still, without prodding a rise in domestic inflation, the policy gymnastics has not been pretty so far.

However, it does appear that a ready tool for faster GDP growth is credit expansion without creating larger non-performing loan portfolios. This could be where artificial intelligence (AI) and machine learning (ML) adaptations prove to be welcome guests. The normality of adaptive technology in financial transactions may be what the doctor prescribes for an economy searching for credit growth.

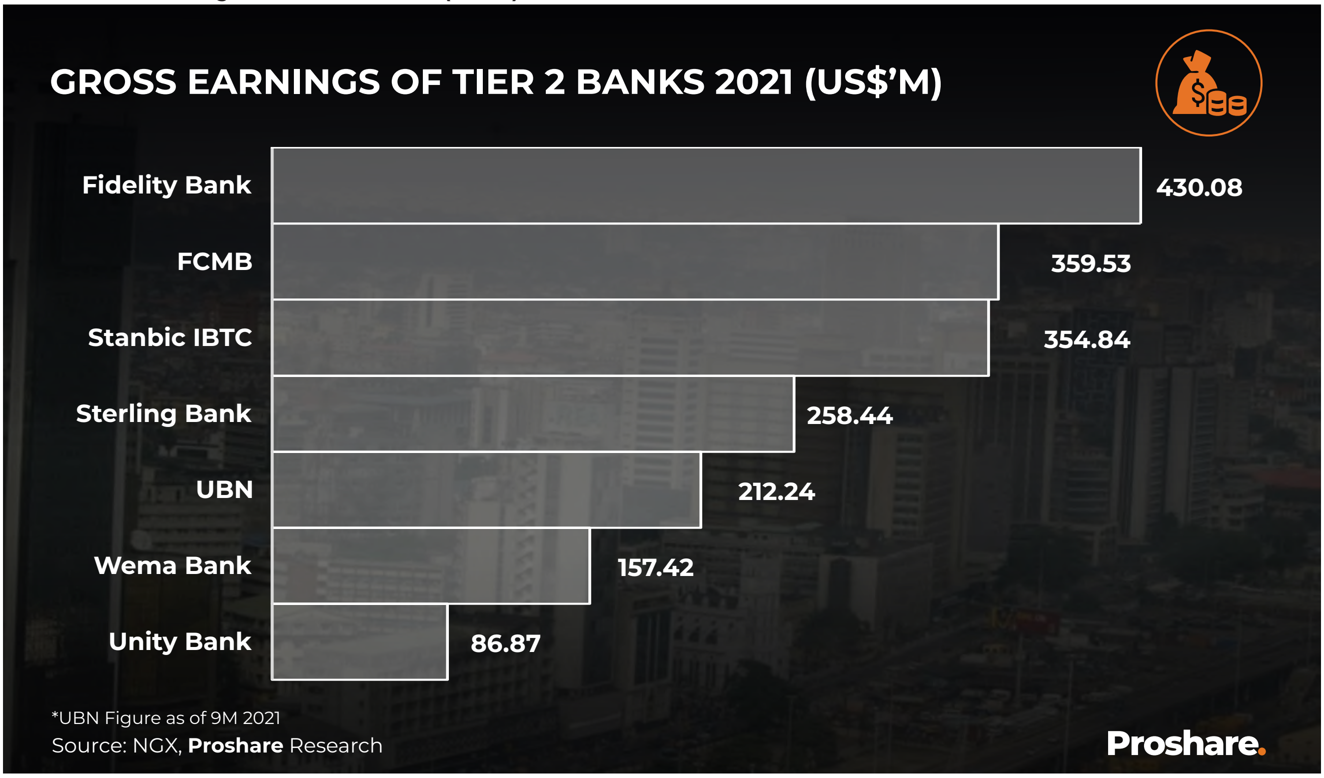
Tier 11 Banks: How They Measure Up

Gross Earnings

The gross earnings of listed banks classified as tier 11 banks had an average growth rate of +4.03% in 2021. Fidelity bank recorded the highest growth rate of +20.97% and also ranked first in gross earnings, kicking off Stanbic IBTC which had the highest gross earnings in 2020. Stanbic IBTC's gross earnings declined by -12.22% just after Union Bank which had the highest percentage decline of -23.20% in gross earnings in this group.

Not surprisingly, Unity Bank ranked last in topline earnings amongst these banks, recording US$86.87mn (N50.38bn) in gross earnings, however, in terms of percentage growth rate, the bank had the second-highest growth rate of +17.97% in 2021 (*see chart 40*).

Chart 40: **Gross Earnings of Tier 11 Banks 2021 (US$'m)**



Profit Before Tax

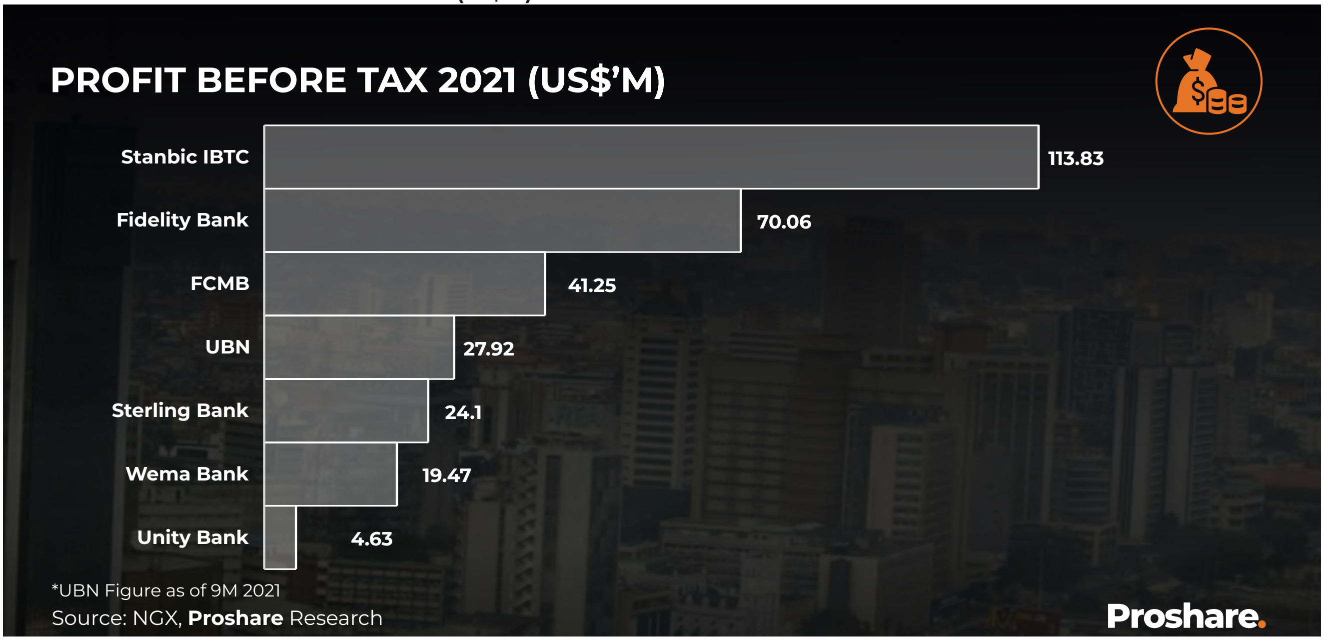
On the side of profit before tax, five banks recorded growth in PBT in 2021. Wema Bank topped the list with a growth rate of +90.32% and ranked sixth in the value of PBT, which was largely driven by +31.7% growth in operating income and a significant decline in impairment of -76.9%.

Fidelity Bank attained the second position both in percentage growth and value in PBT, reporting growth of +44.84% to US$70.06mn (N40.63bn) in PBT.

Although Stanbic IBTC reported the highest PBT of US$113.83mn (N66.02bn) in 2021, PBT declined by -30.30% which was the second-highest percentage decline amongst its counterparts.

Union Bank had the highest percentage decline in PBT, declining by -37.66%, while Unity Bank had the least value in PBT of US$4.63mn (N2.69bn), however, Unity Bank ranked amongst the banks in terms of the percentage growth rate of PBT (*see chart 41*).

Chart 41: **Profit Before Tax of Tier 11 Banks 2021 (US$'m)**



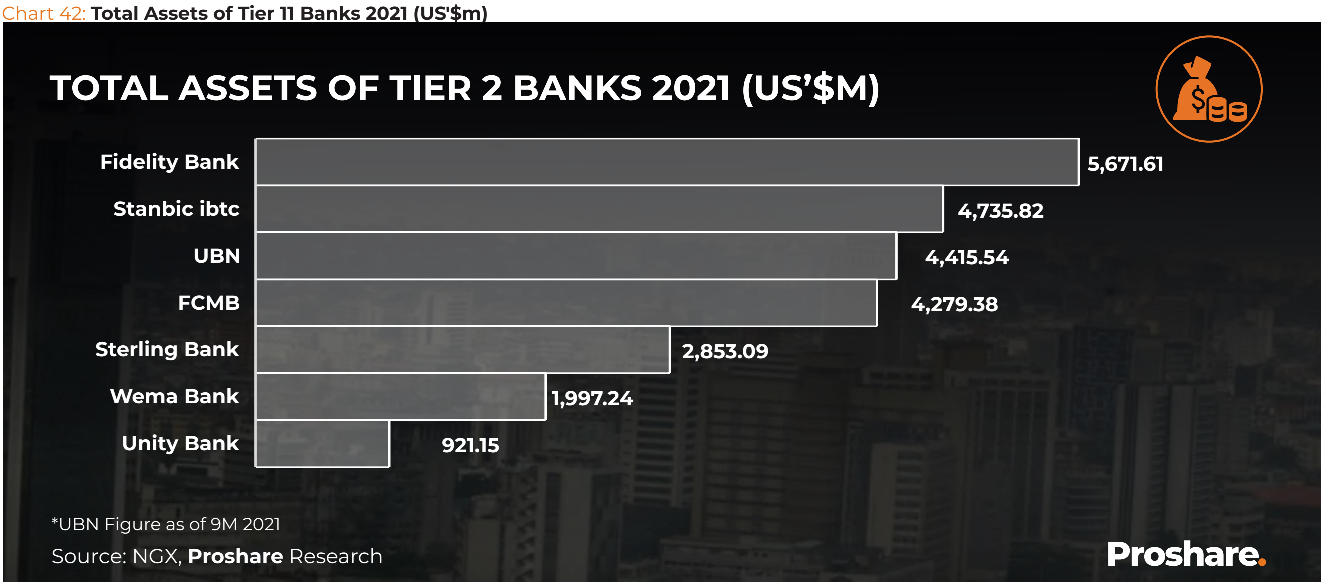
Total Asset

All the listed tier 11 banks reported a significant growth in assets with an average growth rate of +17.35% in 2021. Sterling bank had the highest growth of +20.54% and positioned fifth in the value of the asset, the increase was largely attributed to a +120.63% rise in the "other assets" line item of the bank, +32.13% increase in the cash and balances held with the central bank grew and +20.09% rise in loans and advances to customers.

Fidelity Bank had the second growth rate of +19.27% in assets and had the highest value in total assets amongst tier 11 banks. This was on the back of a significant rise of +17.85% in cash and balances with the central bank.

Unity Bank ranked last both in value and percentage growth, attaining a single-digit growth of +8.59% in total assets and US$921.15mn (N534bn) in value (*see chart 42*).

