Centre for Development
Finance Studies

For Whom the Banks Roll…

The CDFS Short Read – September 2025

Episode 1: To Whom the Banks Owe

This CDFS Short Read in Brief

Banks. Banks. Banks. They are the core 'clients' of the development finance system, play a crucial role in the development of their domestic financial systems, and are therefore central to the local currency question. This CDFS Short Read is the first episode of a series aimed at understanding the business models of commercial banks in Kenya and Nigeria and how they interact with and are influenced by development finance. Much like us, banks are arguably what they eat. It is therefore with their diet that we embark on this analytical journey.

As the primary providers of financing in an economy, commercial banks should be at the core of any investigation of the local currency issue. This is reinforced by their role as the main conduits through which development finance institutions, themselves ill-equipped to directly offer local currency loans, deploy their capital.

It is therefore important to understand the range of services and financing products commercial banks offer, the mix of liabilities they use to finance these products, and the nexus of incentives, whether they be derived from business opportunities or regulatory pressures, that determine both. In other words, what they do, how they do it, and perhaps most importantly why.

In recognition of the need to conduct this analysis against a determining national context, it is focussed on two banking systems, those of Kenya and Nigeria. It begins with funding composition because it shapes the rest: the availability of credit, the maturity profile of lending, and the system's ability to withstand stress.

Kenya and Nigeria's banking systems are underpowered. In both countries, bank deposits – the foundation of financial intermediation – are small relative to the size of the economy. As of year-end 2023, deposits stood at just 35% of GDP in Kenya and 30% in Nigeria. For comparison, in South Africa this measure stands at 75%, while in the United Kingdom it exceeds 100%.

This short read is however not primarily concerned with the quantity of bank funding, but with its composition. In both Kenya and Nigeria, bank liabilities are dominated by short-term customer deposits, which account for more than 80% of total funding. Other funding instruments, whether they be bonds, securitisations or institutional credit, remain marginal. The result is a liability structure that appears liquid but lacks the depth, diversity, and resilience needed for extending long-term credit.

The analysis draws from two levels. First, it examines the sector-wide composition, maturity and currency mix of bank liabilities, as well of the impact of policy.

It then draws on deep dives into six representative banks that serve as the analytic backbone of this series. In Kenya these are KCB, Equity Bank and Standard Chartered Kenya, while in Nigeria Access Bank, FirstBank of Nigeria and Stanbic IBTC were selected.

Together, these banks manage a significant share of sector liabilities and reflect broader system dynamics.

This Short Read then asks whether the current liability structure needs to evolve, and what role development finance, market instruments and policy design might play in rebalancing the diet of deposit funding toward something more fit for purpose.

1. **Balanced Diet.** Why Banks Need More Than Deposits to Stay Healthy

A deposit-heavy balance sheet can look like a virtue – until the moment it isn't. When banks rely overwhelmingly on short-term, callable funding, they may seem liquid and well-capitalised in calm periods, but brittle when asked to lend long, cushion shocks, or stay upright through volatility. This is not a theoretical concern. In many developing markets, deposit dominance has quietly become a systemic design flaw.

In developed markets, deposits remain central, but they rarely exceed two-thirds of bank liabilities. Most banking sectors sit in the 50–70% range. What fills the gap is a set of market-based instruments that provide tenor, risk-sharing, and counter-cyclicality. In Europe, banks rely on covered bond and repo markets. In Canada, deposits are balanced with mortgage-backed securities and medium-term notes. In the U.S., pandemic stimulus temporarily lifted deposits above 75%, but that imbalance is now correcting as wholesale instruments – like FHLB advances[1] and senior debt – regain traction.

