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1 OVERVIEW

The industry's focus on expanding the retail-banking segment of the market continued in the year in review. However, declining household wealth from the collapse in stock market valuations, and lower consumer spending as the economy corrects current levels of leverage on its balance sheet, could slow down this trend. Indeed, deposit rates, which were trending upwards before the ceiling announced by the Bankers' Committee in March, were a measure of the level of intra-industry competition for sourcing of liabilities during the year. In view of the fact that rate trends in the review period may have been indicative of supply-side constraints to the market, the quest for larger retail market shares, even as the market responds to the constraining effects of the global financial crisis, may lead to further intensification in competitive activity, and the rapid deployment of new products/services.

Growth in banks' credit to the private sector continued to increase during the review period, albeit at a much slower rate than it did the previous year. On the back of this growth, the total assets/liabilities of the 23 banks operating in the country stood at ₦13 trillion as at end-December 2008. The corresponding figure for the 12 months to end-December 2007 was ₦10.1 trillion. The weighted average inter-bank call rate, which was 9% in December 2007, had risen to 12.2% by December 2008.

Given the depth and unprecedented circumstances of the global crisis, the public policy response in Nigeria focused on addressing the unanticipated second-round effects of the crisis on the domestic economy. These in turn led to a number of unintended consequences. Consequently, policy volatility climbed up the list of the industry's main challenges in the review period, as operators had to respond to the diverse policy initiatives implemented by the Central Bank of Nigeria (CBN) as part of its response to the global financial crisis. Noteworthy amongst the initiatives was the CBN's decision to deploy Resident Examiners to banks in its effort to ensure the safety and soundness of the sub-sector. Lending

their support to the CBN's commitment to keep domestic credit taps open, the Bankers' Committee agreed in March 2009 to a ceiling on lending (22%) and deposit (15%) rates. With the consumer price index averaging 14% in the quarter to end-March 2009, these rate caps remain positive, although concerns remain that the pressure on the monetary authorities to review this may further test its commitment.

With the lull in the macro-economy, expectations are that margins in the banking industry will come under tremendous downward pressure up to the third quarter of the current fiscal year. In particular, despite higher rates, the build-up of deposits is expected to soften. With the anticipated contractions in business and housing investment, and final domestic demand, we expect lending to decline in the short- to medium-term. Not surprisingly, in this environment, we expect to witness a tightening of the risk acceptance criteria for lending to virtually all sectors of the economy. Profitable business opportunities will still be available for institutions able to deliver superior value propositions, including the ability to cater for the market's current preference for safety of funds over profitability.

Despite these general challenges identified, it is an indication of the industry's continued growth during the review period that "The Banker" magazine in conjunction with Brand Finance, the leading UK-based independent valuation firm, named five Nigerian banks (FirstBank inclusive) among the top 500 financial brands in the world.

The limited integration between the domestic financial services industry and the global financial system has played a useful role in moderating the build-up of negative momentum in the former, because of the ongoing crisis in the latter. Nonetheless, there is clear domestic evidence of negative feedback from the global financial crisis. Accordingly, the domestic fiscal and monetary authorities have identified the provision of liquidity as central to supporting the economy, as it contends with a reversal of capital flows, and the consequent effects of this.

Our Brand Pillars

SERVICE EXCELLENCE

There are no limits to our capacity to improve. In today's tough economic conditions, we will continue to invest in world-class processes and systems to drive efficiencies, enable us to enhance service delivery and maintain our reputation for quality.

INDUSTRY REVIEW AND OUTLOOK



Global and national reputation

FirstBank took first place among five other Nigerian banks in a leading UK-based survey. On a global basis the same survey ranked us among the top 500 financial brands in the world (The Banker / Brand Finance).

In this context, the macroeconomic policy onus in the medium term will be on the design of policies conducive to the mobilisation of domestic savings, and growth in local final demand. This will involve continued reform to the financial services sector, and a strong commitment to dealing with the much talked-about infrastructure constraints. Given current strains on the CBN's balance sheet from its effort to sustain sector liquidity, the restoration of a healthy financial services sector would require the conservative valuation of the industry's loan books and its consistent treatment across all banks.