Chart 42: **Total Assets of Tier 11 Banks 2021 (US'$m)**

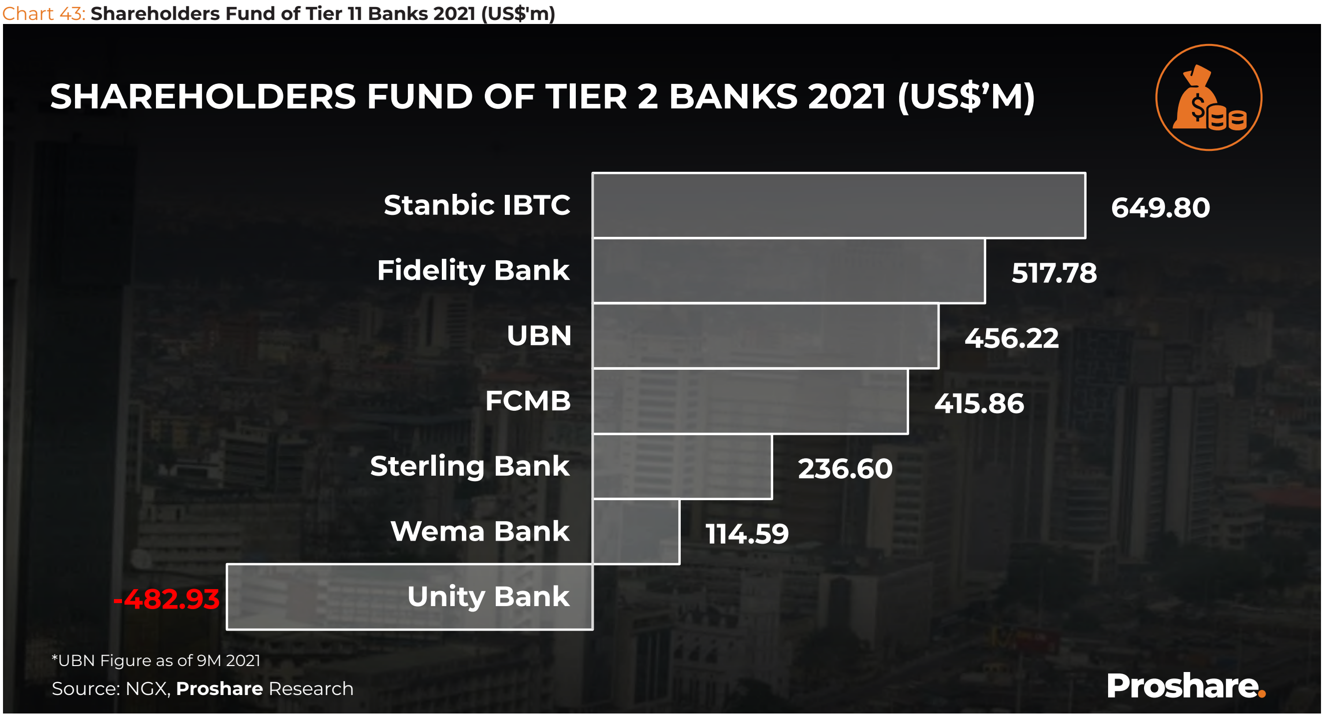


Shareholders Fund

On the stance of equity, Wema Bank had the highest percentage growth in shareholders fund, which rose by +12.38% from US$101.97mn (N59.14bn) in 2020 to US$114.59mn (N66.56bn) in 2021, the strong performance was as a result of a +99.82% increase in the retained earnings of the bank. Fidelity Bank has the highest value of shareholders fund and recorded a +9.79% growth.

Stanbic IBTC's shareholder's fund declined in the period, dipping slightly by -0.45% to US$649.8mn (N376.88bn). Unity Bank still maintained its negative shareholder's fund (*see chart 43*).

Chart 43: **Shareholders Fund of Tier 11 Banks 2021 (US$'m)**



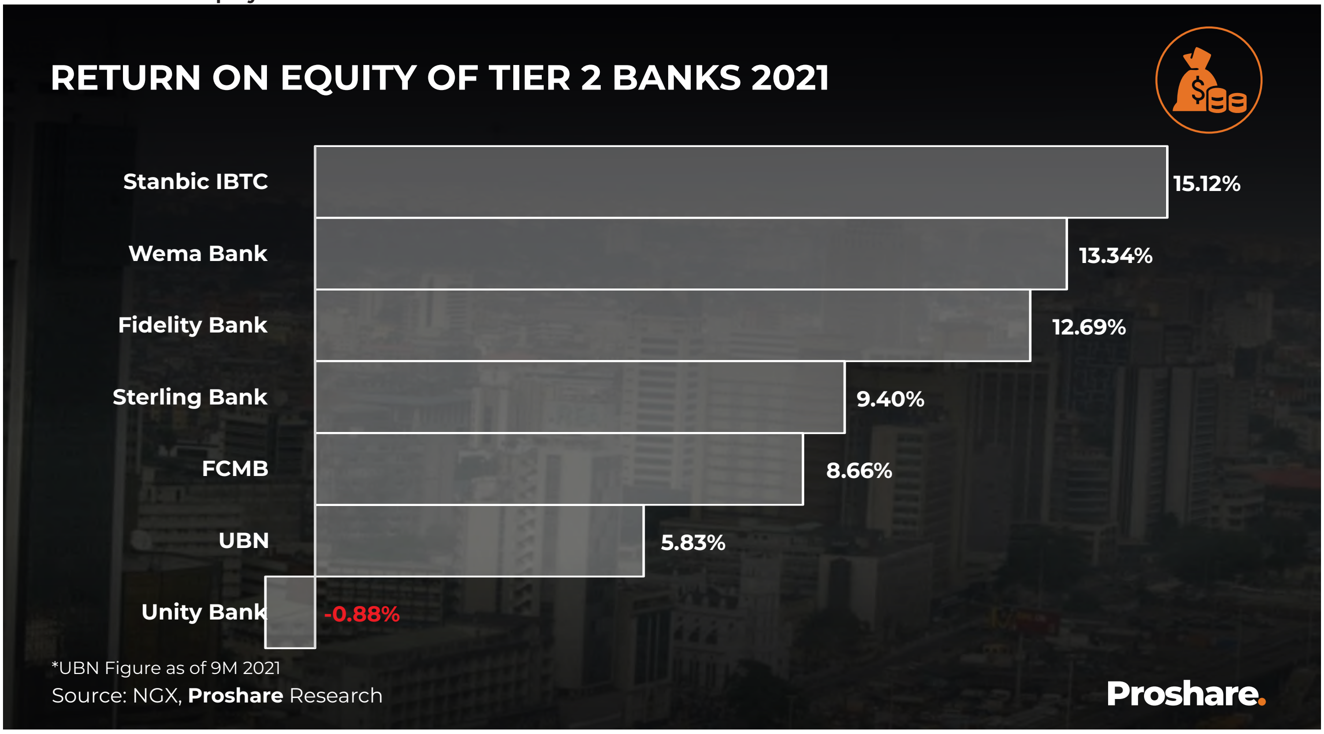
Return On Equity (After Tax)

All the banks in the tier 11 sector reported growth in equity except unity bank which has been on five years negative shareholder's fund. In its recent financials, Unity Bank reported a zero growth in the component of equity, other reserves of the bank declined by -11%, and a -1% decrease in retained earnings.

Stanbic IBTC gave investors the highest return on equity amongst tier the listed banks in 2021 (*see chart 44*).

Chart 44

Chart 44: **Return on Equity of Tier 11 Banks 2021**

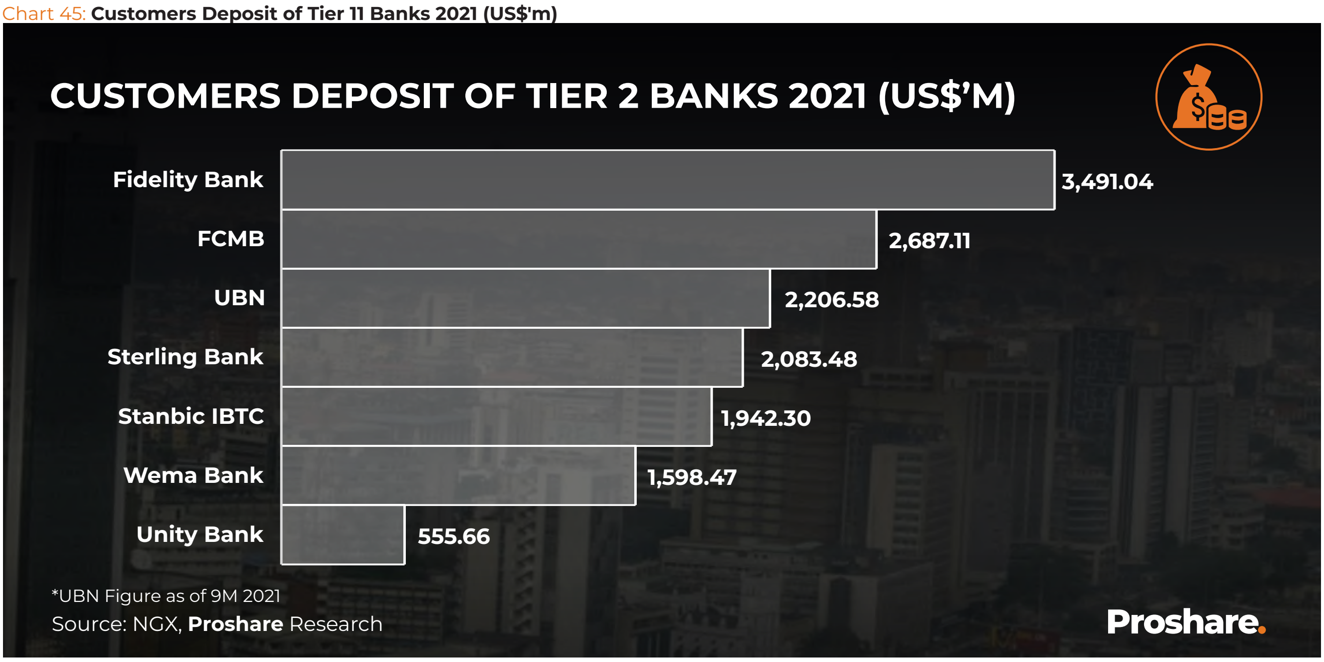


Customers Deposit

With US$3.49bn (N2.02trn) in 2021 in customers deposit, Fidelity Bank ranked first amongst tier 11 banks, with FCMB coming second. However, in terms of percentage growth, Stanbic IBTC recorded the highest growth in customers deposit which grew by +37.39% and Unity Bank had the second-highest growth in this category.

Union Bank of Nigeria (UBN) customers deposit had the least percentage growth, it edged up by +13.63% to US$2.21bn (N1.28trn) (*see chart 45*).