Exhibit 1: Typical Market-based Funding Instruments

Instrument	Description
Short-term Wholesale Instruments	
Repo	• Short-term borrowing secured by high-quality collateral.
Commercial Paper (CP)	• Short-term unsecured debt issued to institutional investors
Medium- to Long-Term Unsecured Debt	
Senior Unsecured Bonds	• Market-issued term funding from institutional investors.
Medium-Term Notes (MTNs)	• Senior debt issued under a flexible program, allowing banks to raise funding in tranches over time.
Subordinated Tier II Debt	• Long-dated debt qualifying as regulatory capital under Basel rules.
Term Loan Facilities	• Bilateral or syndicated loans, typically extended by DFIs.
Secured Term Funding Instruments	
Covered Bonds	• Bonds backed by on-balance-sheet assets, with dual recourse to issuer and the cover pool.
Securitisations	• Pooling and offloading loan assets via special vehicles that issue tradable securities.

[1] *In the U.S., the Federal Home Loan Bank system provides collateralised loans ("advances") to member banks and credit unions – a form of government-backed wholesale funding – to manage liquidity and extend asset duration*

Why does this matter? Because deposits, while cheap and sticky, are also short and impatient. Without complementary funding channels, banks can't safely lend ten-year money. Nor can they transmit market signals: retail depositors don't price credit risk the way bondholders do. A deposit-only funding model therefore suppresses the signals that well-functioning systems use to calibrate risk, price capital, and allocate credit.

Diversification of funding is what allows banks to shift from liquidity storage to economic transformation. It enables SME lending, mortgages, infrastructure loans – financing activity the development finance community considers catalytic. As the World Bank (2020) notes, "Affordable housing finance is a cornerstone of financial sector development and household wealth accumulation." A system that doesn't diversify its funding base will always be structurally limited in how much of that catalytic role it can play.

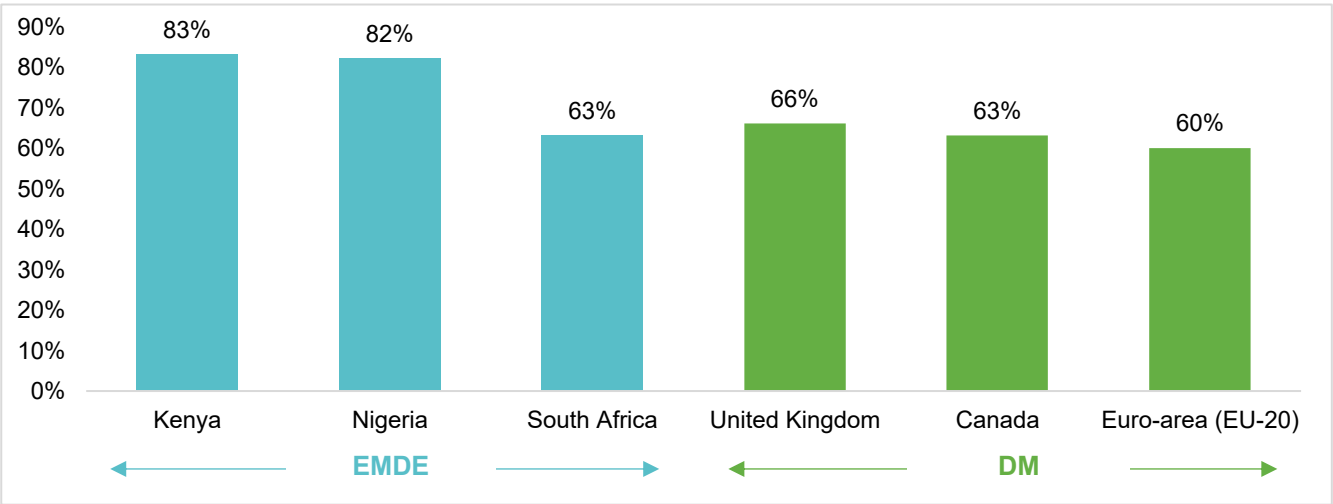
This principle is borne out across advanced banking systems. The European Banking Authority links the euro area's €3.3 trillion covered bond market to banks' ability to finance 20- to 30-year mortgages at low spreads[2] – credit instruments that would be near-impossible to sustain using only short-term deposits. Similarly, during the March 2023 regional banking crisis, large U.S. banks replaced $400 billion in deposit outflows with FHLB advances and senior debt, sustaining credit growth despite a liquidity shock. [3]

