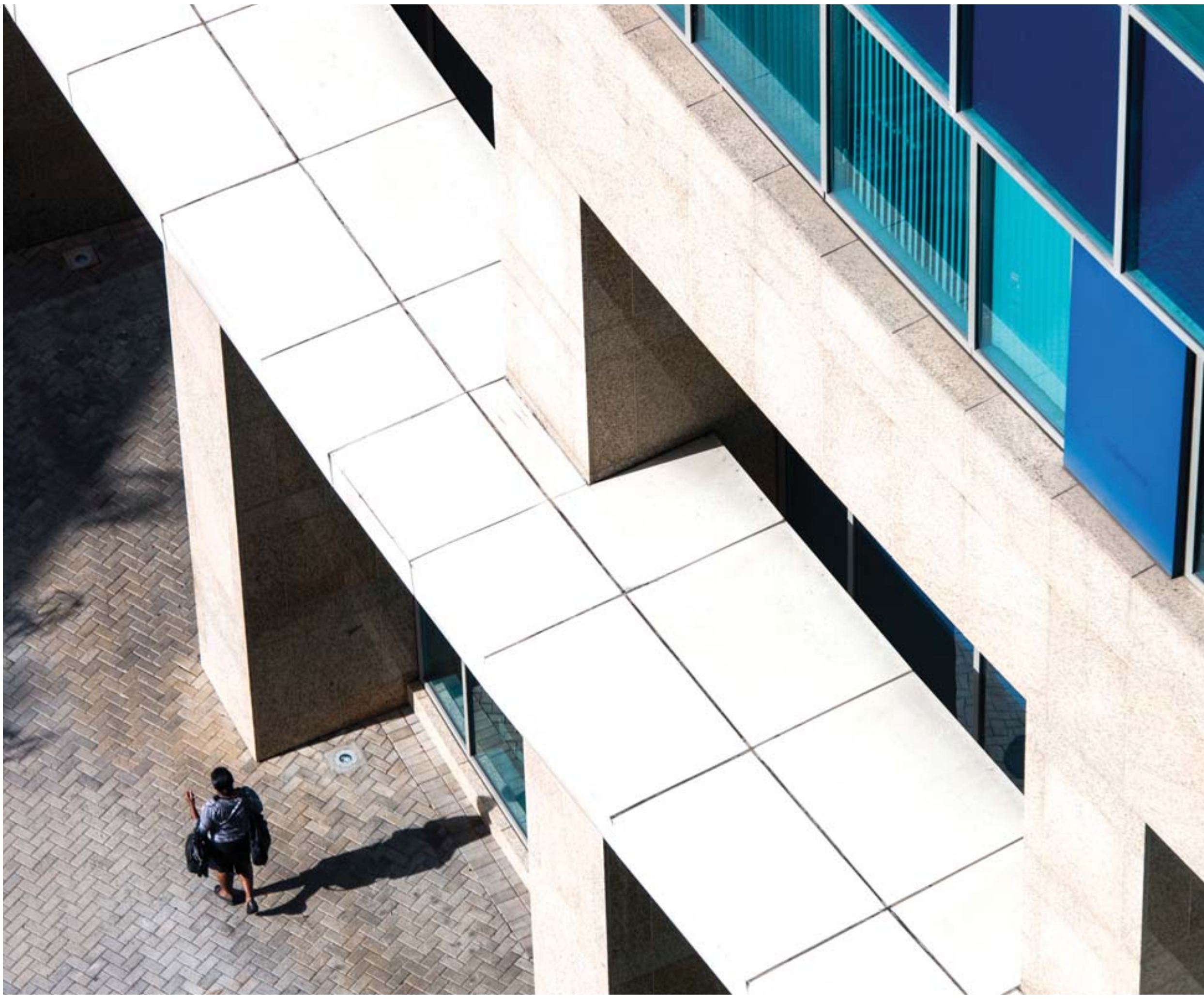
Perspectives on current issues and trends in Financial Services

Financial Focus



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Introduction

Richard G. Njoroge
Partner, PwC Kenya, and Financial Services Industry Leader
+254 20 285 5000
richard.njoroge@ke.pwc.com

Dear readers,

The landscape in Kenya's financial services sector is changing rapidly, brought about by regulatory issues, tax law changes and technology advancements. At the same time, the industry is actively contributing to greater financial inclusion with more customers participating in and benefiting from financial services.

As the playing field for financial services companies becomes more level, competition also continues to increase. Successful companies tap technology and talent to anticipate the challenges and opportunities of tomorrow.