The industry's growth opportunities are expected to shrink as domestic demand tapers off. Increasingly, though, value should be found in the design of products/services, which speak to the markets' needs for bespoke financial solutions. In this circumstance, a re-balancing of service delivery channels away from brick-and-mortar branch banking to alternate e-business-based services would be appropriate.

But more than this, the design of a medium-term economic policy framework, based on the rejuvenation of private enterprise across the economy, will be crucial to sustaining output growth beyond the rate of 5% over the next decade.

1.1 Monetary Policy Management

Concerns over the degree of resilience in the global economy dominated the monetary policy response in the review period. Accordingly, monetary policy management was distinguished by a major paradox: rates tightened in the inter-bank markets even as monetary conditions eased considerably. Up until the August 5, 2008 meeting of the CBN's Monetary Policy Committee (MPC), the main policy worry was the continued upward movement of most rates in the money market. Effective September 2008, in a bid to inject liquidity into the financial system, the CBN reduced the monetary policy rate (MPR) from 10.3% to 9.8%; the cash reserve requirement (CRR) from 4% to 2%, and the liquidity ratio from

40% to 30%. Despite these measures to boost liquidity, growth in broad money supply (M2), which stood at 58% in the 12 months to December 31, 2008, declined to 30% year-on-year by end-February 2009. In the same vein, credit to the private sector grew at a slower rate, increasing by 44% (on an annualised basis) by end-February 2009 from 59.5% in the year to end-December, 2008.

Consequently, the MPC meeting of April 8, 2009 concluded that "liquidity tightness and, hence, relatively higher inter-bank interest rates" was one of the central pressure points for monetary policy, and again reduced the MPR from 9.8% to 8%; the liquidity ratio from 30% to 25%; and reduced the Cash Reserve Requirement (CRR) from 2% to 1%.

1.2 Inflation

Although inflationary pressures eased in most countries in the 12 months to December 31, 2008 as commodity prices fell sharply, the consequence of weak global export demand failed to feed through to the domestic economy. Inflation during the review year remained above the CBN's single digit target, recording a year-on-year rate of 15.1% as at December 2008, compared to 6.6% in the same period last year. On a 12-month moving average basis, inflation for December 2008 stood at 11.6%, compared with 5.4% in December 2007. As the domestic policy response continues to address the possible demand-limiting effects of less liquidity in the financial services system, and the adverse effect this could have on the real economy, the design of a medium-term macro-economic management framework that ensures sustainable growth will require attention in order to check growing inflation pressures. Invariably, this will require appropriate policy responses to the rapid buildup of monetary aggregates and of the banking system's credit to the private sector. Inflation pressures continued to strengthen in the first quarter of 2009, reflecting to, a large extent, the impact of the rapid depreciation of the naira in the fourth quarter 2008.



Central Hotels Limited, Kano, a hospitality project financed by First Funds Limited on behalf of FirstBank

Central Hotels Limited is situated on Bompai Road, Kano. It is an upper three-star hotel with 209 rooms. On completion, the hotel will be managed by African Sun Limited of Mauritius using the Holiday Inn brand to provide high-quality hospitality services in Kano to various grades of travellers and tourists. It is the first internationally branded hotel in Kano.

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1.3 Payments/Clearing System

On the back of its harmonisation of cheque clearing cycles in the country to three working days (T+2) last year, the CBN continued its reform of the payments system through extension of domestic clearing operations to six new zones in the country. These include Awka, Lokoja, Umuahia, Asaba, Osogbo and Gombe. Our expectations are of further expansion of the payments/clearing system reform horizon, as the National Payment System Committee considered four reform initiatives, including the Regulatory framework for Mobile Payments Services, Nigeria Direct Debt Scheme Rules, Transaction Switching Guidelines, and the Nigerian Bankers Clearing House Rules. These initiatives were conceived as integral aspects of the CBN's Payments System Vision 2020 Action Plan, and are expected to regulate the use of mobile phones as e-payment channels, use of e-payment platforms for bill payments and collection, and facilitate interconnectivity of payment switches. In addition, during the review period, the CBN commenced the process of outsourcing the non-core part of its currency processing and distribution work to the private sector.