South Africa provides a regional analogue. With deposits comprising only ~63% of liabilities, banks there routinely issue bonds and commercial paper to support medium-term lending. The South African Reserve Bank highlights this model as one that improves maturity flexibility and credit resilience.[4] The World Bank (2020) and IMF also emphasize that diversified funding models are essential to unlocking long-term finance and deepening domestic capital markets in emerging economies.

2. **Dietary Deficiencies.** Diagnosing Funding Health in Kenya and Nigeria

The banking systems of Kenya and Nigeria share a defining trait: both are among the most deposit-reliant in the world. In each country, deposits account for over 80% of total bank liabilities.

Exhibit 2: Deposit Dominance of Select Markets



[2] EBA, *Report on Covered Bonds (2016)*
[3] Federal Reserve, *Supervision and Regulation Report (May 2024)*
[4] South African Reserve Bank, *Financial Stability Review (2023)*

In Kenya, deposits make up 82% of total bank sector liabilities. The system operates primarily in local currency, with any FX deposits largely hedged. The Central Bank of Kenya (CBK) applies a relatively modest cash reserve ratio (CRR) – currently 3.25% – which is remunerated and predictable, allowing banks to deploy the bulk of deposits into credit or securities. However, market-based funding remains underdeveloped. Bonds account for ≤4% of bank liabilities, and the repo market remains shallow. The result is a high-liquidity, low-maturity transformation model, with the median mortgage tenor below 7 years due to the absence of term funding.

Nigeria's deposit diet is even more unhealthy. While deposits also account for around 80% of bank sector liabilities - roughly one-third are denominated in foreign currency - a legacy of oil exports and widespread dollar use. This leaves Nigerian banks sensitive to devaluation. Every 10% slide in the naira inflates deposit liabilities by nearly ₦3 trillion – equivalent to more than 3% of total banking assets. As FX liabilities rise faster than assets, currency mismatches worsen and FX loan-to-deposit ratios tighten, restricting the ability to extend new dollar lending.

On the naira side, liquidity is constrained by a very high reserve requirement. The statutory CRR is 32.5%, and the effective rate often exceeds 45% due to additional unannounced debits by the Central Bank. These balances earn no return, tying up a large share of naira deposits and imposing what analysts estimate to be a 6–7% drag on return on assets – a hidden tax on intermediation. [5]

Alternative funding mechanisms remain underdeveloped. Most Eurobonds are five-year bullet structures, requiring full repayment at maturity and exposing banks to rollover risk. In local markets, the picture is even starker, with naira bond issuance by banks accounting for just 0.3% of total system assets, reflecting shallow capital markets and weak investor appetite for bank debt.

What is the Cash Reserve Ratio (CRR)?

The Cash Reserve Ratio (CRR) is the portion of customer deposits that banks are required to hold – typically with the central bank – to help manage liquidity in the financial system. To give banks clarity over how much of their funding can be deployed, the CRR is typically

- ☑ **Fixed**
- ☑ **Transparent**
- ☑ **Moderate**

If set as excessively high or unremunerated, or applied unpredictably, the CRR acts as a hidden tax on financial intermediation. Banks must lock up large volumes of deposits that earn no return, even as they continue to pay interest to depositors. **This weakens lending capacity, shrinks margins, and may discourage deposit mobilisation altogether.**