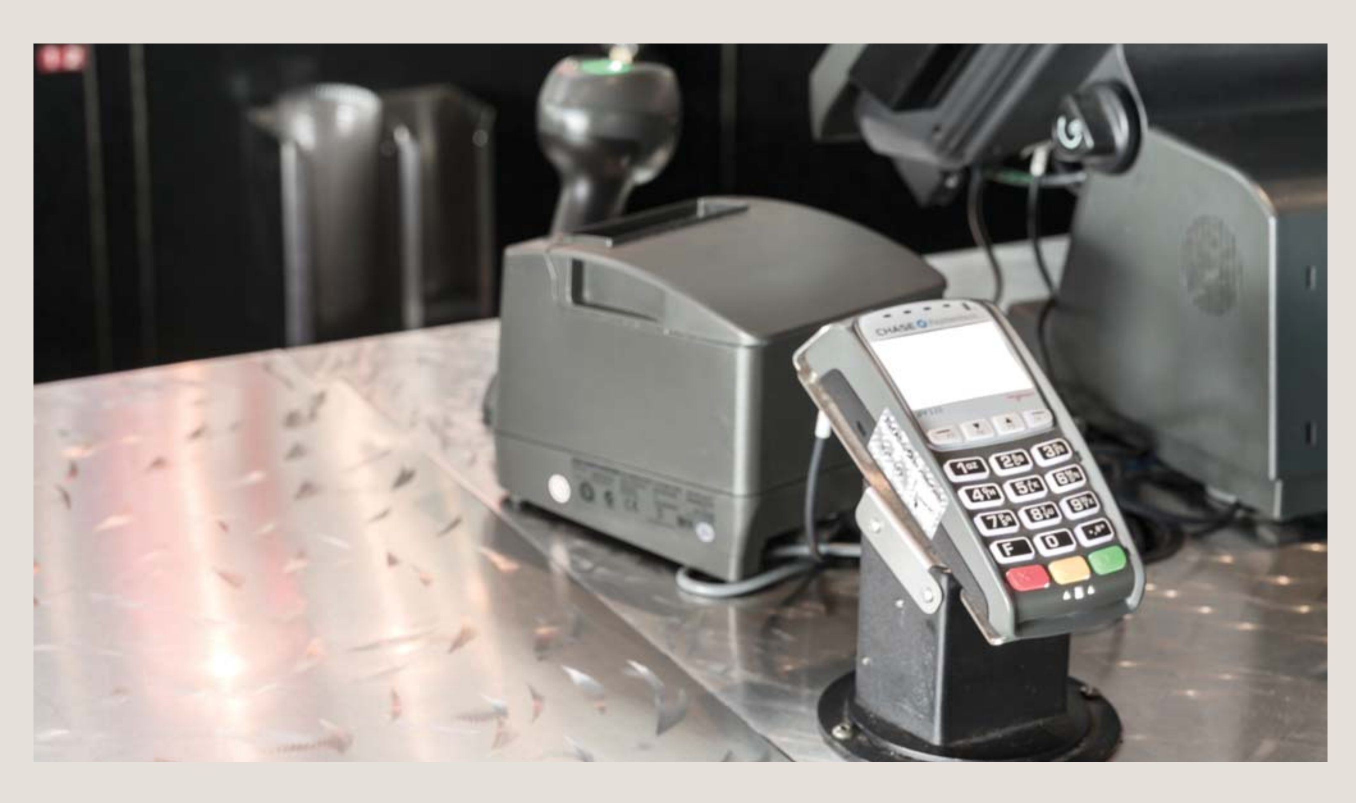
At PwC, we work with different financial institutions to manage the risks, requirements and opportunities of today and tomorrow. In our annual Financial Focus publication, we seek to describe some of the major developments in the industry as well as give you an informed view about what is coming around the corner.

We hope that the information and viewpoints shared by our contributors—all of whom are practitioners in the field—will prove thought-provoking and useful to you. We are always available to discuss any of these issues in greater detail with you.

As I have read these articles, I have been struck by a number of trends that resonate throughout the publication. First, it is clear that to position themselves for success, financial institutions must anticipate change and respond to rapidly changing customer needs. Demand for services is driven by complexity and expectations.

Customers expect to conduct transactions swiftly and conveniently and, increasingly, from their mobile phones. A keen understanding of customer needs and how customers spend their time and money can help financial institutions to design appropriate products, marketing and technologies to serve them.

Another common thread throughout this publication is the impact of regulation and regulatory change on financial institutions. Industry players can have a view of whether



the regulation goes too far, or if the change is onerous or justifiable. Compliance in most cases carries a cost and so the attitude towards regulation therefore tends to be critical. From past experience, where the regulators are open to dialogue, then it may be possible to make adjustments to the timing and implementation, thereby making the changes less painful to financial institutions.

Very often, our clients and contacts in the industry object not to the principle of the regulation but to the way that it is implemented. That is why dialogue is so important.

Sometimes the regulatory environment reflects an 'old rules, new market' reality. The rules can lag behind developments in industry. In certain instances, it has taken a while to change the rules. M-PESA was established in the absence of very clear regulation.

Other times, it may seem like the regulator is playing catch-up with developments in the market —such as we find with the rules on non-operating holding companies, which have become necessary with the formation of groups by Kenyan banks and expansion strategies into the region.

Real Estate Investment Trusts are an exciting innovation by regulators but they have not yet had full uptake by the industry because of uncertainties about some of the rules, especially the impact of Capital Gains Tax.

There are several proposed bills affecting the financial sector (such as the Insurance Bill, the new Central Bank of Kenya Bill and the proposed FSA Bill) that are at different stages of development. In the past it has taken a long time to have bills discussed and passed by Parliament and it will help the sector if the pace of enacting such legislation is increased.

A final trend that pervades these articles is the persistence and severity of fraud. It is a major problem for the industry worldwide. Fraudsters are becoming more sophisticated and many financial institutions tend to react to fraud rather than proactively design and implement strategies to fight fraud before it happens. Our law enforcement agencies often seem to lack the capacity, skills and resources to investigate and prosecute fraudsters in more complex cases.

The marketplace for financial services is changing rapidly. The lines continue to blur between companies of different kinds providing or marketing financial services.

These are very interesting times to work in financial services, and we hope that the articles in Financial Focus help to clarify some of the more relevant issues. As always, please let me or any of our contributors know if you wish to discuss these issues further.