Chart 45: **Customers Deposit of Tier 11 Banks 2021 (US$'m)**



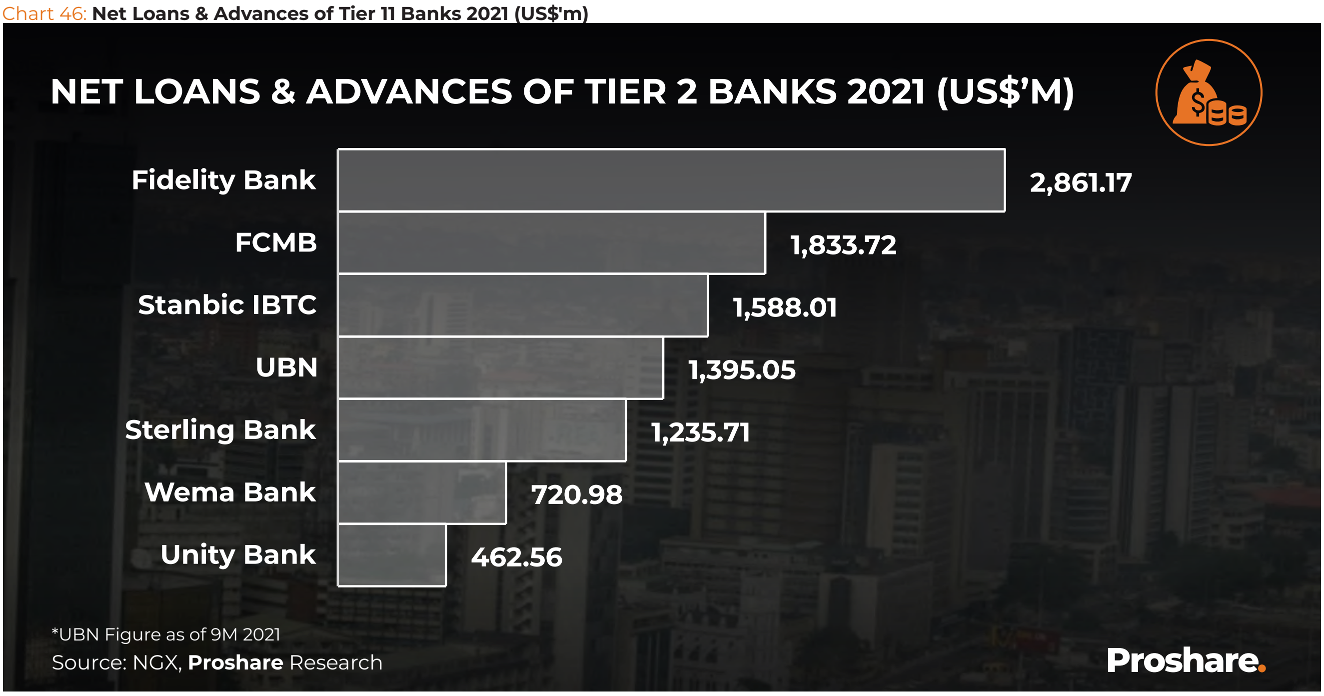
Net Loans and Advances

Tier 11 banks had double-digit growth in net loans and advances in the period, Stanbic IBTC led the pack with a +47.33% rise in loans and advances to customers.

In terms of value, Fidelity Bank had the highest net loans and advances of US$2.86bn (N1.66trn) and FCMB trailed behind with US$1.83bn (N1.06trn). Wema Bank recorded the least growth of +16.13% to US$720.98mn (N418bn) in 2021.

Unity Bank which had the lowest loans and advances to customers had a +32.76% increase in the period (*see chart 46*).

Chart 46: **Net Loans & Advances of Tier 11 Banks 2021 (US$'m)**



Some Ratio Analysis for Nigerian Banks

The analysis of the price-to-earnings ratio (P/E ratio) of Nigerian banks reveals that investors in most banks in the country are getting value for their investment. Analysts note that a P/E ratio between 8 and 15 is appropriate for value stocks in the industry. However, stocks with lower ratios have hidden values that may prompt investors to take a long position. The beta values above 1 for most banks reveal that the portfolio of banking stocks moves in line with the market direction, reflecting the high volatility of the banking stocks. Albeit, Access Bank, Stanbic IBTC, and Union Bank had beta values that reflect lower volatility.

Analysis of the net interest margin reflects the gaps in the investment profitability and efficiency of banks in the country. Available data shows that Sterling Bank had the most profitable investment return at 7.7% while Stanbic IBTC had the least return at 2.7% and others had net interest margins that oscillate within the range. On the flip side, investors across the banks made high returns on their equity investment as the cost of equity for the banks was high at an average of 15.96% with a variance of 2.70 in 2021.

Conversely, a lower cost of funds is indicative of cheaper access to funds in the interbank market. Available data reveals that most Tier 1 banks and Stanbic IBTC had access to cheaper funds than others in the industry within the period under review. GTCO had the lowest cost of funds at 0.88% while WEMA Bank had the highest cost of funds at 4% (*see table 24*).

Table 24: **Nigerian Banks' Valuation Ratios**

VALUATION RATIOS

Bank	Beta	P/E Ratio	Net Interest Margin	Cost of Equity	Cost of Funds
FBNH	1.65	10.63	4.40%	16.40%	1.90%
UBA	1.21	2.29	5.40%	15.93%	2.20%
GTCO	1	4.26	6.74%	15.68%	0.88%
Access Bank	0.93	2.17	4.30%	15.60%	N/A
Zenith Bank	1.21	3.47	6.70%	15.93%	1.50%
ETI	1.59	1.53	5.00%	16.38%	
Stanbic IBTC	0.88	7.86	2.70%	15.54%	1.50%
Sterling Bank	1.39	3.40	7.70%	16.14%	3.90%
Fidelity Bank	1.23	2.16	4.40%	15.96%	N/A
FCMB	1.51	3.46	6.90%	16.29%	
Union Bank	0.12	13.59	3.00%	14.64%	N/A
Unity Bank	1.54	0.02	N/A	16.31%	N/A
WEMA Bank	1.82	0.04	6.40%	16.65%	4.00%

**GTCO, Zenith, Access, ETI, UBA's Data as of FY 2021*
**FNBH, Sterling, FCMB, Fidelity, Union Bank, and Wema Bank Data as of 9M 2021*
**Stanbic IBTC's Data as of H1 2021*

Source: **NGX, Proshare** Research

Proshare.

Banking Regulation at **Home** and **Abroad**.

Banking Regulator's Industry Classification of Banks - Context and Calibration

"The Banking collapse was caused, more than anything, by bad government policy and the total failure of bad regulation, rather than by greed." ***- Nigel Farage***

The core function of the banking regulators is to provide regulatory and supervisory guidance to banks. To effectively conduct this function, the regulator classifies banks in different forms: scope of operation and systemic importance, among others. Whereas the operational classification is dependent on each national banking authority, the classification based on systemic importance is more of adapting the global standard to suit national needs. Banking regulators emphasize the regulatory requirement of the latter to support banking operations, provide insurance for depositors and debt holders, and act as coverage to absorb unexpected losses that could trigger financial instability. The inherent risks in the banking operation underscore the extent to which banking operators must comply and maintain the regulatory requirements such as capital adequacy, liquidity, and cash reserve requirements to reflect the potential costs of default or failure based on their systemic importance.

The Basel Accord of 1988 requires banks to maintain a certain level of capital in relation to their risk-weighted assets to minimize risks and losses to depositors' funds. Banking regulators across the world have adopted the recommended capital requirements to segregate banks in terms of strength and influence on the financial system. This underscores the guidelines on authorised minimum share capital, capital adequacy ratio (CAR), and tier capitals measures by regulators across the world.

As a primal requirement, banking regulators set an authorised share capital for operators in the industry. This share capital describes the value of share capital that a banking operator must hold to operate in the country.

Then, the regulators set prudential guidelines and regulatory capital that operators in the industry must comply with and maintain to support the soundness of the financial system. The total regulatory capital of banks incorporates Tier 1 Capital which is aimed at absorbing losses without constituting an event of default on the bank and Tier 11 Capital which is to absorb losses when Tier 1 capital has been eroded and the bank is in liquidation.

Tier 1 capital is the bank's core capital (going concern) and consists of Common Equity Tier 1 (CET1) and Additional Tier 1 Capital (AT1), net regulatory adjustments relevant to the categories. This covers permanent shareholders' equity (issued and fully paid ordinary shares and perpetual non-cumulative preference shares) and disclosed reserves (retained earnings, statutory reserves, SMEEIS reserves, and other reserves as identified by the Central Bank).

Tier 11 capital is the supplementary capital which includes undisclosed and revaluation reserves, debt/equity capital instruments, subordinated term debts, and loan-loss reserve net investments in unconsolidated financial subsidiaries and investments in the capital of other financial institutions.

Essentially, bank capital is described in tiers based on the relative size of the bank's assets and liabilities indicated by shareholders' equity, reserves, retained earnings, subordinated term debt, and hybrid capital instruments. This has formed the basis for classifying banks by the banking regulators aside from classification based on operational scopes and functions.

Global Calibration of Banks

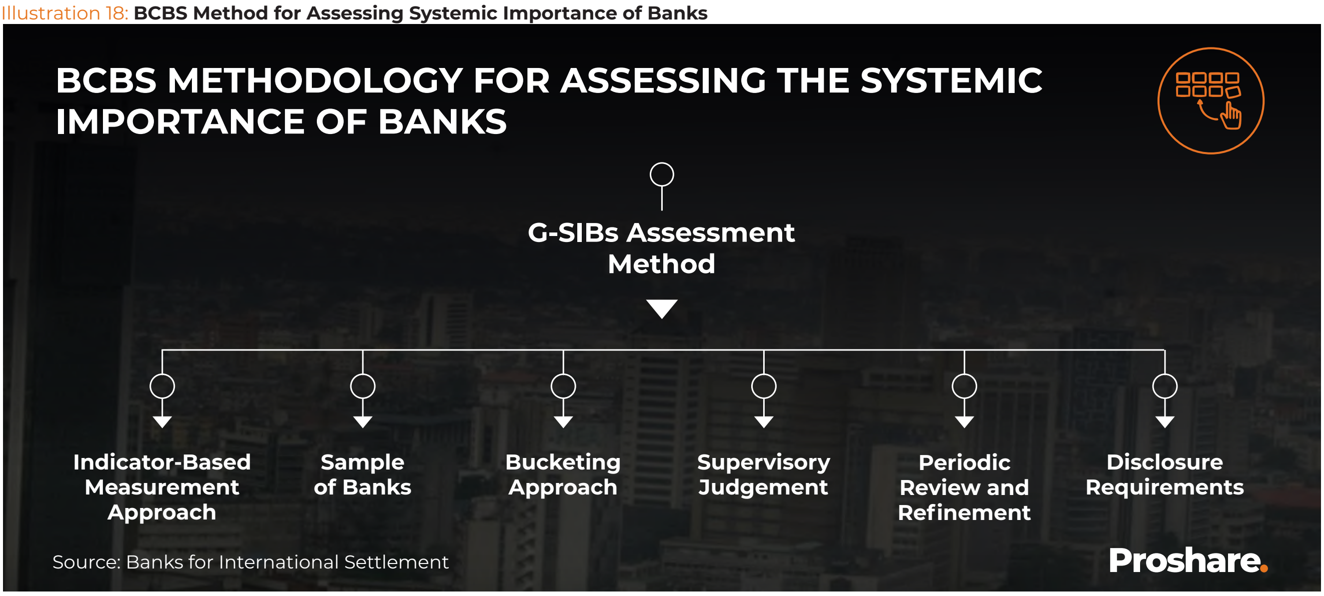
The Basel Framework is the global standard for the supervision and prudential regulation of banks. The primary focus of the framework is on the capital adequacy level applied to risk-weighted assets rather than the business model of banks. Hence, the Basel Committee on Banking Supervision (BCBS) constantly revises its regulatory capital requirement to reinforce and enhance the understanding of key banking supervisory and regulatory issues and improve the quality of the supervision and regulation. The core principle of the BCBS has the following primary objectives:

- Depositor protection
- Consumer protection
- Financial stability and
- Financial inclusion

The BCBS principle gives discretionary authority to each national banking regulator to legislate on prudential guidelines and regulations provided they do not conflict with the BCBS objectives. Banking supervision and regulation as structured by the committee is to reduce the probability and impact of the failure of a systemically important financial institution. The systemic importance of a banking institution is determined by its size, interconnection, substitutability, complexity, and global or domestic jurisdictional activities.

The BCBS broadly categorized banks into Global Systemically Important Banks (G-SIBs) and Domestic Systemically Important Banks (D-SIBs). The Basel Committee's methodology for assessing the systemic importance of banks uses some measurement approaches (*see illustration 18*).

Illustration 18: **BCBS Method for Assessing Systemic Importance of Banks**



Global Systemically Important Banks (G-SIBs) are banks with potential cross-border effects on the financial institutions of many countries and the global economy at large. This is not particularly a problem for national authorities and therefore requires a global minimum requirement. The BCBS methodology to identify G-SIBs assigns a weight of 20% each to five indicator-based measurement criteria of systemically important banks: size, cross-jurisdictional activity, interconnectedness, substitutability/financial institution infrastructure, and complexity. The committee also assigned equal weight to the multiple indicators in each of the categories, excluding the substitutability category (*see table 25*).