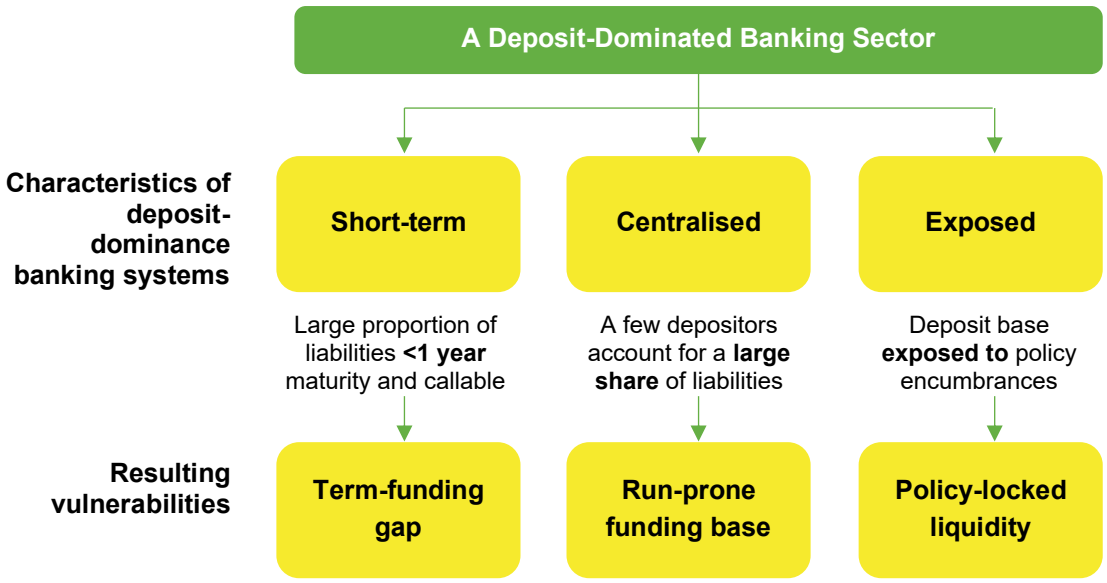
Both systems exhibit a form of funding malnutrition – overfed on deposits but starved of market-based nutrients. They rank in the global top decile for deposit share and bottom decile for bond-based funding. But their symptoms differ. Kenya's system is dehydrated on duration, unable to stretch beyond short-term credit; Nigeria's is bloated with FX risk and suffers from chronic liquidity loss. These structural imbalances weaken both systems' ability to lend long, absorb shocks, and support the kind of economic transformation that a balanced funding diet would enable.

[5] Fitch Ratings, *Nigeria Bank Sector Outlook (2023)*

3. **Sugar Rush.** How Deposit Dependence Creates Systemic Vulnerability

A heavily deposit-dominant banking system can appear sturdy in calm waters – low-cost, stable, and liquid. But when deposits account for more than 80% of bank liabilities, as they do in both Kenya and Nigeria, three key structural weaknesses begin to surface beneath the apparent strength.

Exhibit 3: Characteristics and Vulnerabilities of Deposit-Dominance



The first is a term-funding gap.
Like a system powered by simple carbohydrates, short-term, callable funding gives banks quick energy but no staying power. Without access to stable, long-tenor liabilities, they can't lend long. Both Kenya and Nigeria aspire to scale mortgage markets, finance infrastructure, and support SME expansion, yet less than 1% of their system funding has the necessary maturity.[6] Approximately 84% of Kenyan loans and 78% of Nigerian loans mature within three years; barely one in twenty runs beyond a decade. [7]

The consequences are visible. Kenya's entire residential mortgage market – just 30,000 loans worth around KES 270 billion (USD 2 billion)[8] – amounts to barely 2% of GDP, whereas mortgage debt is over 26 % of GDP in South Africa.[9] In Nigeria, green-transition ambitions are held back by the absence of ten-year naira funding. Local-currency debt for infrastructure projects seldom stretches beyond seven years; the country's first 10-year naira bond only emerged in 2017. In the meantime, most commercial climate projects are either structured in foreign currency or delayed altogether, an energy transition

[6] CBN, CBK Bank Supervision Report (2023), Fitch Ratings Nigeria Bank Sector Outlook (2023).
[7] IMF FSAP: Kenya (2022), Nigeria (2020); Afrinvest Bank Sector Report (2023); FSD Kenya Annual Review (2023).
[8] Kenya Mortgage Refinance Company (2022), CBK Mortgage Market Update.
[9] CDFS analysis; South African Reserve Bank Monthly Release of Selected Data (No 417 November 2023)

bottleneck driven less by policy than by balance sheet design.