As customer expectations shift, experience shows that successful financial institutions use ongoing technological innovation to re-define and refine the customer experience

Digital financial services: 2020 and beyond

Robinson Njau is a Manager with PwC Kenya's Technology Advisory practice
+254 20 285 5384
robinson.njau@ke.pwc.com

There is popular YouTube video of a one year old child who gets really frustrated when she discovers a print magazine is just, well, a magazine. To her dismay, there are no sliding images, no interactive content and nothing for her chubby fingers to play with. She looks at her parents, clearly wondering, "Is it broken?"

Today's children are tomorrow's banking customers.

Customer expectations are changing

Already, many of today's banking customers expect more from financial services providers. Their expectations are shaped by their experiences outside the banking sector where content, interactions and features may be much richer and more compelling—like in the entertainment and media sector. They trust their peers more and rely on recommendations to make decisions on whether to buy one bank's products and services or shop elsewhere. Brand loyalty is increasingly influenced by peer reviews and other social media influencers—not necessarily financial experts. They are better informed, with access to information about their banks' competitors' services at the touch of a button. Finally, they have choices and voices. With easy access to alternatives, the barriers to defection will be low.

Banks will have to make an extra effort to retain customers by giving them a unique value proposition. Their voices are amplified and their messages reach millions via social media. These and other trends impact the market for financial services now and to 2020 and beyond[1].

As customer expectations shift, experience shows that successful financial institutions use ongoing technological innovation to re-define and refine the customer experience.

Once upon a time, having a mobile telephone that could take pictures would not have ranked high on the hierarchy of customer needs. But the emergence and convenience of this technology altered the whole ecosystem for mobile phones and – by extension – cameras and photograph processing. Digital photography technology was invented by Kodak in 1975 but the company was stuck in the photographic film era and did not embrace the new technology.

In 2006, Kodak had 90% share of the $6B film market. In 2010, Kodak still had 90% share of the $100M film market but they filed for bankruptcy in January that year. Now, the company has fully embraced digital photography and digital printing. The lesson for financial institutions is that no one has a crystal ball but it is possible to influence the future of financial services through innovation—and by making the right decisions at the right time, informed by both data and experience.

The challenges of the future financial institution

Financial institutions like banks face rapid and irreversible changes across technology, customer behaviour and regulation. The net effect is that the industry's current shape and operating models are no longer sustainable into the future. The combined power of these three drivers of industry change – technology, customers and regulation – is increased by the fact that they are often closely interwoven. For example, technological change creates new categories of customer utility, which

in turn fuel further technological investment. Similarly, regulatory changes prompt both service and structural innovations, which together change the nature of the activities or entities that need regulating. And all the while, shifting attitudes and expectations from customers are redefining the reality and perceptions of the banking industry.

Banks in the East African region and around world face a new reality. Cost-cutting can only get you so far. Regulatory expectations remain high and recent attempts to raise fees for basic services are fuelling competition of a new kind. The solution is deceptively simple: retire old business models and instead focus on profitability that is aligned with today's evolving marketplace.

How can banks achieve this? It is hard to miss in today's environment: Digital. Digital is everywhere and customers demand it. The inherently intangible nature of banking makes it almost uniquely suitable for digitisation and online delivery. Brett King, in Bank 3.0: Why Banking is No Longer Somewhere You Go But Something You Do, outlines the digital transformation occurring in banking. "The average person is spending 94 minutes a day on apps, checking email and texting," he writes.

"Customers log onto mobile banking 20 – 30 times per month… [and] Internet banking 7 – 10 times per month."

"By 2016 the number of digital interactions with a bank will outnumber a face to face interaction 400 to 1."

Being '2020 ready' with specific actions

What do banks need to do to survive by the year 2020 in order to serve these digital savvy customers? In 2014, PwC conducted a digital banking survey with banking Chief Information Officers across the globe. The survey findings concluded that banks need to make the following digital banking investments to be ready for year 2020 and remain relevant to current and future customers.

1. Customer centricity – Entrench a customer centric culture in customer strategies that will be implemented through Customer Relationship Management systems. This will ensure that financial institutions move from "doing too much telling and not enough asking".

2. Knowledge of customer – Boost exponentially the knowledge of the

Although new features and functionalities help banks to meet customer needs, they require a deep transformational adjustment to deliver the digital experience that today's consumers seek (and that tomorrow's customers will demand)

customer – through data analytics and the underlying data governance structures. Customers expect their financial institutions to reuse data in ways that save them time and eliminate duplicate conversations.

3. Multi-channel integration - Optimize all customer contact processes granting a consistent multi-channel access and experience (the so-called 'omni channel experience'), enabling customers to interact with their bank seamlessly across channels, regardless of the transaction type or where they are in the process.

4. Social Banking – Many financial services organizations are currently deploying social tools and strategies in ways that are transforming customer engagement and product development. These social strategies and technologies are deepening relationships with customers, enhancing product innovation efforts and reducing operating costs. Social banking is becoming more interactive and moving away from the occasional tweet and lonely Facebook page. Social banking promotes innovation in different ways such as the co-creation of personalized products, social care (through video chats on social platforms) and tracking and rewarding influencers and sentiments.

5. Mobile Banking – With an increase in smartphone ownership, financial institutions are investing in mobile and online services. In Africa, this technology helps to address a general lack of formal banking infrastructure (like 'brick-and-mortar' service centres). Smart mobile wallets and mobile money movement (this is the most common use of mobile banking in this market), PFM (Personal Financial Management) tools and remote deposit capture through the phone's camera to allow the customer to pay bills and make deposits are just a few of the ways that banks can leverage technology to cut costs and/or improve customer retention.

   Future innovations will arise from the use of High Definition (HD) and as the security of mobile devices is enhanced through advanced biometrics (finger print, palm, iris and facial-recognition features). Here we are looking at solutions such as using GPS technology to guide customers to branches and ATMS and leveraging wearable technology to offer instant and interactive financial information.