The Federal Inland Revenue Service (FIRS)-induced implementation of Real Time Gross Settlement System (RTGS) in November 2008 was a major market discontinuity that threatened our liability generation strategy. The policy meant the loss of FirstBank's lead bank mandate since all banks would have to remit all FIRS collections to CBN directly, and it translated into loss of our indirect collection that traditionally accounts for the largest portion of our volumes.

However, the shock of the change on our volumes was accommodated by the development of more customised collection products, and the deepening of our presence in, and share of the revenue collection market. The FIRS later reverted to the lead collecting bank business model after facing challenges of reconciliation resulting from the direct remittance to CBN by all designated banks.

The CBN's reform focus on the e-payment platform complements noticeable growth in the markets' use of e-payment platforms during the review period. ATM transactions, electronic payments, and point-of-sale transactions played increasingly large roles in the retail payment system and this was consistent with the industry's bid to grow returns through increased penetration of the retail banking segment by using a multi-channel service delivery platform. In responding to the market's adoption of this payment platform the CBN re-stated existing restrictions on bank deployment of off-site ATMs, and directed the redeployment of existing outlets in public places to banks' premises by June 30, 2009. In addition, the CBN set in motion the process for the licensing of an additional ATM consortium in the country.

The public sector adopted another level of business sophistication during the period. The FGN's directive to its Ministries, Departments and Agencies (MDAs) on the compulsory implementation of e-payment for all funds presented a mix of challenges and opportunities to banks, who must, therefore, reposition in response. The prevalent e-business re-orientation in public business was therefore instructive, as it required banks to deploy e-payment platforms to MDAs in order to acquire income rights and other primary bank privileges. A new competition trend soon evolved, driven by pricing models, varied e-payment product specifications, and discerning customers' needs, which are inevitable for customer loyalty and retention dynamics. Non-bank players (service providers) also emerged as competition for MDAs payment mandates. In response, we upgraded our electronic payment system (FirstBank EPS) to meet current realities and required functionalities.



Opportunities and challenges in the banking sector

Public policy on economic issues, and ongoing initiatives to develop the national banking infrastructure, require all banks to reposition in response.



The new Tejuosho Market in Surulere, Lagos, under construction with financing from FirstBank

In pursuit of the Lagos State Government's policy to increasingly modernise markets in the state, the project is meant to establish an ultramodern market complex in place of the old Tejuosho market, which was gutted by fire a while ago.

INDUSTRY REVIEW AND OUTLOOK



Industry consolidation

We continue to expect increased merger and acquisition activity within the industry in the context of a much tougher operating landscape.

1.4 Consolidation/Integration

With Bank PHB's acquisition of a 59% equity stake in Spring Bank, the second phase of the industry consolidation continued. Slightly more subdued than the regulation-inspired first phase, this second phase was expected to have leveraged opportunities from the growing integration of the local financial markets with the global economy. In response to the crisis, this outlook has changed significantly. Given a much tougher operating landscape, industry consolidation may well progress more rapidly than was previously forecast. Although the process of market correction may be drawn out, industry combinations along diverse lines would help rebuild both capital and market trust, while significantly moderating leverage levels. We continue to expect increased merger and acquisition activity within the industry.

1.5 Regulatory Reforms

Policy responses to the fall-out of the global crisis defined the regulatory universe in the review period. In view of its focus on maintaining banking sector liquidity, the CBN's policy response horizon became manifestly narrower, concentrating on near-term concerns. Chief amongst these were the waiver of the application of the requirements of the Prudential Guidelines to margin loans, leading to their re-structuring until December 2009, and an interest rate cap on both deposit (15%) and lending (all in 24%) effective April 1, 2009.

At the long-end of the policy spectrum, aside from strengthening institutional coordination through the Financial Sector Regulatory Coordinating Committee (FSRCC), the regulatory authority also embarked on a review of the contingency planning framework for systemic distress, with emphasis on enforcing code of corporate governance. The CBN's concern over disclosure levels and transparency standards in the industry was reinforced during the year by the adoption of a common year-end for all banks, effective December 2009. A common platform for

the comparative evaluation of industry financials would, no doubt, be a useful additional tool. In the period under review, the CBN posted resident examiners to banks and lent its voice to the establishment of credit bureaux.

