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## Nigeria: the end of a custody monopoly

*Nigeria has become synonymous with corruption and political and economic instability. But the reforms of President Olusegun Obasanjo, president for two terms between 1999 and 2007, have restored hope that the most populous country in Africa is on course for prosperity at last. Local custodians are betting on it*

**One effect** of the forced consolidation of the Nigerian banking industry in 2004-2005 is an enlargement of the number of custodians. A sub-custody market dominated for years by a single provider—Stanbic, the Nigerian arm of the Standard Bank of South Africa—now looks likely to sport as many as four.

Chief among them is First Bank of Nigeria, which has launched an aggressive international marketing campaign (see sidebar). Other local banks set to offer custody include UBA and First City Monument Bank (FCMB). “We expect to take on international accounts and sub-custodian mandates by September,” says Malcolm Gilroy, COO of UBA Global Markets.

Stanbic, after calling off a proposed merger with Oceanic Bank, was at press-time poised consummate a regulator-approved \$400 million merger by tender offer with IBTC Chartered Bank. The South African bank has pursued a merger with IBTC, which has total assets of \$1.1 billion and a network of 56 branches in Nigeria, since the fall of last year.

Ladipupo Balogun, the managing director of FCMB, says the law obliges all international investors holding Nigerian assets to employ a local custodian. Nigerian pension funds are under a similar obligation and Balogun points out that the local stock broking and fund management communities are about to face the same requirement.

“The Nigerian Securities and Exchange Commission is going to change the laws, and stockbrokers will be required to have separate custody accounts,” says Balogun. “This will ensure that they do not abuse the funds. We expect at least four banks to set up custody businesses. Our focus will be on attracting the assets of the captive customers we have through our stock broking and asset management business.”

Custody thrives, of course, where savings and stock markets meet. So it is no surprise that the proliferation of custodians in Lagos coincides with a new confidence in the political and economic stability of the country. The stagflation and military despotism of the 1980s and 1990s have given way to a newly elected president

and an economy growing at 7-8% a year even outside the dominant oil sector.

The growing economy is attracting international portfolio investors. The consolidation of the banking sector, which saw 89 banks shrink to 25 better-capitalized groups, has helped. So has reform of the pension and insurance sectors, which has increased the volume of funds available for trading and investment. The Nigerian Stock Exchange is absorbing the liquidity with newly listed instruments, including Exchange Traded Funds (ETFs) and derivatives linked to real estate.

Farooq Oreagba, the head of strategy at the Nigerian Stock Exchange, says that JPMorgan, Renaissance Capital, Rand Merchant Bank and Deutsche Bank are all exploring participation in the Nigerian ETF market. The exchange is preparing an index of the 40 Nigerian stocks. Its largest component—to the dismay of the exchange—is the banking sector, but it could form the basis of equity derivative instruments as well as ETFs.

Rules designed to encourage the launch of closed-end funds have also been published by the exchange. Real Estate Investment Trusts (REITs) are being developed too, in an effort to encourage investment in physical infrastructure. The first REIT is

now listed on the exchange, and Oreagba says that many more are “in the pipeline.” It is understood that the International Finance Corporation is considering launching a REIT.

“We are looking to list a structured real estate fund, which will have downside protection with embedded upside options,” explains Oreagba. “A private placement of Naira 5 billion (£20 million) was successful and we are going to try and list it on the exchange. We want the guys who took it up to realize some value. Once that gets going, more and more will come along.” Activity in the local bond markets is driven chiefly by the need of the newly merged Nigerian banks to raise funds to meet the more onerous capital requirements set by the Nigerian central bank. It has imposed a minimum capital requirement of \$25 million. Capital was also needed to absorb the 64 banks that agreed to merge.

Regulatory changes have helped the bond markets to meet these new fundraising requirements. Since June 2006, dealers in bonds have been required to make a market in all bonds, rather than those they liked. Gilroy says that bonds worth Naira 500 billion have been issued on the exchange during the course of the last year, many of them acquired by international investors.

The success of a bond issued by UBA itself indicates the strength of the market, says Gilroy. The first tranche of the five-year Naira 100 billion mortgage-backed securities were bought at a yield of 75 basis points over government bonds. An initial yield of 9.98% has since improved to 9.75% on the back of vigorous secondary market trading. Gilroy says the buyers include hedge funds as well as local banks and pension funds.

The need for investment in housing will prompt more mortgage-backed issuance, predicts Gilroy. He expects state governments to set up mortgage banks, like the German Landesbanken. However, limitations in credit assessment know-how is likely to retard progress until a new credit checking bureau is established in 2008.

For a country with an unfortunate image, these are positive developments. It is significant that Alex Trotter, an analyst with Afrinvest, is no longer even talking about obvious subjects, such as political stability and corruption. Instead, he is worrying about transaction costs. “The market needs someone who can compete and bring down the high cost of transactions,” he says. “Capital is abundant, but we need something that will reduce the frictional cost of transactions.”

—Nick Kochan

## First Bank of Nigeria enters the sub-custody business

At last, Stanbic Nigeria has a serious competitor for sub-custody business. Publicly quoted First Bank of Nigeria (FBN), one of the best-capitalized and profitable to emerge from the consolidation process of 2004-2005, is offering settlement and asset-servicing to foreign and domestic custody clients off a technology platform purchased from Sectech (see article on page 22).

Ironically, FBN can claim a common origin with Stanbic: The ancestry of both banks lies in Standard Bank. Like many foreign banks in Africa, its original owners were expropriated by nationalization, and FBN did not recover its poise until it was privatized again. Its shares are now widely held, and not only by Nigerians, allowing it to emerge

from the consolidation period in a better strategic position than Stanbic.

Faced with the higher capitalization requirement set by the Nigerian central bank, Stanbic came close to exiting the market.

It later held abortive merger discussions with Oceanic Bank, but at press-time was close to finalizing a merger with IBTC.

The uncertainties of the last two years have unsettled network managers at the global custodian banks. Their concern at times during that period that they would be left without a custodian in Nigeria at all has reminded them of the need to encourage alternatives to protect their clients' interests.

Local banks have responded to the opportunity. Several have improved their credit ratings through consolidation and acquired some knowledge of securities services by acting as licensed pension fund custodians under the new pension legislation. FBN was the first to launch this service and the first to buy the Sectech Custody 2000 platform.

In terms of sub-custody, Stanbic remains the incumbent, and FBN will have to work hard to dislodge the South African bank. But there is plenty of scope to develop a domestic clientele. As the capital market in Nigeria grows, driven by pension funds, insurers and the various collective funds now emerging, independent custody will thrive. The FBN decision to enter the business looks soundly based.

—Charles Stevens