Challenges and opportunities going forward

Many senior banking IT executives around the world share the view that legacy core banking system challenges and the regulatory environment present the greatest impediments to achieving digital objectives. Although new features and functionalities help banks to meet customer needs, they require a deep transformational adjustment to deliver the digital experience that today's consumers seek (and that tomorrow's customers will demand).

Going digital does not necessarily mean that financial institutions must spend millions of dollars on new investments or abrupt disruptions in existing technology. There is no doubt that sizable investment will be necessary in some areas, but financial institutions can also explore opportunities through existing channels and infrastructure by leveraging them better and investing in specific targeted areas.

Improvements can spur innovation, as well as boost revenue and efficiency through channel ubiquity (a surge in digital banking channels such as mobile kiosks and social media). They can also free the bank to improvise on revenue models (such as social media-based gift cards and payments) and reduce the costs associated with disjointed legacy platforms.

The evolution of REIT in Kenya commenced in July 2011 following the Introduction of REITs through the 2011/12 Budget Statement. A number of industry players are in the process of seeking approval from the CMA for the purpose of listing their REITs

REITS right now in Kenya

Rachael Gitonga is a senior manager in PwC Kenya's Assurance practice
+254 20 285 5582
rachael.gitonga@ke.pwc.com

Real Estate Investment Trusts (REITs) allow investors to share ownership in real estate properties. Investors buy units in the REIT and earn dividends based on the value of their investment and the income performance of the trust. REITs offer high liquidity, relative to outright real estate ownership, by enabling investors to sell units quickly. Investors share ownership in large properties, like major office buildings or hotels that would otherwise be difficult to afford. Another benefit is the tax exempt status accorded to REITs.

In addition, payments for redemption of units or sale of shares received by unit holders or shareholders are exempt from tax on capital gains which was recently re-introduced after being suspended for three decades.

The downside is that REITs generally exhibit low growth since they must pay 80% - 90% of income back to investors. Thus, only 10% - 20% of income can be reinvested back into the business. In addition, REIT investors cede control of all the operational decisions that an individual property owner would make.

REITs, right from the start

The evolution of REIT in Kenya commenced in July 2011 following the Introduction of REITs through the 2011/12 Budget Statement followed by amendments to the Income Tax Act introduced by the 2012 Finance Act effectively exempting the income of REITs from tax.

In June 2013, the Capital Markets (Real Estate Investment Trusts) (Collective Investment Scheme) Regulations, 2013 was gazetted. A number of industry players are in the

All distributions of income of a REITs shall be deemed to have been already tax paid and thus distributed free of tax. In addition, payments for redemption of units or sale of shares received by unit holders or shareholders are exempt from tax on capital gains which was recently re-introduced

process of seeking approval from the CMA for the purpose of listing their REITs. The Capital Markets Authority (CMA) has approved and licensed five REIT Managers; Stanlib Kenya Limited, Fusion Investment Management Limited, CIC Asset Management Limited, Centum Asset Managers Limited and UAP Investments Limited.

A REIT is defined as an arrangement in respect of real estate or interest in real estate of any description , structured in accordance with the rules prescribed by Capital Markets Authority ("CMA") to enable a person taking part in the arrangement, whether by becoming an owner of the property or any part of it or otherwise, to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the real estate or interest in the real estate or sums paid out of such profits or income.

A REIT may be structured in two forms:

- **D-REIT:** A development and construction real estate investment trust; or
- **I-REIT:** An income real estate investment trust.

Are REITS right for you?

Legal form

A REIT is structured as an unincorporated common law trust which is divided into units, established under a trust deed and has a trustee who is independent of the REIT, manager and the promoter. It also must have a REIT manager and a trustee who are licensed persons.

A REIT can be open ended or close ended. An open ended fund means a person may acquire additional units from time to time and dispose of them by having the units redeemed by the trustee. The size of the fund may expand or contract as investors acquire or dispose units. The value of units in an open ended fund is determined by the net asset value of the fund. On the other hand, in a close ended fund, the number of REIT securities issued remains constant over time except where a new issue of REIT securities is made or there is reduction in the capital of the fund initiated by the trustee or as a consequence of termination or winding up of the trust. The value of the units in this fund is driven by investor demand.

Offers in respect of a REIT

An offer or an issue of REIT securities shall be made either as

- A restricted offer to professional investors in accordance with an offering memorandum; or
- An unrestricted offer in accordance with a prospectus.

A "professional investor" means any person licensed under the Act, an authorized scheme or collective investment scheme, a bank or subsidiary of a bank, insurance company, co-operative, statutory fund, pension or retirement fund; or a person including a company, partnership, association or a trustee on behalf of a trust which, either alone, or with any associates on a joint account subscribes for REIT securities with an issue price equal to at least KES 5 million.

Capital requirements

The minimum value of the initial assets of a real estate investment trust in a D-REIT is KES 100 million and in an I-REIT is KES 300 million.

Listing requirements

REITs can only be listed on a market segment of a securities exchange approved by the CMA which limits trading to a restricted minimum parcel size of KES 5 million.

Taxation of REITs

The income of a REIT registered by the Commissioner is exempt from income tax except for the payment of withholding tax on interest income and dividend. However, withholding tax does not apply in cases where the REITs unit holder or shareholders are generally exempt from tax. Unit holders who are exempt from tax may include among others registered retirement schemes.

All distributions of income of a REITs shall be deemed to have been already tax paid and thus distributed

free of tax. In addition, payments for redemption of units or sale of shares received by unit holders or shareholders are exempt from tax on capital gains which was recently re-introduced.