The second is liquidity concentration. Deposit-heavy systems aren't just short-term. They're unbalanced. In both Kenya and Nigeria, a small number of large depositors contribute a disproportionate share of bank funding. At FirstBank Nigeria, the top 20 depositors account for 28% of total funding; at KCB Kenya, it's 22%.[10] These concentrations create vulnerability. When confidence dips, a handful of clients can trigger large-scale outflows – like a sudden loss of blood pressure in a fragile circulatory system.

But it's not just the size, it's the speed. Technology has collapsed the reaction window. What once took days or weeks now happens in minutes, as mobile apps and real time payment rails let even retail customers sweep balances at the tap of a screen. As the IMF cautions, *"the potential speed of withdrawals is hence crucial; advancing digital frontiers allow bank customers to reallocate deposits almost instantly"* [11]. In India, a social media fuelled digital run on Yes Bank in early 2020 drained roughly a quarter of the bank's deposits – about INR 720 billion – before regulators imposed a moratorium and orchestrated a rescue. [12] During Nigeria's 2023 naira-redesign, aimed at withdrawing old notes from circulation, corporate withdrawals spiked by 15% in a single day. [13]

These systems now operate with thinner liquidity buffers and far less time to act. Traditional assumptions about deposit stickiness no longer hold. For treasurers and regulators alike, the risk is not just that money moves, but that it moves faster than banks can react.

The third is policy-exposed liquidity.
In a deposit-dominant system, liquidity is not fully in the hands of the banks that hold it. Because deposits are the part of the balance sheet most exposed to regulatory control, central bank policy becomes a source of structural constraint. In Nigeria, that control takes the form of a high, unremunerated cash reserve ratio (CRR) often in excess of 45%, which results in nearly half of all naira deposits being locked up, earning no return, and unavailable for lending. For example, in 2024, ten of Nigeria's largest banks parked ₦20.8 trillion in CRR accounts with the Central Bank – more than four times their combined Tier-1 capital.

In a deposit-dominated system, there are few alternatives. Banks can't shift toward bond markets or wholesale instruments when reserve requirements bite. Instead, they simply lend less. They pull back on term credit, cut exposure to riskier borrowers, and shrink their balance sheet to fit the part they can actually deploy.

While Kenya offers a contrast – its reserve ratio is just 3.25% and is remunerated – its deposit dominance means its banks are still at risk of policy-driven liquidity strains.

[10] Internal supervisory data (CBK, CBN); SBG Securities analyst notes (2023).
[11] https://www.imf.org/en/Publications/fandd/issues/2024/03/Containing-Technology-driven-bank-runs-Krogstrup-Sangill-Sicard

[12] https://economictimes.indiatimes.com/industry/banking/finance/banking/yes-bank-failure-to-honour-sudden-spike-in-withdrawals-led-to-bailout/articleshow/74642541.cms?from=mdr
[13] CBN press release, January 2024; Afrinvest Nigeria Banking Report (2024)

Goldilocks, Basel, and the Frontier Funding Paradox

Our argument for funding diversification may raise a legitimate question. Did the post-2008 reforms, led by the Basel Committee and the Bank for International Settlements (BIS), not urge banks to lean more heavily on deposits? Haven't banks in developed markets spent the past decade building up their deposit base to comply with liquidity ratios like the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR)? Why then call for something different in Kenya and Nigeria?

Clearing the air

The answer lies in what Basel III was solving for.