Table 25: **BCBS Indicator-Based Measurement for G-SIBs**

BCBS INDICATOR-BASED MEASUREMENT APPROACH

Category (and weighting)	Individual indicator	Indicator weighting
Cross-jurisdictional activity (20%)	Cross-jurisdictional claims	10%
	Cross-jurisdictional liabilities	10%
Size (20%)	Total exposures as defined for use in the Basel III leverage ratio*	20%
Interconnectedness (20%)	Intra-financial system assets*	6.67%
	Intra-financial system liabilities*	6.67%
	Securities outstanding*	6.67%
Substitutability/financial institution infrastructure (20%)	Assets under custody	6.67%
	Payments activity	6.67%
	Underwritten transactions in debt and equity markets	3.33%
	Trading volume	3.33%
Complexity (20%)	Notional amount of OTC derivatives*	6.67%
	Level 3 assets*	6.67%
	Trading and available-for-sale securities	6.67%

**Extended scope of consolidation to include insurance activities.*

Source: Banks for International Settlement, 2022

Proshare.

The G-SIBs indicators were chosen to reflect the different aspects of what generates negative externalities and makes a bank critical for the stability of the global financial system. Invariably, the reference point for assessing the systemic impact of G-SIBs in the global economy.

There are currently 30 G-SIBs as of November 2021 based on the Financial Stability Board (FSB) and BCBS calibration using higher capital buffer, total loss-absorbing capacity, resolvability, and higher supervisory expectations. Some of these G-SIBs are Agricultural Bank of China, Credit Suisse, ING Bank, Morgan Stanley, Royal Bank of Canada, Standard Chartered, Goldman Sachs, Barclays, Bank of America, Bank of China, Citigroup, JP Morgan Chase, HSBC, China Construction Bank, Toronto Dominion, and UniCredit, among others.

On the other hand, Domestic Systemically Important Banks (D-SIBs) as a complementary perspective to G-SIBs are banks that may not be significant from an international perspective but could have an important impact on the domestic financial system and the economy. Some D-SIBs may have cross-border externalities, but the effects are not global. The BCBS set the reference point for the assessment of D-SIBs as the activities in the national economy and prescribes the following principles:

- National authorities establish the discretionary methodology for assessing and classifying banks as domestic systemically important banks.
- The assessment criteria reflect the potential implication of the failure of a bank.
- The primary reference system for assessing the implication of the failure of a systemically important bank is the domestic economy.
- Home authorities assess the degree of the systemic importance of banks at their consolidated group level, while host authorities assess subsidiaries in their jurisdictions.
- The national authorities assess SIBs concerning the bank-specific factors and other measures that can inform the bank-specific factors such as size, interconnectedness, substitutability, and complexity.
- National authorities subject the assessment criteria to regular updates to reflect the evolving state of the financial system.
- The national authorities make the assessment criteria and methodology public information.

The BCBS described the calibration of D-SIBs as a principles-based assessment. As such, each bank either meets the criteria to qualify as a SIB or falls short of the criteria. However, the national authorities have the sovereign discretion to apply the requisite weights to the choice assessment criteria depending on the national circumstances.

Through its prudential guidelines and regulatory requirement, the BCBS introduced the Capital Adequacy Ratio (CAR) as a minimum capital requirement to ensure that banks hold sufficient capital to meet their current and expected liabilities. Although the CAR requirement was a provision for G-SIBs as endorsed by the founding G10 countries, it has since been endorsed and adopted by many countries and banks -irrespective of their classification due to the usefulness of the concept in measuring the strength and potential fatalities of a failed banking system.

The capital adequacy ratio weighs the bank's capital with respect to the level of risk they carry. The subsequent revisions to the Basel framework modified the composition of the ratio as regulators adjust capital requirements to better capture the banking business models, product innovation, and market evolution. Specifically, Basel III increased the CAR banks are required to hold from 8% under Basel II to 10.5% under the new Basel III Accord.

Nigerian Banking Regulation and Classification in Context

Banking regulation has evolved over a long period in Nigeria. The period before 1952 was termed the free banking era due to the lack of banking regulations. The Banking Ordinance of 1952 marked the first era of banking regulation and classification in Nigeria. The ordinance classified Nigerian banks into indigenous and expatriate banks with a minimum paid-up capitalization of N25,000 for indigenous banks and N200,000 for expatriate banks. It was however repealed by the CBN Ordinance of 1958 which was also repealed by the 1969 Banking Act.

The plethora of reforms and amendments to the CBN Act and the Banking Act between 1952 and 1989, when the finance and banking sector was liberalised, led to the development of many specialised banks.

Merchants Banks sprang up in 1960 while the 1970s saw the debut of Development Banks and the 1990s saw the evolution of Community banks and Mortgage Banks. In 1991, the Nigerian Export-Import Bank was established to facilitate economic growth through trade and commerce while the CBN introduced the Rural Banking Programme (RBP) in 1977 to facilitate the development of rural banking. The development of RBP led to the opening of branches in rural areas by commercial banks.
However, the aftereffects of the banking industry distress in the 1990s led to some more reforms and consolidations intended to usher-in sanity into the industry. The Banks and Other Financial Institutions (BOFI) and the CBN Acts of 1991 were enacted to provide regulation for the increased activities and complexities in the banking sector. For the first time, the Acts gave the CBN the autonomy to regulate and license banks.

In post-1993, CBN introduced new reforms that mandated an increase in minimum capital requirement to N500million. The regulator mulled Universal Banking in 1999 and adopted it in 2001 where banks were allowed to undertake a wide range of services, such as wholesale and retail banking, trading in financial instruments, underwriting of new debts and equities, and sales of insurance products. The adoption of Universal Banking raised many ethical, regulatory, and corporate responsibility issues for the operators and the regulator.

Consequently, in July 2004, the industry regulator announced a 13-point reform with 18 months compliance deadline to restructure and strengthen the banking industry. The reform includes a directive for all commercial banks to raise their minimum capital base to twenty-five billion naira (N25bn). At the expiration of the 18-month deadline, 25 out of 89 banks were standing. The banking consolidation improves the bank size, structure, and operational features.

Despite the improvement in the banking industry, the financial crisis of 2008 exposed other inadequacies in the Nigerian banking industry which featured a large junk of risk investments by banks. The aftermath of the financial crisis was significant disruptions in the balance sheets of banks.
The banking needs and operations evolve, the CBN further expounded the capital base requirement for banks in 2010 to provide clarity to the market and promote a sound financial system by disaggregating the capital base in terms of the operating license. The banking industry currently operates under this reform. Nonetheless the review of the regulatory framework and the minimum capital base, among other reforms, the industry is still struggling with undercapitalization, high non-performing loans, insolvency, and poor corporate governance.

CBN Calibration of Banks

The Central Bank of Nigeria Act 2007 as well as the Banks and Other Financial Institution Act (BOFIA) 2020 classified Nigerian banks into three layers of licensing with different capital base (share capital) requirements that define their operations.

- Commercial Banks
- Merchant Banks
- Specialized Banks

A commercial banking license in Nigeria is further classified into Regional Commercial Banks, National Commercial Banks, and International Authorization Banks. In terms of capital requirement, National Commercial Banks are required to maintain a minimum share capital of N25billion or as may be prescribed by the Central Bank of Nigeria (CBN). Regional Commercial Banks are to maintain a minimum share capital of N10billion while International Authorization Banks are expected to maintain a share capital of N50billion. As of 2021, the minimum share capital of most banks falls short of the regulatory requirement (*see table 26*)

Table 26: **Authorization and Share Capital of Nigerian Banks as of 2021**

AUTHORIZATION AND SHARE CAPITAL OF NIGERIAN BANKS 2021

	Authorization	Issued and Paid-up Share Capital (N'bn)
Wema	National	19.29
FBN	International	17.95
Access	International	17.77
UBA	International	17.11
Zenith	International	15.69
GTB	International	14.72
UBN	National	14.63
Fidelity	International	14.48
Sterling	National	14.39
FCMB	International	9.90
Stanbic IBTC	National	6.48
Unity	National	5.84

Source: **NGX, Proshare** Research

Proshare.

Merchant Banks in Nigeria are required to provide specialist services such as wholesale banking and investment banking services with a minimum share capital of N15billion or as may be prescribed by the CBN. Elsewhere, Specialized Banks are banks licensed to provide special banking services such as non-interest banks, development banks, mortgage banks, microfinance banks, and other banks designated by the CBN. The Specialised Institutions Regulations 2010 fixed the minimum share capital for national non-interest banks at N10billion, regional non-interest banks at N5billion, and primary mortgage banks at N5billion, among others.

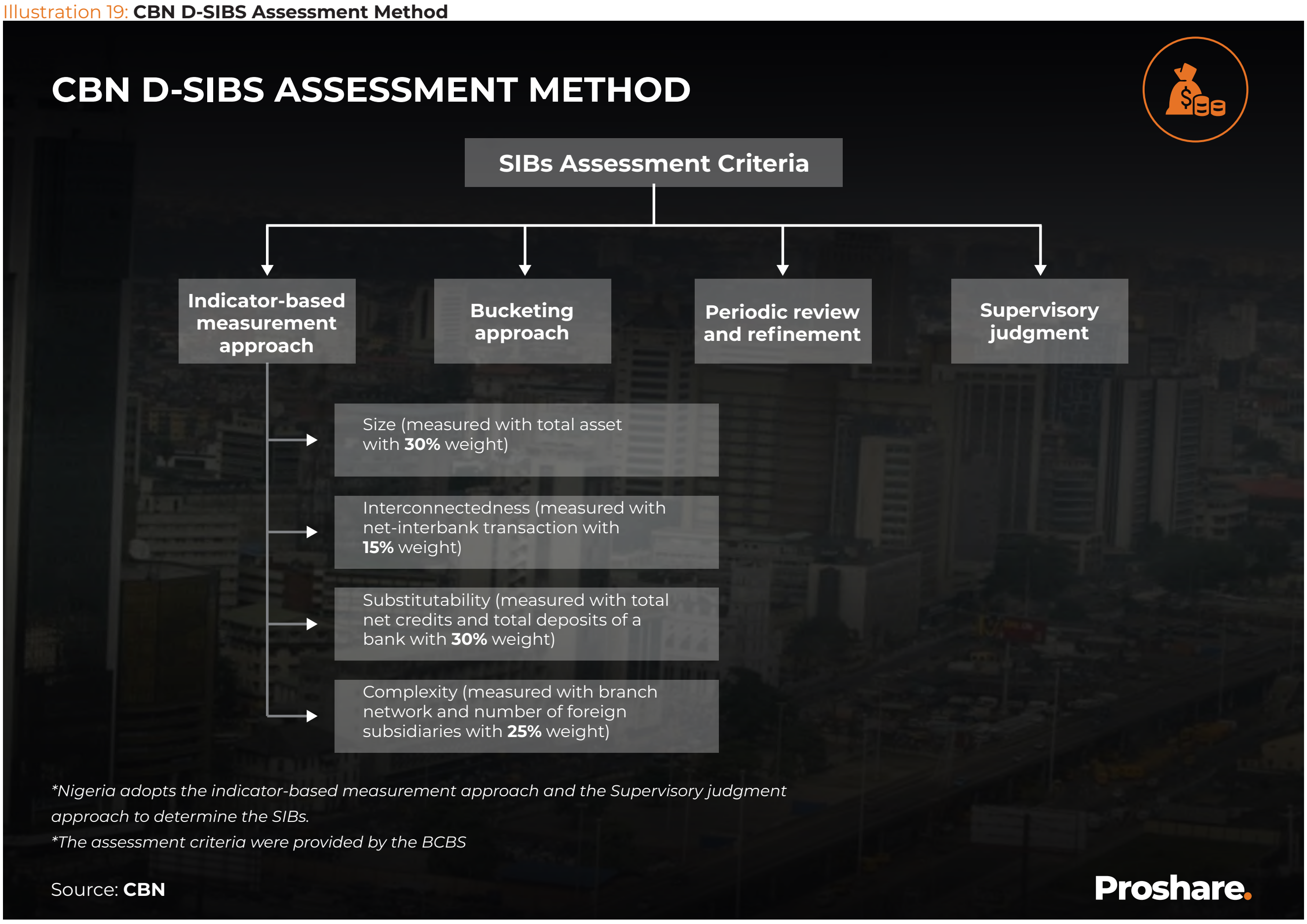
Notably, these operational/functional classifications of banks were intended to promote a sound financial system in the country following the repeal of the erstwhile Universal Banking Guidelines.