With regards to VAT, rental income earned from the sale, renting, leasing of non-residential premises would be subject to VAT. The sale, renting, leasing, hiring or letting of Land and residential premises is exempt from VAT. In addition, if a REIT has been set up as a charitable organisation and it obtains tax exemption as provided under the Income Tax Act, such a REIT will also be exempt from VAT on the supply of social welfare services which are not made by way of business.

Asset/Income/activity tests

The trustee of a REIT may invest in:

- Eligible real estate directly;
- Eligible real estate assets through investment in an investee company incorporated in Kenya which directly owns the eligible real estate and which is wholly beneficially owned and controlled by the trustee in its capacity as the trustee of the REIT;
- Eligible real estate assets through an investee trust in which the trustee of the REIT in its capacity as trustee is the sole beneficiary and has absolute control of voting and right to appoint and remove the trustee of the investee trust;
- Cash, deposits, bonds, securities and money market instruments;
- A wholly beneficially owned and controlled company subsidiary which conducts real estate related activities; and
- Other income producing assets including shares in property companies incorporated in Kenya whose principal business is real estate related or REIT securities in other Kenyan REITS, provided that the shares or REIT securities are listed on an approved securities exchange.

An I-REIT shall in each financial year after the second anniversary of its authorisation earn at least seventy percent of its income from rent, licence fees or access or usage rights or other income streams of a similar nature generated by eligible investments in income producing real estate. Any profits or capital gains from the sale of real estate shall be excluded in determining the income of the I-REIT.

Distributions

The trustee may only make distributions to REIT securities holders from realized gains, realized income or from cash held in the fund which is surplus to the investment requirements of the trust. The trustee of an I-REIT shall, subject to a higher minimum being specified in the scheme documents and to the provisions of these Regulations, distribute, within four months after the end of each financial year, a minimum of eighty percent of the net after tax income.

For a D-REIT , where the trustee is of the opinion that the level of distribution recommended by the REIT manager is not in the interests of REIT securities holders, the trustee shall call a meeting of REIT securities holders to approve, by way of ordinary resolution, a lower distribution.

The current tax on capital gains was re-introduced in its 1985 form with some cosmetic changes but without consideration of modern day realities

Capital gains tax: Neither new nor improved

Peter Mungai is a Tax Manager in PwC specialising in Financial Services
+254 20 285 5204
peter.mungai@ke.pwc.com

Introduction

Implementation of the 2010 Constitution and the devolved form of government has come with significant challenges for Kenya. The revamped political landscape has given rise to major expenditure needs, notably a huge wage bill.

The increased wage bill and need for improved and enhanced infrastructure has significantly pushed up the national government budget which currently stands at KES 1.77 trillion for 2014/15 fiscal year. Much of the national budget is funded by taxes and this has necessitated the broadening of the tax base. It was expected that non-tax revenues should increase as economic activity expands, driven especially by the extractive sector.

KRA's daunting task of broadening the tax base has brought about the recent re-introduction of the tax on capital gains with effect from 1 January 2015. The capital gains tax has been suspended for three decades.

The current tax on capital gains was re-introduced in its 1985 form with some cosmetic changes but without consideration of modern day realities. This has wrought confusion on the operation and implementation of tax on capital gains and the resultant ambiguity could stall KRA's efforts to collect it.

Tax on capital gains will arise upon transfer of property situated in Kenya and the applicable tax rate is 5% which is final tax. For purposes of tax on capital gains, property includes land, buildings, quoted and un-quoted shares, marketable securities and every description of property, whether movable or immovable.

A transfer takes place when a property is sold and the gain is the excess of the selling price over the buying price plus incidental costs. Where the selling price or buying price cannot be determined or is not at market price, the prevailing market price will apply.

As with other sectors of the economy, the financial sector (including banks, insurance and retirement schemes among others) has experienced some challenges in operating tax on capital gains.

This is due to their unique products and therefore the unique manner in which financial service businesses are taxed in Kenya and the associated tax status of certain income items. For example, investment income for general insurance businesses is exempt from tax and so are registered retirement schemes.

Focus on the financial services sector

Insurance companies: business income and capital gains

There is debate as to whether insurance businesses (life and general) are required to account for tax on capital gains given the unique way in which such business are taxed in Kenya.

One school of thought holds that insurance companies are not required to account for tax on capital gains because the taxation of insurance business is covered under Section 19 of the Income Tax Act while tax on capital gains is covered under other parts of the Income Tax Act and therefore may not be applicable to insurance businesses.

However, this conclusion may not be entirely accurate. Under the current tax regime, the taxation of business income and the taxation of capital gains operate independently and separately. Section 19 of the Income Tax Act deals with the taxation of business income of insurance companies while tax on capital gains is provided for in other parts of the tax legislation and applies indiscriminately. Therefore, insurance businesses are required to account for tax on capital gains where applicable in addition to accounting for tax on their business income.

That said, what constitutes business income and what constitutes capital gains should be carefully considered to avoid a mix up especially with regard to investment income. Gains from investment activities such as buying and selling of shares and other securities could constitute business income for tax purposes and not capital gains. But the gains realised from non-trading activities like the sale of a building owned by an insurance company or shares and securities not held for trading could constitute capital gains.

Tax on financial assets held by banks

The business of banking includes trading in financial assets such as debt and equity securities, derivatives, loans and advances. Assets can further be classified into assets held for trading or available-for-sale assets and assets held to maturity. The classification depends upon the intention for acquiring the given assets. The intention for classifying assets under 'held for trading' or 'available-for-sale' is to sell such assets in the short term while the intention for acquiring assets under the 'held to maturity' classification is to earn income over the term of such financial assets.