In the run-up to the global financial crisis, many banks in developed economies had overindulged in wholesale funding. When markets froze, liquidity evaporated. Banks that had been more deposit-reliant, by contrast, proved more resilient. *Huang and Ratnovski (2009)* show that Canadian banks' crisis resilience stemmed in part from being "in the top quartile of the OECD sample in terms of their use of depository funding," which "may have insulated them from the freeze of wholesale funding markets." Their regression results confirm that banks relying less on deposits and more on wholesale channels were more likely to face distress.

Regulators responded with a new framework, Basel III (French for "diet", incidentally), designed to rein in systemic risk and prevent a repeat of collapses like Northern Rock or Lehman Brothers.

Goldilocks applied to bank funding

But the story doesn't end there.

In a follow-up study, *Huang & Ratnovski (2010)* demonstrate that optimal bank funding composition requires balancing the 'bright side' of wholesale funding, including flexibility and market discipline that comes with it, against its 'dark side', which they define as vulnerability to uninformed panics.

This need to balance can be expressed as yet another application of the Goldilocks Principle. Banks should seek to find the optimal funding mix, acknowledging that an excessive reliance on either deposits or market funding is unlikely to be satisfactory.

Context is key to diagnosis

It is further important to highlight that this optimal mix is a function of a series of contextual factors.

The BIS framework is based on the assumption that deep capital markets exist as alternatives and that deposit bases are already substantial. The main risk is therefore deemed to be excessive wholesale funding. In frontier economies where such access is limited, the risk shifts from excessive wholesale dependence to insufficient funding diversification.

A call to Kenyan and Nigerian banks to diversify their sources of funding should therefore not be construed as inconsistent with the post-GFC BIS guidance, but rather as an application of the optimisation principle in a materially different context.

4. **Supplement or Solution?** Using DFI Funding to Nourish Long-Term Stability

DFI funding has become a regular supplement in the liability diet of banks in Kenya and Nigeria. Often issued in hard currency, these injections – whether long-term loans, subordinated capital, or guarantees – fill a clear structural gap. But the deeper question is whether they strengthen the system, or simply keep it upright.

Used well, DFI funding can introduce both tenor and resilience. Long-dated loans give banks breathing room beyond short-term deposits. Subordinated capital deepens the buffer against shocks. When structured in local currency, or swapped into it, it reduces maturity mismatch and FX risk. And when accompanied by covenants tied to SME lending, climate, or gender outcomes, it can gently shape bank portfolios.

But these benefits are only catalytic if they unlock the next stage and facilitate funding diversification. A deposit-heavy system doesn't rebalance when DFIs simply replace one bilateral line with another. The source changes, but the structure stays the same. A different patch, but still a patch.

There's also a currency complication. Most DFI funding still arrives in hard currency. Unless swapped or hedged, these liabilities create currency mismatches. As the World Bank has noted, "hard currency funding may appear cheaper upfront but shifts currency risk to borrowers and weakens long-term sustainability."[14] In nutritional terms, what looks like energy can quickly turn to imbalance.

Exhibit 4: Hard Currency Share of DFI Funding (2020-present)

Bank	Hard-currency share	Theme
Access	95 %	SME, Climate, Gender, Trade
Stanbic IBTC	85 %	SME, Gender
FirstBank	80 %	SME, Gender
SCB Kenya	100 %	Trade, Gender
Equity	90 %	SME, Climate, Gender
KCB	85 %	SME, Climate

The real shift comes when DFIs help banks wean off deposit dependence. That means anchoring bond deals, backing securitisations, and standing behind local-currency issuance that can extend duration and diversify risk. It's the difference between intravenous support and real metabolic change.

Kenya has begun to move in this direction. DFIs have supported early medium-term note issuances, offered partial guarantees on local-currency structures, and underwritten pilot securitisations. These small steps signal movement toward a funding model that is longer, more stable, and less dependent on short-term flows.

[14] World Bank (2020), *Developing Local Currency Bond Markets: A Framework for Policy Reform*

Transaction spotlight: Kenya's Medium-Term Notes

In 2023, the IFC anchored the Kenya Mortgage Refinance Company's inaugural local-currency medium-term note (MTN) issuance, purchasing ~40% of the KES 10.5 billion (~USD 93 million) bond, thereby enabling tenors well beyond deposit maturities.