Meanwhile, the CBN in collaboration with the Nigerian Deposit Insurance Corporation (NDIC) also adapted the framework of the Basel Committee on Banking Supervision (BCBS) and the Financial Stability Board (FSB) to classify banks in the country based on their systemic importance. Precisely, the CBN structured Nigerian banks as:

- Systemically Important Banks (SIBs)
- Banks with international authorization and
- Banks with regional and national authorization.

The SIBs are subject to strict regulatory supervision and enhanced oversight due to their importance to the banking system and financial ecosystem. Thus, for a bank to be designated a SIB in Nigeria, it must satisfy the CBN adapted model of the BCBS SIBs assessment criteria (*see illustration 19*).

Illustration 19: **CBN D-SIBS Assessment Method**



The adapted criteria require the cumulative score of qualifying banks to be at least 5% using an indicator-based measurement approach and regular subjective judgment of the CBN. And to be continually classified as a SIB, the assessment criteria include six consecutive months of meeting the set criteria. More concisely, the CBN grants a bank that has total assets of at least 5% and minimum total credits and deposit liabilities of 6% each of the industry in the last six months to be considered a SIB. Instinctively, this provides a simplified but more observable approach for measuring SIBs.

Based on this simplified model of the CBN SIBs assessment criteria using total assets, total credits, and deposit liabilities, **Proshare** Analysts' calculation shows seven banks made the list as domestic systemically important banks in Nigeria (*see table 27*).

Table 27: **Derived Systemically Important Banks in Nigeria**

DERIVED SYSTEMICALLY IMPORTANT BANKS IN NIGERIA

Publicly Quoted Banks	Total asset as proportion of industry assets	Total credits as proportion of industry total credits	Total deposits as proportion of industry total deposits	Conclusion
	(> 5%)	(> 6%)	(> 6%)	
Access	19.8	18.09	22.52	SIB
ETI	19.73	16.53	21.76	SIB
Zenith	15.95	13.66	16.85	SIB
UBA	14.42	11.54	18.28	SIB
FBNH	14.36	15.22	17.31	SIB
GTCO	9.18	7.34	10.75	SIB
Fidelity	5.55	6.75	5.27	SIB
Stanbic IBTC	4.63	3.81	4.06	Non-SIB
FCMB	4.21	4.33	4.46	Non-SIB
Sterling	2.75	2.9	3.19	Non-SIB
UBN	4.38	3.54	3.53	Non-SIB
Wema	1.98	1.7	2.52	Non-SIB
Unity	0.9	1.09	1.21	Non-SIB

SIB: Systemically important bank and Non-SIB: Non-systemically important bank

Source: FY2021 Financial Statement, **Proshare** Research

Proshare.

Essentially, the Nigerian banking regulator broadly classified banks based on functions/scope of operation and systemic importance to the financial system. The bank tier classification of banks is not a designation shared by the CBN but by the market operators and financial media. Notwithstanding, the Proshare Analyst calibration of Nigerian banks reveals that a systematically important bank may not be a Tier 1 bank, but a Tier 1 as understood today is most certainly a systematically important bank.

Meanwhile, the CBN also weighs and calibrates banks in terms of their risk-weighted capital requirement based on the evolution of the Basel Accords. In the regulatory requirement, SIBs are required to maintain a Higher Loss Absorbency or additional capital surcharge of 1% to their capital adequacy requirement. According to the CBN, this should however be met with the Common Equity Tier 1. The Common Equity Tier I capital as the highest weighted component of the total qualifying capital fully absorbs the losses, thereby reducing the probability of failure and ensuring the bank remains a going concern.

CBN Capital Adequacy Regulation

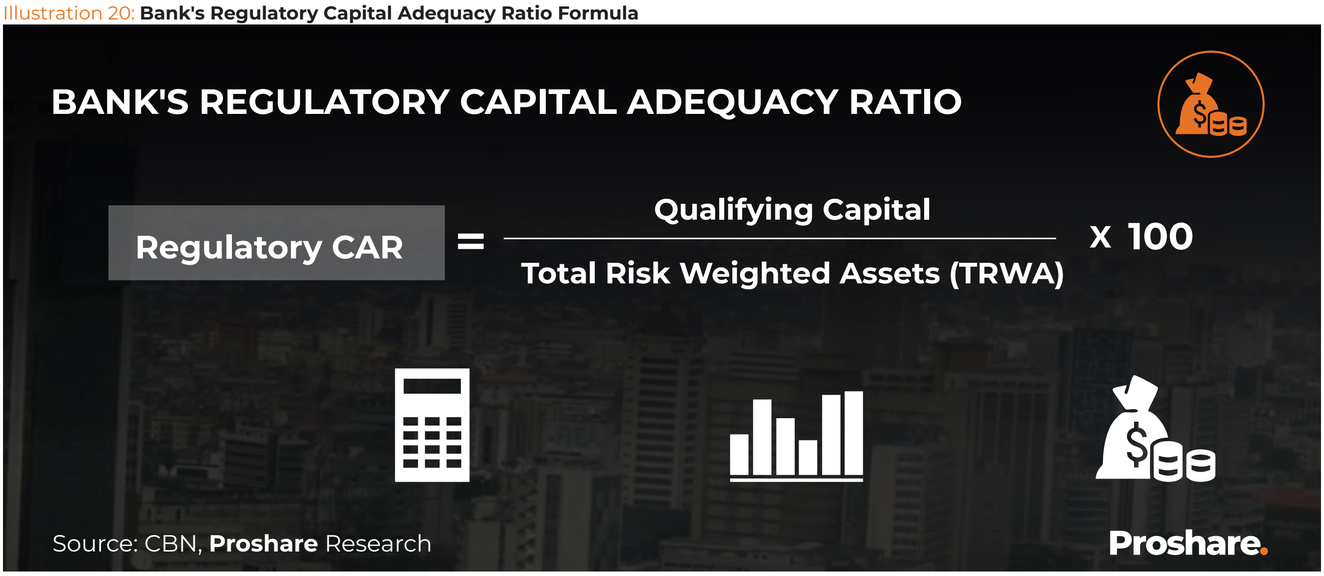
The general capital adequacy requirement of the Nigerian banking industry considers the relevant risk factors and the internal capital assessments of each bank to ensure that the capital held by each bank is commensurate with the bank's overall risk profile. Yet, SIBs are subject to higher capital requirements and policy measures to reduce the probability and systemic impact of their failure.

The CBN set the domestic regulatory CAR to accommodate the different classes of banks and consistently with the international minimum standard of 10.5% under Basel III. A minimum regulatory CAR of 15% applies to all banking groups or banks with international authorization and banks categorized by the CBN as Domestic Systemically Important Banks (D-SIBs) in Nigeria. A minimum CAR of 10% applies to all other banks.

In the computation, the total qualifying capital (also called eligible capital) equals the summation of Tier 1 capital and Tier 11 capital. Tier 1 capital is the going concern capital which includes the summation of Common Equity Tier 1 and Additional Tier 1 capital, less the relevant regulatory adjustments.

On the other hand, total risk-weighted assets (TRWA) equals the sum of credit RWA, market RWA, and operational RWA. Invariably, the TRWA incorporates the risk-weighted balance sheet and off-balance sheet assets calculated based on a standardized credit risk approach and a 12.5 multiple of the market and operational risks charges (*see illustration 20*).

Illustration 20: **Bank's Regulatory Capital Adequacy Ratio Formula**

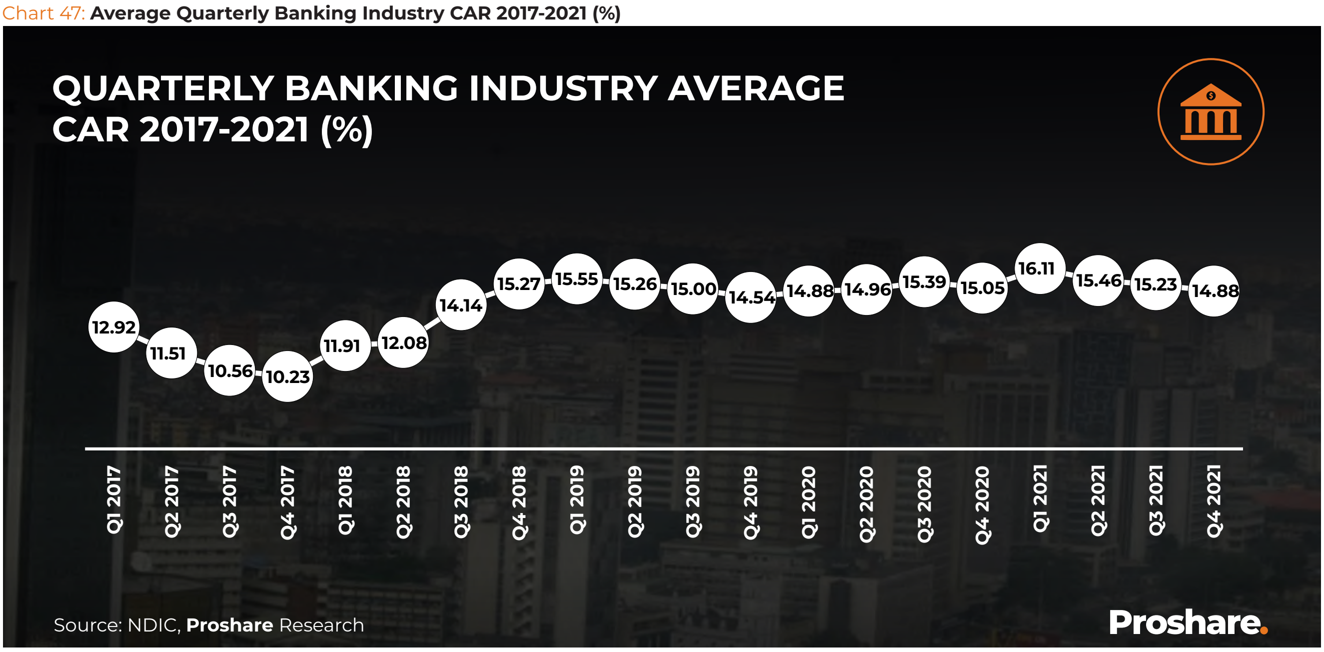


For ease of regulatory filing and compliance, banks are required to submit an electronic copy of their respective capital adequacy positions to the CBN using the prescribed reporting templates by the central bank and are to comply with the frequency of release on a stand-alone or consolidated basis.

The BCBS recommended that Tier 1 capital should constitute more than 50% of the total qualifying capital. More so, for banks designated as SIBs, Tier 1 capital is expected to constitute at least 75% of the qualifying capital. By implication, the Tier 11 capital of the SIBs should not be more than 25% of the total qualifying capital. For a holding company structure, the CBN requires that the minimum CAR should not be less than the CAR of any banking subsidiary within the group.