1.6 Foreign Exchange Management

Foreign exchange markets were perhaps the strongest transmission channel of the global financial crisis to the sub-continent, as domestic currencies succumbed to downward pressure as foreign investors divested their African portfolios. However, on the back of its strong external reserve position, and the CBN's apparent commitment to boosted foreign exchange supply to the market in response to ballooning demand, the naira remained relatively stable up until the third quarter of the year.

However, continued external financing constraints towards year-end 2008 and sharp reduction in the CBN's sale of foreign exchange upset the stability. With the inter-bank market coming under severe pressure, the apex bank was compelled to commit to maintaining market liquidity through a daily two-way price quote. By January 2009, the main foreign exchange management challenge was how to pursue the stabilisation of the exchange rate. In pursuit of this goal, the apex bank reversed its earlier policy trajectory, temporarily reverting to the Retail Dutch Auction System (RDAS), while implementing a number of other initiatives. Significantly, the CBN temporarily suspended inter-bank foreign exchange transactions, cut regulatory limits on banks' net open foreign exchange positions from 20% to 1% of shareholders' funds, introduced a band of plus or minus 3% on the sale of foreign exchange, and restructured the bureaux de change segment of the market.



The new Adeniran Ogunsanya Shopping Complex in Surulere, Lagos, under construction with financing from FirstBank

Aligned with the Lagos State Government's goal to modernise markets in the state, the ongoing reconstruction of Adeniran Ogunsanya Shopping Complex will provide shoppers with a value-added retail environment.

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A distinctive approach

FBN Microfinance Bank commenced operations with three branches in January, with the aim of bringing a distinctive approach to service delivery in this sector.

1.7 Capital Market

In the six months to end-June 2008, the primary market was very active, with 130.5 billion new shares admitted into the daily official list as against 26.8 billion recorded the previous year. The bonds segment remained just as active with FGN Bonds of 3, 5 and 10-year tranches valued at ₦278.5 billion issued and allotted. The market hit an all-time peak in February 2008 with the All-Share Index closing at 65,075.02 and market capitalisation at ₦12.4 trillion. However, activity in the market decelerated rapidly as highly capitalised companies in the insurance and banking sub-sectors suffered massive price losses. The reversal in the fortunes of the market came after a controversial statement purportedly forbidding banks from lending against share purchases was attributed to the CBN.

By end-December 2008, the All-Share Index and total market capitalisation of the listed securities fell by 45.8% and 31.7% to close at 31,450.78 (1984 = 100) and ₦7 trillion, respectively as against 57,990.22 (1984 = 100) and ₦10.2 trillion in December 2007. To stem the share price haemorrhage and related value loss, the Securities and Exchange Commission (SEC) appointed three market makers in November 2008, with specific responsibility for creating markets and liquidity on the Exchange. Nonetheless, underscoring the market's role as a major link in the economy's relation with the global economy, activity on the markets has remained subdued.

1.8 Microfinance

The CBN continued to license microfinance banks (MFBs) in the review period in pursuit of its goal of attracting the bulk of funds in circulation (outside banks) into the informal financial services sector, and increasing the proportion of the economically active populace with access to the formal financial services sector. However, given the huge financing gaps at the micro-enterprise level, a lot more of these institutions will have to be licensed, even as existing MFBs broaden their operations. Despite the specialised nature of their markets, however, a number of these institutions have rolled out their operations and complementary tools and personnel like the 'formal' banks. Conscious of the fact that the implications of these expensive office complexes, status vehicles and fixed asset acquisition costs on the operations of this category of financial institutions are likely to be adverse, FBN Microfinance Bank commenced operations with three branches on January 19, 2009, based on a thorough appreciation of the distinctive ways in which service may be delivered in this sector, and the required levels of skills and competencies.

In the review period, the Microfinance Inter-Bank Market was launched to provide microfinance banks with access to funds, particularly during this period of tightness in the markets. Average inter-bank rates in this market as at end-March 2009 stood at 18.7%.



A part of the factory of Mimonet Nigeria Limited, Lagos, a garment manufacturer financed by First Funds Limited on behalf of FirstBank

The company started operations in 1995 as a small fashion house from the family home, but has grown to become a major provider of clothing to individuals across the country.