A substantial portion of banking business involves trading in financial assets and also taking positions on financial assets based on the desired categorisation. With the introduction of tax on capital gains, questions have arisen about which financial assets may attract tax on capital gains.

The answer to this question is not straightforward. It depends on the nature of the specific financial asset, the intention behind the acquisition

of such an asset and the accounting categorisation thereon.

Generally, gains resulting from the sale of financial assets 'held for trading' or 'available-for-sale' would comprise business income and hence be taxable as business income while gains resulting from assets 'held to maturity' or not for trading financial assets will generally comprise capital gains. Other assets disposed by banks such as buildings will also qualify as capital gains.

Are retirement benefit schemes required to account for tax on capital gains?

Under the current tax regime, the income of registered retirement benefit schemes or funds is exempt from tax. The exemption is an absolute one and thus implies that registered pension schemes or funds are exempt from tax even on capital gains.

Other challenges

Tax on capital gains also faces others challenges involving the collection mechanism and the due date for remitting the tax to the KRA. KRA in recent guidelines has indicated that tax on capital gains is a transactional tax and should be paid on or before the 20th day of the month following the transfer of an eligible property. This position could be applicable on transactions involving investment shares effected by stockbrokers but could be challenged for other capital gains transactions. The reason for this is the confusion brought about by reproducing the old legislation on capital gains that does not reflect current business circumstances.

Stockbroker's obligations with regard to listed shares

KRA has directed that stockbrokers should collect and remit tax on capital gains realised in case they sell shares on behalf of investors. The current legislation is not abundantly clear on the requirement for stockbrokers to collect and remit tax and can be open to different interpretations. Furthermore, there is a larger question about whether stockbrokers have the capacity to enhance compliance. The compliance role calls for a determination of the net gain on transaction by transaction and the maintenance of supporting documents thereon. There is also some confusion as to the applicable rate of tax—whether it is 5% or 7.5%, the 1985 rate.

This is indeed an onerous task. It is outside the ordinary business of stockbrokers and may be practically impossible to implement, complicating the collection of this tax.

Conclusion

The reintroduction of tax on capital gains is understandable given the need to fund the country's expanding budget. However, the structure of the legislation on capital gains as it is currently written cannot yield the targeted revenues. We expect a number of amendments to the legislation that will properly streamline and operationalise the tax on capital gains.

Fast-forward FATCA: What to expect

Are you ready for 2015?

The provisions of the Foreign Account Tax Compliance Act (FATCA) have brought significant implementation challenges to the financial services industry around the world. In Kenya, the full effects have yet to be really felt due to either a reliance on overseas HQ organisations supporting local organisations; financial intuitions "doing the bare minimum required" (e.g. register on the IRS FATCA portal) or a lack of appreciation of the implications.

The next phase of information reporting compliance requirements under the FATCA regime will bring additional challenges and responsibilities because:

- As payors of "withholdable payments," Foreign Financial Institutions (FFIs) will need to collect and review the recently revised withholding certificates (e.g., Forms W-9 and W-8); perform increased due diligence on the payee; and enhance their withholding and reporting processes.

- As payees (recipients) of withholdable payments, FFIs will need to be able to provide the revised withholding certificates to their various counterparties. In order to do that, FFIs will need to review and understand the FATCA status of each of their legal entities and product offerings.

- As both payors and payees, FFIs should evaluate the extent to which their information reporting policies, procedures, governance structures and systems need to be updated to meet the new requirements.

Requirements and readiness The first major compliance milestone for FATCA implementation was on July 1, 2014 with the start of FATCA withholding on US source fixed or determinable, annual or periodic (FDAP) income

Sam Mensah is a senior manager with PwC Kenya's Human Resource Services tax advisory practice and a member of PwC Kenya's FATCA Advisory Services Team.
+254 20 285 5119
samuel.mensah@ke.pwc.com

The next phase of information reporting compliance requirements under the FATCA regime will bring additional challenges and responsibilities for certain payments. Many FFIs may have already taken effective action to enhance existing information reporting and withholding procedures to meet the burdens of FATCA compliance. While July 1, 2014 has passed, there remain a number of significant milestones in the coming months which will require close attention.

For a successful navigation of the complexities of FATCA and the requirements looming on the horizon, FFIs need to undertake a complete compliance initiative that:

- Identifies and engages internal and external stakeholders,
- Leverages third parties and service providers, as needed,
- Defines roles and responsibilities of internal and external stakeholders,
- Ensures initial and ongoing legal entity, products and services, payments and payee analyses so that withholding and reporting requirements are clearly defined and
- Builds on existing information reporting and withholding regimes to incorporate FATCA changes.

Requirements as payors

FATCA required a new set of entity categories and certifications to be added to the IRS Form W-8 series. These expanded withholding certificates create a more complex due diligence process for withholding agents in order to ensure completeness, accuracy and consistency with other documentation.

For example, an FFI receiving a Form W-8BEN-E from a participating foreign financial institution (PFFI) will be required to verify the name of the entity, the country and the global intermediary identification number (GIIN) provided with the information on the IRS website.

Certain certifications must be present on the form for it to be valid. The complexity involved in tax form validation requires controls that ensure that the review is performed by a qualified person and that there is appropriate approval and sign-off.

For entities

Effective January 1, 2015, for example, withholding agents may only accept the newly revised Forms W-8BEN-E or W-8-IMY for certification of the FATCA status of a foreign entity or intermediary. A February 2006 version of the Form W-8BEN received from an entity on or before December 31, 2014 will remain valid until it expires (which is typically to the end of the third calendar year following the year it was provided).