The Nigerian banking industry CAR has remained well above the BCBS recommendation of 10.5% in the last four years. The industry CAR, which was at its minimum of 10.23% in Q4 2017, grew to 15.27% in Q4 2018 and peaked at 16.11% in Q1 2021 before settling at 14.88% in Q4 2021 (*see chart 47*). The fluctuation was due largely to the increase in total risk-weighted assets arising from significant growth in credit against the slight growth performance of the qualifying capital.

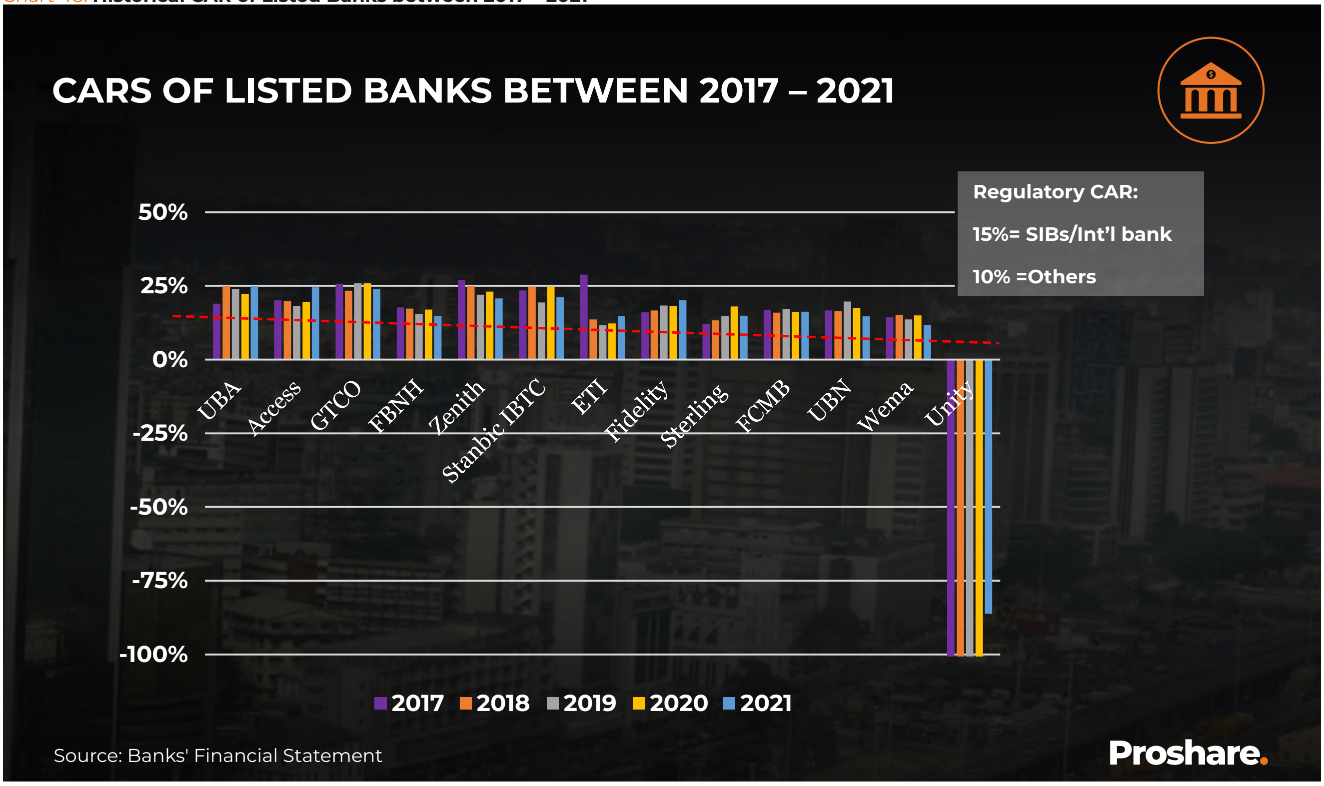
Chart 47: **Average Quarterly Banking Industry CAR 2017-2021 (%)**



The distribution of qualifying capital between Tier 1 and Tier 11 capital by the Nigerian banking industry has been outperforming the BCBS recommendation in terms of minimum CAR and the proportion of Tier 1 capital.

In terms of minimum CAR, the trend of individual CAR of banks listed on the Nigerian Exchange Limited has been a mixed bag over the last five years. Some banks have recorded growth in their CAR while others saw a slight decline. Among the banks designated as top tier banks, GTCO, UBA, and Zenith top their chart in annual CAR within the last five years (2017-2021) with CAR of between 19% to 27% while the other members of the top tier banks have CARs that oscillates between 15.5% to 20.06% within the period. Stanbic IBTC and Fidelity led the other banking category with annual CAR of between 16% and 24.70% while Unity bank recorded negative CAR as high as -201.59% in 2019 and -86% in 2021 due to the bank's negative shareholders' funds (*see chart 48*).

Chart 48: **Historical CAR of Listed Banks between 2017 – 2021**



Meanwhile, UBA, Access, and GTCO had the highest CAR at 24.90%, 24.52%, and 23.83% in FY2021 respectively. Other banks that had CAR that outperformed the SIBs requirements were Stanbic IBTC at 21.12%, Zenith at 20.66%, Fidelity at 20.11%, and FCMB at 16.24%. Albeit all the banks recorded CAR that was largely in compliance with the regulatory capital requirements for their respective category in 2021 except Unity bank with a negative CAR.

In terms of the composition of qualifying capital, the proportion of Tier 1 capital in the total qualifying capital of each bank-SIBs and others has also remained well above the BCBS recommendation for SIBs. On average in 2021, the proportion of Tier 1 capital in the total qualifying Capital for the Nigerian banking industry averaged about 83%, which was higher than the 75% threshold for SIBs. On an individual basis, only ETI had Tier 1 capital that was lower than the 75% threshold at 67% (*see table 28*).

Table 28: **The Capital Adequacy Ratio of Listed Banks in 2021**

THE CAPITAL ADEQUACY RATIO OF LISTED BANKS IN 2021

Bank	Tier 1 Capital (T1 Cap)	Tier 2 Capital (T2 Cap)	Qualifying capital (QC)	% of T1 Cap in QC	RWA	CAR
	N'm	N'm	N'm	%	N'm	%
UBA	551,466	106,517	657,983	84	2,642,796	24.90%
Access	927,506	271,810	1,199,316	77	4,891,614	24.52%
GTCO	704,446	24,238	728,684	97	3,057,999	23.83%

Bank	Tier 1 Capital (T1 Cap)	Tier 2 Capital (T2 Cap)	Qualifying capital (QC)	% of T1 Cap in QC	RWA	CAR
	N'm	N'm	N'm	%	N'm	%
Stanbic IBTC	321,917	21,522	343,439	94	1,625,838	21.12%
Zenith	1,130,832	99,002	1,229,834	92	5,953,302	20.66%
Fidelity	231,471	75,607	307,078	75	1,526,722	20.11%
FCMB	170,997	56,999	227,996	75	1,404,190	16.24%
Sterling	117,154	24,273	141,427	83	951,825	14.86%
FBNH	434,139	71,504	505,643	86	3,413,574	14.81%
ETI	1,472,781	725,307	2,198,088	67	14,912,957	14.74%
UBN	117,582	38,458	156,040	75	1,068,135	14.61%
Wema	30,007	10,001	40,008	75	346,013	11.56%
Unity	-277,461	-454	278,060	99	322,640	-86.18%

FBNH data is as of Sept 2021 and ETI data as of June 2021.

Source: Audited Financial Statement, **Proshare** Research

Proshare.

Banks' Capital Adequacy Ratio in Context

The devastating effects of the low capitalization and the financial crisis of 2008 on the banking industry left some harsh lessons for the Nigerian banking industry regulators. The crisis resulted in the loss of fortunes for the depositors, shareholders, investors, government, and the economy. This was predicated on the roles of the banking industry as a financing and payment infrastructure for the economy and a channel for transmitting monetary policy to the real economy. It thus became evident that the sustainability and safety of the economy depend on the banking industry whose health and safety also depend largely on its capital adequacy.

Capital adequacy is a situation where a financial institution's capital level is enough to absorb its losses and asset shortfalls, i.e., having sufficient capital for current operations and future growth. The capital adequacy ratio then measures the sufficiency, soundness, and safety of the bank. It is an important metric of a bank's risk exposure as its risk-weighted component incorporates credit risk, market risk, exchange rate risk, and interest rate risk. Essentially, the capital adequacy ratio has direct implications on banks' riskiness and macroeconomic indexes. The ratio has direct implications for the banks' riskiness as banks' capital adequacy requirement is essentially a scale between capital and risk assets. Similarly, the ratio has significant implications on the deposit-asset ratio since the larger the ratio of capital to assets (or capital to deposits) the safer the customers' deposits. The imposition of a minimum capital adequacy standard on banks strengthens the safety of deposits and the soundness of the banking system.

At the macro level, the implication of capital adequacy requirement on macroeconomic stability is also founded on the fact that the framework for achieving a stable financial system and macroeconomic environment is a regulatory policy that is preventive of instability. In cases where the system is on the verge of instability, the regulatory policy is remedial. The basic tenet of the relationship is that the banking capital adequacy requirement is a policy tool for dousing excessive activities, ensuring sustainability, and maintaining financial stability. Therefore, sentiments and subjectiveness cannot be allowed to have their way for the sake of financial stability.

Meanwhile, there is a growing trend of systemically important banks operating under a holding company structure in the country. This increasing relationship between the banking industry and the non-bank financial intermediary increases the level of systemic risks in the industry and underpins the possibility of financial disruption in the event of a weak banking system. Hence, the capital requirements of such banks must be subject to higher requirements and stricter subjective judgment by the regulator.

Calibrating banks based on their systemic importance to the financial system and applying higher minimum capital adequacy ratios thus reduce the possibility of insolvency in the financial system and promote the stability and efficiency of the system. To achieve the required capital adequacy, the regulators essentially require increasing the qualifying capital, strengthening the bank's balance sheet, or shrinking the risk assets on the bank's books.

Basel 111 and the New Look of Bank Capital

"Have courage, take risks, and don't be afraid of failing; these are the main ingredients of creating change that you want to see take place in this world." ***- John Taskinsoy***

Taskinsoy's admonition may sound reasonable and should, but in finance, the latitude for risk-taking becomes constrained by the compelling need for institutional safety. In this context, global banking oversight has tightened the regulatory requirements on the riskiness of bank capital.

Since 1975 global financial regulators have taken an interest in the size and nature of bank capital relative to the size of their balance sheets and have come up with different guidelines from Basel I through Basel II and onto Basel III. Basel III appears to have lagged global financial market evolution as analysts have pushed for a Basel IV.

The key elements of Basel III that have led to a tightening in bank capital requirements include:

- Basel III retained the proportion of core capital banks should hold in their capital stack but increased the proportion of tier 1 capital. Basel II required that banks hold 8% of their capital as tier 1 (equity and declared reserves) and tier 11 (undisclosed reserves and unsecured subordinated debt instruments) as a proportion of risk-weighted assets (RWA). In comparison, Basel III retained this to 8%.

- Basel II expected that 50% of the 8% held in bank capital as a proportion of RWA should be tier 1 capital; Basel III raised the proportion to 75% of the 8% capital as a percent of RWA.

- Basel II allowed for a tier 111 capital layer, but Basel III eliminated this riskier capital category.

- Basel III introduced a countercyclical capital buffer or rainy-day capital to serve as an additional cushion.

- Basel III recommends that banks could see an imposition of 0% to 2.5% additional reserve during periods of economic expansion to create a cushion for economic reversals and potential institutional stress.

- Basel III's liquidity coverage ratio requires that banks hold a "sufficient reserve of high-quality liquid assets (HQLA) to allow them to survive a period of significant liquidity stress lasting 30 calendar days."

If a countercyclical buffer reserve of 2.5% is summed with a capital requirement of 8% of RWA, a 10.5% reserve could be demanded of banks. The goal is to ensure that banks would have enough reserves and capital to absorb the shock during times of economic downturn (as was experienced with COVID-19 between 2020 and 2021). Countercyclical buffers would entirely involve tier 1 capital.