Nigeria is further behind. Most DFI involvement remains bilateral: hard-currency loans, trade finance lines, and Tier II injections. These are essential for stability, especially in moments of stress, but they don't yet add up to a structural shift. The system still relies overwhelmingly on deposits, topped up with DFI credit, rather than market-based liabilities that can be scaled, recycled, and priced by the market.

In short: the most catalytic DFI intervention may not be the next loan. It may be the last one - if it helps banks graduate from short-term fixes to a funding base that is diversified, resilient, and built to last.

Exhibit 5: Liability Effect and Catalytic Potential of DFI Liability Support

LEAST CATALYTIC

MOST CATALYTIC

DFI Instrument	Liability Effect	Catalytic Rationale
Hard-currency long-term loan	Adds tenor but introduces FX risk if unhedged	• Fills short-term gap, but doesn't shift structure • FX exposure may offset benefits
Subordinated Tier II capital	Strengthens capital base and adds liability stickiness	• Improves capital adequacy and investor confidence • However, usually bilateral and not replicable through markets
Local-currency credit line	Adds tenor without introducing FX risk	• Builds bank's track record in managing LCY term funding • More catalytic if linked to initiatives to develop future market-based refinancing
Anchor investment in local MTN	Signals creditworthiness, builds pricing benchmarks	• Establishes issuance precedent, building investor confidence • More catalytic when scaled or replicated across banks
Partial risk guarantee on bond issuance	De-risks market entry, enables bond issuance	• Removes barriers to market access and de-risks issuance • Key enabler for new issuers and smaller banks
First-loss tranche in securitisation	Enables off-balance sheet financing and capital recycling	• De-risks early securitisations, building investor confidence • Lays the institutional groundwork for scalable, repeatable issuance

5. **Re-wiring the System.** What comes after deposit dependence?

This short read has argued that *how* banks fund themselves is just as important as *what* they fund.

Deposit-heavy systems may look liquid and stable, but under pressure, the cracks show. Short-term liabilities constrain maturity transformation. Currency mismatches inflate risk. Central bank policies, however well-intentioned, extract liquidity and suppress lending. What results is a system that is overfunded on paper, but underpowered in practice.

Development finance institutions have stepped in. They have filled gaps, stabilised liquidity, and extended tenor where markets would not. But catalytic funding does more than plug holes. It rewires the system.

We call this the catalytic ladder. To climb it, an instrument must:

1. **Reshape the liability structure** – by extending tenor, diversifying instruments, or shifting currency mix;
2. **Unlock market-based funding** – by crowding in new investors, enabling bond issuance, or seeding securitisation;
3. **Leave behind infrastructure** – like credit ratings, performance histories, or legal frameworks that can be reused.

Some instruments do this better than others. Risk guarantees and anchor investments can enable bond issuance. First-loss tranches in securitisations create new funding pathways and leave behind the infrastructure to repeat them. Direct loans, by contrast, may stabilise but rarely transform.

There are real-world examples of this transition. In Colombia, the IFC and IDB Invest worked with banks and the development bank Bancóldex to structure local-currency guarantees, anchor bond issuances, and support SME loan securitisations.[15] These interventions helped crowd in domestic pension funds, catalyse new asset-backed securities markets, and establish reusable legal and credit-rating structures. The most catalytic element wasn't the funding it was the market infrastructure left behind – the templates, investor appetite, and replicable structures that endure beyond the DFI's exit.

Without rewiring the liability structure, the system stays fragile – well-fed in appearance but undernourished in function.

[15] IFC (2020). *Innovative Financial Structures to Mobilize Private Capital for SMEs in Colombia*; IDB Invest (2021). *Mobilizing Private Capital through Capital Markets in Latin America: The Role of Guarantees*.

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