For individuals

The February 2014 version of Form W-8BEN (Individuals) must be used for certification of an individual's FATCA status. While the pre-February 2014 version will remain valid until it expires, FFIs should put systems in place to ensure that the new form is proactively used.

Reporting

The first reporting for 2014 payments under the FATCA regime is not due until March 2015 so there is not long to go. Some of the reporting requirements include having to make declarations on Forms 1042 and 1042-S. These forms have recently been updated to include FATCA-relevant fields and will be used to report US source income paid to non-US persons that are classified as withholdable payments under FATCA.

How familiar is your organisation in first understanding which form should be used in which situations as well as what constitutes a fully completed form? These are just some of the questions that FFIs should be looking to address.

Requirements as payees

FFIs that receive withholdable payments may also be subject to 30% withholding under FATCA. Non-US entities that fail to timely and properly identify themselves to their withholding agents / counterparties may be subject to 30% withholding. FFIs may be subject to FATCA withholding if they fail to provide valid documentation and a GIIN to prove their compliant status.

FATCA has introduced a complex regime that may necessitate significant structural and operational changes to ensure effective and ongoing compliance

Operational challenges

FATCA has introduced a complex regime that may necessitate significant structural and operational changes within FFIs and related group entities to ensure effective and ongoing compliance.

Governance

Industry leading practice is to establish or enhance a governance structure with sufficient reach and seniority to ensure comprehensive compliance. This is necessary to ensure that timely decisions are made involving all key stakeholders.

Written policies and procedures documenting required controls are the foundation of a good FATCA compliance program. Likewise, documented controls ensure verification, approval and sign-off for key processes to ensure compliance or that compliance breaches are able to be discovered and remediated in a timely manner.

Ongoing legal entity analysis should also be an integral part of the compliance and controls program. As operations continue to evolve, entities will be formed, acquired, dissolved or liquidated.

FFIs need to ensure that there is an ongoing assessment so that an entity's FATCA classification is updated or certified where necessary. Changes in circumstances affect the validity of withholding certificates. It is therefore important that the lines of communication between the stakeholders in an organisation allow for adequate updates to documentation and entity certification.

Responsible Officer

A number of successful FATCA compliance programs have executive sponsorship from within the organization. For FFIs that are located or resident countries like Kenya where there is no inter-governmental agreement (IGA), the FATCA regulations provide specific instructions and certifications for a Responsible Officer (RO) of an FFI.

An RO structure is recommended since it allows for consistency and coordination in the company or group's compliance program and will satisfy the need for an effective and practical governance and controls structure. As such, the RO should be a person with sufficient authority within an FFI to ensure effective cooperation and compliance from key stakeholders.

System and Process Enhancements

System enhancements are an essential part of most FATCA compliance programs. The same (old) systems that were previously used to track payments and other existing withholding

obligations are likely to be used to track withholdable payments under FATCA, but will this be sufficient?

The FATCA status of entities subject to withholding also will need to be tracked in operating systems and accounting platforms. This will require adding additional fields to capture "FATCA triggers" such as types of individuals, entities and withholdable payments.

Automating these processes will ensure more effective compliance and reduce the incidence of human error and material breaches under FATCA.

Given the risks associated with non-compliance for FFIs in their role as withholding agents, the implementation of a governance structure should be undertaken sooner rather than later.

FATCA requirements loom large now that we are only a few months away from when the first reporting milestones come into effect. Challenges exist and will continue to persist, but these challenges are manageable if there is a methodical and timely approach to determining and complying with FATCA requirements.

PwC Kenya's FATCA Advisory Services Team

Richard Njoroge
+254 20 285 5000
richard.njoroge@ke.pwc.com

Sam Mensah
+254 20 285 5119
samuel.mensah@ke.pwc.com

Handerson Mwandembo
+254 20 285 5244
handerson.mwandembo@ke.pwc.com

The ever-sweetening insurance pie

The insurance industry has consistently recorded double digit growth over the last decade, with the industry doubling in premium size over the last five years. Insurance penetration levels, measured as a percentage of premiums to GDP, increased from 3.16% (2012) to 3.44% (2013). The Gross written premium increased by 21% from Ksh 112B (2012) to Ksh 135B (2013), with the projected 2014 premiums expected to grow by over 20% based on IRA's third quarter results.

This growth has not gone unnoticed, with a myriad of international insurance powerhouses showing heightened interest in the local market. The year 2014 alone has seen a number of international players acquire stakes in local companies, with the likes of Swiss Re, Prudential, Metropolitan International and Leapfrog Investments acquiring stakes in Apollo Investments Limited, Shield Assurance, Cannon Assurance and Resolution Insurance respectively.

Ingredients for success

In a survey carried out by PwC in 2014, 45 CEOs and senior executives from Kenya (8), South Africa (31) and Nigeria (6) were asked to rank the top three countries in Africa (excluding their own country) that they considered most important for their company's growth over the next three years. Unsurprisingly, Kenya was ranked second (after Nigeria), a finding which supports the international focus observed over the last year.

But what exactly is attracting these international players to Kenya? The CEOs and senior executives identified the positive GDP growth of the country as one of the attraction points. Despite security concerns dampening economic growth in the country, investors remain buoyant over Kenya's prospects. With heavy investments made by the government on infrastructure and a much-welcomed change in fortunes in the oil and gas sector, Kenya remains well placed for future economic growth.