With the rise in decentralized finance (Defi) and open banking, the race to capital rigor has sped up. Analysts are now calling for a Basel IV that looks a the digital evolution of banking and would require a tighter regulation of bank capital related to digital assets and liabilities. For example, would CBN's digital currency (CBDC) count as tier 1 capital? And would any other digital asset based on blockchain technology with appropriate encryption and protection qualify for tier 1 bank capital?

William Coen, former Secretary-General of Basel Committee, said in 2016 that he so no reason for a further Basel Roman numeral as the tweaking of Basel III were simple refinements. Whether agreed that the refinements deserve another Roman numeral or just modifications of Basel III, the important thing is that the rules on capital will tighten further, especially concerning a review of the calculations of risk-weighted assets.

In this regard, technical changes will occur, including:

- Improving the earlier accords' standardized approaches for ***credit risk***, credit valuation adjustment (CVA) risk, and ***operational risk***. These rules lay out new risk ratings for various assets, including bonds and real estate. Credit valuation risk refers to the pricing of ***derivative instruments***.

- Constraining the use of the internal model approaches used by some banks to calculate their capital requirements. Banks will generally have to follow the accords' standardized approach unless they obtain regulatory approval to use an alternative. Internal models are faulted for allowing banks to underestimate the riskiness of their portfolios and how much capital they must keep in reserve.

- Introducing a leverage ratio buffer further limits the leverage of global systemically important banks (banks considered so large and important that their failure could endanger the world financial system). The new leverage ratio requires them to keep additional capital in reserve.

- Replacing the existing Basel II output floor with a more risk-sensitive floor. This provision refers to the difference between the amount of capital that a bank would need to keep in reserve based on its internal model instead of the standardized model. The new rules would require banks to hold capital equal to at least 72.5% of the amount indicated by the standardized model, regardless of what their internal model suggests.

Basel IV should have started on Jan. 1, 2022, but banks have five years to comply. Besides, most banks are yet to even abide by the rules of Basel III.

Tier 1 Banks: The Tale of the Tape - Who is in out and who is out?

The Methodology

The classification of Banks into tiers has taken several dimensions over the years. In times past, analysts focused on certain Statement of Position items such as Assets, Loans and Advances, and Deposits size, others considered Statement of Profit or loss items such as Gross Earnings and Net Interest Income. However, the problem with absolute figures is that they tend to downplay efficiency and may overcompensate for size. Take assets, for example, the size of a bank's assets may on the face of it appear to be a good basis for ranking it over and above a smaller bank, but this completely loses sight of the quality of the assets in question. The same applies to Gross Earnings, which in and of itself does not differentiate between Interest and Non-Interest Income. Meanwhile, if the measurement were share capital, all the banks listed on the Nigerian Exchange Limited (NGX) have their share capital below the N25bn statutory minimum prescribed by the CBN. None would qualify as a tier 1 bank.

This time the share of business Assets domiciled in Nigeria (at least N5tr), 3-year average CAR (16%), and a minimum deposit Size of N2.5tr.

As an alternative to limited absolute figures, there are a plethora of financial ratios that can be employed in assessing different aspects of the health of banks at once. However, the inherent problem of ratios is that given their sheer number and variety banks tend to highlight favorable ratios and downplay other not so favorable ratios. The selection problem leaves room for cherry-picking where certain ratios are favorable, and several others are not.

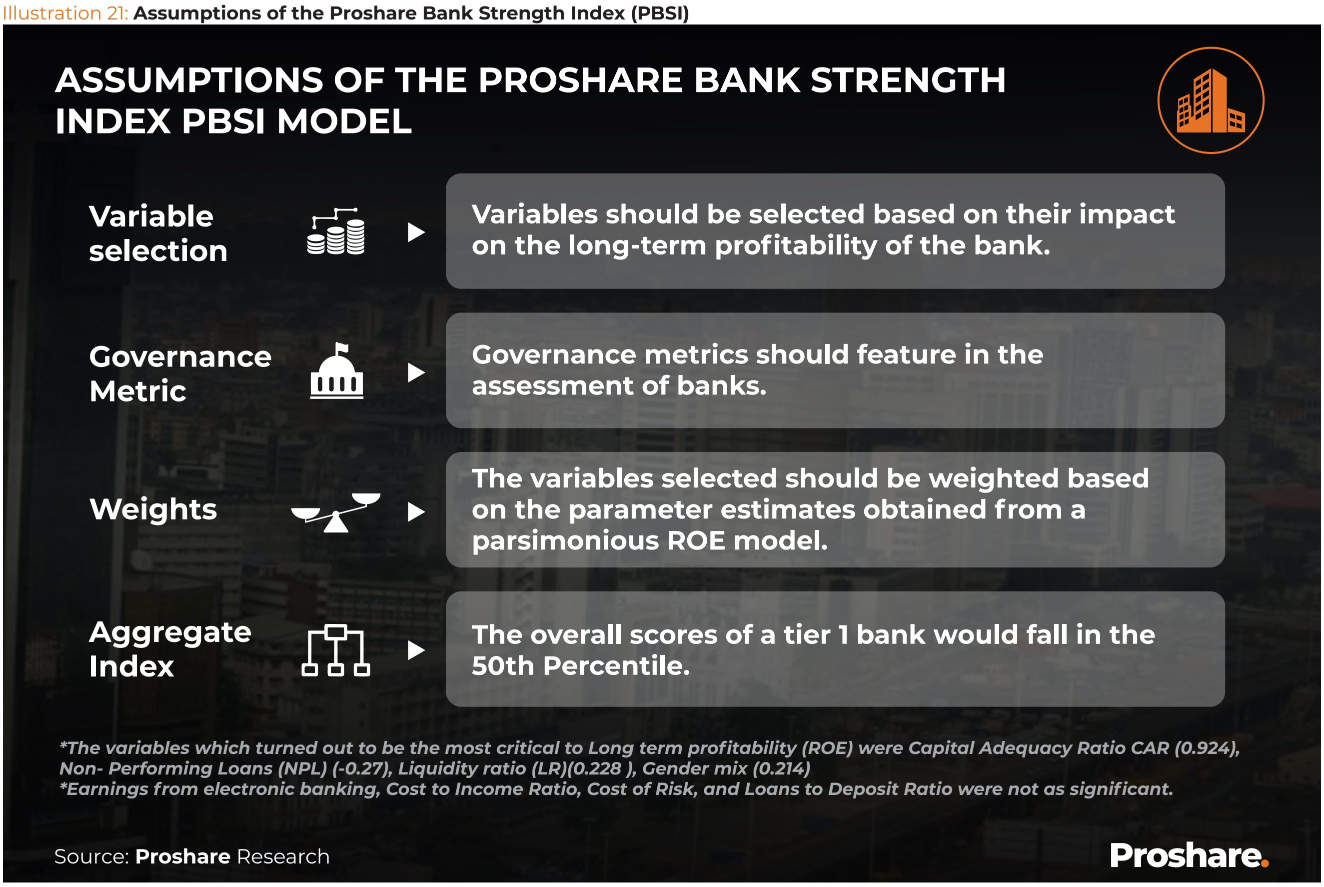
The first known attempt at ranking Nigerian Banks into Tiers was made by analysts at Afrinvest, Lagos-based research, and financial advisory firm, in its 2013 Banking Sector Report. In that report, Nigerian banks were classified into two categories namely: tier-1 and tier-2. The report stipulated conditions similar to some CBN prudential guidelines such as a minimum CAR of 15%, NPL cap of 5%, and Liquidity ratio of 30%. In addition, the Afrinvest Tier-based classification required banks to have N1tr worth of Assets. Commercial banks had to meet up with all the requirements to be regarded as first-tier banks, while those banks that fail to meet up to the requirement are classified as second-tier banks. Since then, Tier 1 banks have been captured with the moniker 'FUGAZE', a collective acronym for FBNH, UBA, GTCO, Access Bank, Zenith Bank, and ETI.

This marked a notable improvement on the methodology adopted in previous unstructured classifications. By focusing more on specific banking ratios, this method provided an efficiency-based assessment. It however failed to provide compelling arguments as justification for the choice of selected variables as well as the threshold it sets for qualifying banks. In 2020, Afrinvest decided to introduce a new set of parameters and ranking (which never gained as much acclaim as the first). This time the ***share of business Assets domiciled in Nigeria*** (at least N5tr), 3-year average CAR (16%), and a minimum deposit Size of N2.5tr.

This approach is not only arbitrary but also overlooks important quantitative and qualitative factors such as governance factors which have real implications for the long-term profitability-the focus of investors, who happen to be the major beneficiaries of the Tier1&2 classifications.

Overall, the arbitrariness of existing classifications makes it imperative to come up with a more reliable basis for classifying banks into tiers. Therefore, Proshare Analysts classifies banks based on their percentile score on the Proshare Strength Bank Index. Banks with scores in the 50th Percentile are regarded as Tier 1 banks, while the rest are considered Tier 11 banks. In its simplest form, the PBSI sums up measures of Asset Quality, Profitability, and Liquidity. The banks with scores in the 50th percentile ranked as tier 1 (*see illustration 21*).

Illustration 21: **Assumptions of the Proshare Bank Strength Index (PBSI)**



Analysis

The Proshare Bank Strength Index (PBSI) considers various bank performance ratios but attaches weights to each performance ratio and aggregates them into a single score. The choice of performance ratios and the weights assigned to them is based on the outcome of econometric analysis. To eliminate arbitrariness in the ratio selection process, Proshare sought to identify the most significant determinants of long-term profitability by modeling the Return on Equity (ROE) of quoted Nigerian Banks using the Pooled Ordinary Least Square (POLS) Technique, thereafter, estimating the degree of impact of each of the major performance ratios on ROE as illustrated below:

Model: $ROEit = \alpha + \phi CARt + \rho NPLt + \chi LIQt + \theta BDVt + \varepsilon it$

To do this, panel data covering multiple cross-sectional units over multiple periods was collected and analyzed. The results obtained showed that Capital Adequacy Ratio (CAR) is the single most important factor that determines the long-term profitability of Banks. Non-Performing Loans (NPL) came in second, Liquidity Ratio (LIQ) is third while Board diversity (BDV) is the fourth most decisive in determining ROE (*see table 29*).

Table 29: **Regression Output**

REGRESSION OUTPUT

Variables	Measuring	Coefficient
CAR	Capital Adequacy Ratio	0.924
NPL	Non-Performing loans	-0.27
LIQ	Liquidity Ratio	0.228
BDV	Gender Mix and Board Diversity	0.214
Model	Pooled Ordinary Least Squares	
Data Form	Panel Data	
	Year	5
	Cross-sections	12
	Observations	60

Source: STATA 14.2

Proshare.

Notably, variables such as Asset size and Gross earnings returned statistically insignificant coefficients

Results

Ranking Nigerian Banks: Proshare Bank Strength Index (PBSI)

Based on the FY 2021 results of the banks, Proshare's BSI ranks Access Bank at the top of the Nigerian Banking stack, having recorded a Capital Adequacy Ratio (CAR) of 24.5% an NPL of 4%, a Liquidity ratio of 51%, and a Board gender mix of 38.2%. Access scored 41.39%, while UBA came in second place with a score of 39.34%. A closer look at UBA's figures shows that the lender recorded a slightly higher CAR (24.9%) than GTB which clinched the top spot. Likewise, UBA had a better NPL ratio (3.6%) but lower liquidity and Board diversity ratios limited the bank to second place. Stanbic IBTC makes an entry into the list of first-tier banks with a score of 36.86% which is in the 80th percentile.

Zenith Bank which scored 36.14%, came in the 72nd percentile while GTB scored 33.60% to come in at the 63rd percentile. Fidelity Bank takes the sixth position with a PBSI score of 31.3% thereby coming in at the 54th percentile. Importantly, of all the banks eventually categorized as the first tier, GTB alone exceeded the recommended 5% NPL threshold. All banks that qualified as Tier 1 banks met the 15% CAR requirement and the 30% Liquidity ratio conditions (*see table 30*).

Table 30: **2021 Ranking of Banks Based on the Weighted Proshare Bank Strength Index (PBSI)**

2021 RANKING OF BANKS BASED ON THE WEIGHTED PROSHARE BANK STRENGTH INDEX (PBSI)

Period	Weights		0.924	-0.27	0.228	0.214			
	Banks	ROE	CAR	NPL	LIQ	BDV	Score	Percentile	Tier
FY 2021	ACCESS	17.80%	24.50%	4.00%	51.00%	38.20%	41.39%	100.00	1
	UBA	15.60%	24.90%	3.60%	47.60%	30.00%	39.34%	90.90	1
	Stanbic	14.70%	21.10%	2.10%	38.00%	43.20%	36.86%	81.80	1
	ZENITH	20.40%	21.00%	4.20%	71.60%	7.07%	36.14%	72.70	1
	GTB	20.60%	23.80%	6.04%	38.26%	21.00%	33.60%	63.60	1
	FIDELITY	12.50%	20.10%	2.90%	40.40%	20.00%	31.30%	54.5	1
	ETI	18.99%	14.80%	6.25%	49.60%	31.25%	30.01%	45.40	2
	WEMA	17.80%	15.46%	4.90%	30.00%	33.00%	26.88%	36.30	2
	UBN	7.30%	14.60%	4.30%	35.10%	29.00%	26.56%	27.20	2
	FCMB	8.90%	16.88%	4.10%	35.30%	18.00%	26.41%	18.10	2
	Sterling	10.40%	14.80%	0.70%	37.90%	4.00%	23.00%	9.00	2
9M 2021	FBNH*	7.2%	15.5%	7.3%	32.80%	11.00%	22.41%	0.00	2

**FBNH figures were obtained from the bank's 9M 2021 result presentation.*

Source: Result Presentations (2021)

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The 2021 PBSI scores for ETI, WEMA, UBN, FCMB, Sterling, and FBNH were below the 50th percentile and were classified accordingly as second-tier banks. Of this group, ETI, UBN, and Sterling Banks did not manage to meet the 15% CAR threshold. All banks in this tier however recorded NPLs lower than the 5% threshold except for ETI. FBNH and ETI are based on the current classification.

Envisaging a situation where a single year result may see a bank qualify as a first-tier in one year and fail to do so in the following year, we smoothen the performance ratios by using 3-year averages against a single year figure.

Using the three-year average of the banks' performance indicators, the same six banks remain first-tier banks except that Stanbic IBTC now ranks as the first with a PBSI score of 38.66% while Access, UBA, GTB, Zenith, and Fidelity Banks make up the list of first-tier banks in the same order. Taking a three-year average of FBNH's critical performance ratios helped the bank to inch up by one spot pushing Sterling bank to the bottom of the rack (*see table 31*).

Table 31: **Weighted Proshare Bank Strength Index (PBSI) Using 3-year Average of Performance Ratios**

WEIGHTED PROSHARE BANK STRENGTH INDEX (PBSI) USING 3-YEAR AVERAGE OF PERFORMANCE RATIOS

Period	Weights		0.924	-0.27	0.228	0.214			
	Banks	ROE	CAR	NPL	LIQ	BDV	Score	Percentile	Tier
3-year Average	Stanbic	22.10%	23.47%	3.33%	39.26%	41.60%	38.66%	100.00	1
	ACCESS	16.83%	21.70%	4.70%	48.00%	31.60%	36.51%	90.90	1
	UBA	16.47%	23.57%	4.53%	45.30%	24.00%	36.04%	81.80	1
	GTB	26.20%	24.07%	6.32%	42.17%	25.86%	35.70%	72.70	1
	ZENITH	22.20%	22.00%	4.26%	65.03%	7.70%	35.68%	63.60	1
	FIDELITY	12.10%	18.87%	3.33%	37.73%	15.89%	28.56%	54.50	1
	UBN	9.63%	16.07%	4.70%	40.63%	24.00%	28.00%	45.40	2
	ETI	14.50%	12.90%	7.86%	49.40%	31.25%	27.77%	36.30	2
	FCMB	9.03%	17.25%	3.70%	34.13%	18.00%	26.59%	27.20	2
	WEMA	14.18%	14.69%	5.66%	31.14%	33.00%	26.23%	18.10	2
	FBNH	11.63%	15.57%	8.27%	36.40%	23.90%	25.58%	9.00	2
	Sterling	10.00%	15.83%	1.60%	37.40%	12.50%	25.42%	0.00	2

Source: Result Presentations (2021)

Proshare.

In summary, the PBSI ranks Nigerian banks based on their aggregate points from CAR, NPL, LR, and Board's Gender Mix (a proxy of Governance. These performance ratios were selected after querying half a dozen other variables namely: Assets Size (Ass), Gross Earnings (GRE), Net Interest Margin (NIM), Cost to Income Ratio (CIR), Digital Earnings, Loans to Deposit Ratio (LDR) Cost of Risk (CoR) and Ratio of Non-executive-to total directors.

Conclusion

Conclusion - A Regulator's Need to Reshuffle the Card Deck

Nigeria's Central Bank does not openly classify domestic banks into tier 1 and tier 11. Nevertheless, there is a broadly accepted ***notion*** of banks' systemic importance, riskiness, and rating.

Prospective Investors in local Nigerian banks use this perception of tier 1 banks previously best reflected by the acronym FUGAZE (FBNH, UBA, Access Holdings, Zenith Bank, and ETI) to make critical investment decisions.

The Proshare research and review, in this report, of the basis of the use of FUGAZE as tier 1 banks question the validity of the acronym as a shorthand for Nigeria's top tier banks. Indeed, the outcome of the research indicates that banks like Stanbic IBTC and Fidelity Bank should qualify for the top-tier classification.

The report also noted that some banks might be systemically important because of their age, asset size, and customer distribution. These banks might not be tier 1 even though they are systemically important. FBNH, for example, is systemically important for its age, rural penetration, and branch network. Still, it may be wrong to classify it as a tier 1 bank in its present operational state. The bank's relatively high cost-to-income ratio (CIR), low loan-to-deposit ratio (LDR), and forbearance status would make it a borderline tier 1 institution but a higher-end tier 11 bank more accurately.

The Proshare report argued for adopting a **Bank Strength Index** (PBSI), which provides an objective basis for the classification of banks and enables market stakeholders to understand the fundamentals of tier 1 and 2 descriptions for local Nigerian deposit money banks (DMBs).

The Proshare Index goes beyond simple operational numbers and attempts to use proxies for the quality of management and board oversight. The regression analysis showed that board diversity was essential for board performance. At the same time, many believe that the existence of independent directors was a strong indicator of qualitative board oversight; the outcome of the research could not confirm this hypothesis. However, the regression did establish that gender mix was an essential determinant of board and management performance and that banks with more gender-diverse boards showed a better return on equity (ROE).

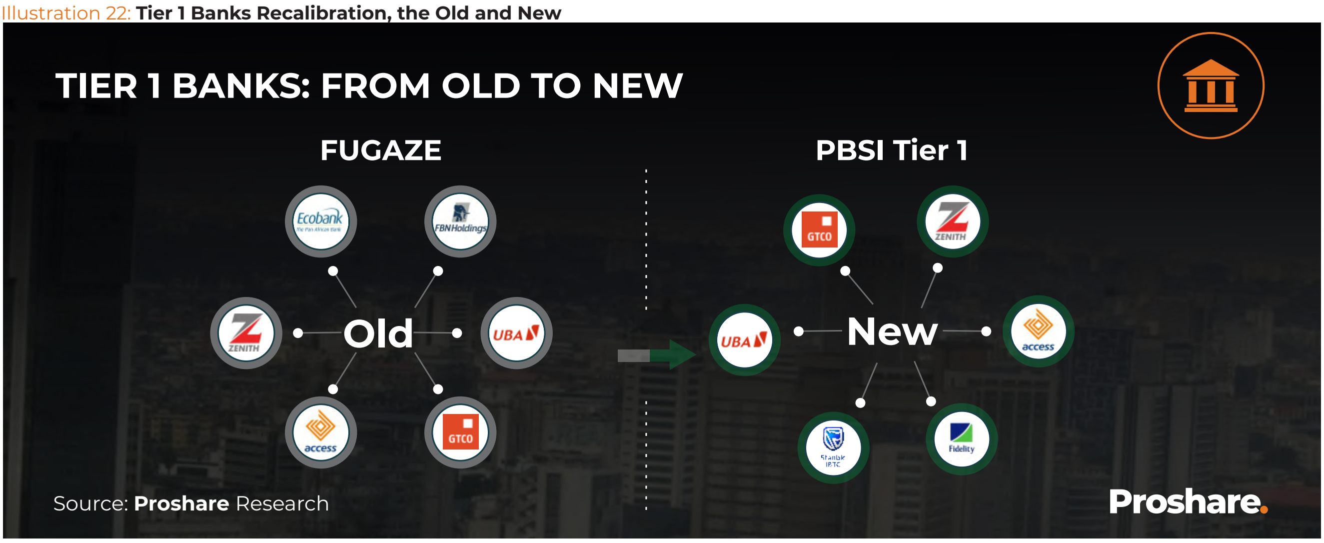
In the light of the report's outcome, the banking industry may need the adoption of metrics like the PBSI to establish a firm and verifiable basis for bank classification into tiers 1 and 2. The CBN may need to evolve a metrics-based calibration of banks and place them officially into separate tiers. The advantage of the approach would be:

- Prospective investors, financial advisers, and customers would have an objective basis for bank tier classification.
- Relative risk assessments of banks would be clearer.

- Equity market pricing of banks would be more objective.
- Incentivized mobility of banks to upper tiers become founded on well-defined performance indicators.
- Peer comparison and competitive assessments become less notional and more data-based.

With regular monitoring of banks concerning fundamental indices, the deck of banks in tiers 1 and 2 will change periodically, providing greater market clarity about bank status. A static notion of tier 1 banks as FUGAZE distorts relative bank strength and status assessments and leads to wrong funding options and investment access. The industry captains need to cooperate with the CBN to formalize the bank classification (*see illustration 22*).

Illustration 22: **Tier 1 Banks Recalibration, the Old and New**



Of course, people will point out that such classification does not exist in Western European and American markets, but neither does FUGAZE. Yet, Nigerians have used the acronym to refer to the country's top banks. The point is a banking system operation must be agile enough to accommodate nuances in different economies.

Change is difficult, but it is necessary; corporate and systemic agility and flexibility separate the living from the dead. One only has to ask the dinosaurs.

Proshare's research suggests the need for a broad industry consensus which would include the CBN, the banks, the Chartered Institute of Bankers (CIBN), the Bank Directors Association of Nigeria (BDAN), the Nigerian Deposit Insurance Corporation (NDIC), and the Asset Management Company of Nigeria (AMCON). The consensus would agree on the criteria for classifying banks into tiers 1 and 2 and establish the framework for the periodic review of the criteria using Proshare's research as a baseline.

Futurist and fintech honcho Brett King recently noted that "banking is what you do and not where you go" as this becomes increasingly evident, the whole idea of banking as distinct from banks will initiate a system reset and require recalibration of banks and their sphere of competitive importance. Nigerian banks and their regulators must set the markers for proper classification and assessment in real-time in a world dominated by innovation and collaboration.

We note that the available data on bank ratings applies to different periods the Proshare Bank Strength Index (PSBI) for 2021 did not include credit ratings. However, the PBSI methodology would be updated to include bank credit ratings in a follow-up report in June 2022.

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Tables

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