The relatively untapped Kenyan insurance market presents a great opportunity for insurance companies in Africa and around the globe. The current penetration level of 3.44% (2013) vis-à-vis the global average of 6.28% and advanced markets average of 8.27% highlights the potential within our local industry. This coupled with the ever-growing middle class as

Seth Chengo is a Manager in Assurance Services, specialising in the insurance industry sector and actuarial services.
+254 20 285 5287
seth.chengo@ke.pwc.com

The relatively untapped Kenyan insurance market presents a great opportunity for insurance companies in Africa and around the globe

well as consumer awareness means that we are likely to continue experiencing double digit growth in this industry, at least in the short term.

Another attraction point is the existence of innovative distribution channels. Bancassurance continues to provide a unique distribution channel for insurance products as customers are more likely to interact with their bank's employees compared to insurance salespeople. Innovative products have led to the emergence of microinsurance which targets customers who have historically not participated in insurance programmes. With technological advancements in the country, including MPESA, more and more people can access and pay for these new products at lower cost and with minimal administrative effort.

A recipe for regulation

This growth has not been without its fair share of challenges. In the same survey carried out by PwC, the Kenyan CEOs interviewed unanimously identified the increased regulatory burden as a major challenge in the industry. The last two years have seen the Insurance Regulatory Authority (IRA) introduce a risk-based approach to liability and solvency management. This has been done through the introduction of a number of guidelines by the IRA as well as the onset of the Risk-based capital model. The insurance bill is currently under discussion and is likely to rubber-stamp IRA's efforts.

In my capacity as an actuarial specialist, I have been involved in several board room discussions in the past year where regulatory changes have been at the heart of these deliberations. Insurers increasingly feel that the onerous IRA demands may lead to the closure of a number of insurance companies or even force companies to recapitalize at short notice.

In our survey, CEOs also highlighted that it is becoming increasingly difficult to attract and maintain industry experts. The new IRA guidelines require each insurer to have an internal actuary and risk management expert. Taking actuaries for example, there were only 12 Fellows of the Institute and Faculty of Actuaries (UK) registered in Kenya as at September 2014. Given that the Kenyan industry has over 40 insurance companies, availability of qualified experts may continue to be a short-term challenge.

Undercutting was also flagged as one of the challenges being faced by the industry, most notably in the general insurance and group policies sectors. The industry continues to be heavily broker-driven, with business often given to the lowest price bidder and/or the highest commission payer. This has led to a disparity between the price charged for a policy and the true cost of the policy, with insurers often making underwriting losses from their core business.

Half-baked, but getting there

Despite the observed challenges, the insurance industry appears to be on the upturn. If properly implemented, the risk-based regime will ensure that companies hold the right levels of provisions and capital reflective of the risks they have written.

Well run insurers with a strong risk management discipline will reap the benefits of lighter capital demands whereas risky insurance policies will be the preserve of well-capitalised insurers. This will ideally also minimise undercutting tendencies as this will attract significant capital charges.

The IRA remains cognisant of shortages in local experts and is working with insurers to put in place stop-gap measures in the interim as more and more Kenyans obtain international qualifications.

Taking actuaries as an example, despite having few qualified actuaries, there are over 400 students currently sitting their professional examinations. This will definitely lead to a healthy stream of actuaries in the not-too-distant future.

The industry is poised to continue its growth pattern with prudential management of insurers, regional expansion and local penetration of insurance products expected in the coming years. Innovative products are also expected to increase in number with bancassurance and microinsurance already leading the way. This is definitely an industry to closely monitor!

The Finance Act 2012 introduced amendments to the Banking Act that allowed for beneficial ownership of banking institutions by an approved non-operating holding company, under the supervision of the Central Bank of Kenya (CBK)

Non-operating holding companies are long overdue

Isaac Otolo is an Associate Director of Transaction Services in PwC Kenya's Advisory practice.
+254 20 285 5690
isaac.otolo@ke.pwc.com

The Kenyan banking sector has been good to its investors. Even in a crowded market of 43 banks, one mortgage finance company and an increasing number of licensed deposit taking microfinance institutions, most institutions continue to report significant year on year growth in profits. That said, a number of the indigenous Kenyan banks have looked beyond our borders and have expanded into the region, following their customers who have gone to seek growth outside Kenya.

While regional expansion has yielded mixed results for the adventuring banks, back home the subsidiaries have presented some regulatory challenges. One of these challenges is the deduction of investments in subsidiaries when calculating core capital ratios. Effectively, this has meant that any investments in subsidiaries, particularly those with significant operations, have required banks to raise additional tier 1 capital, especially when these parent banks are not supported by healthy balance sheets. Further, the Kenyan parent bank has also had the additional headache of oversight over its subsidiaries. For regional regulators, there has been concern over the possible effect on banking subsidiaries in their jurisdictions should the parent bank fold.

Before the Finance Act 2012, ownership of more than 25% of the share capital of any banking institution was restricted to entities that were either themselves banking institutions, a Government, a State Corporation, or a foreign company that is licensed to carry out banking business in its country of incorporation. The Act introduced amendments to the Banking Act that allowed for beneficial ownership of banking institutions by an approved non-operating holding company, under the supervision of the Central Bank of Kenya (CBK). Rather than being mere shells with subsidiary undertakings, the spirit of the new regulations foresees these non-operating holding companies as sources of strength for their subsidiaries, paving the way for the introduction of banking groups. CBK's oversight role will include the requirement for compliance with liquidity and capital adequacy ratios by all banking entities in the group.

So what are the benefits? The immediate one for the current parent Kenyan banks is that the banks will no longer hold banking subsidiaries themselves, at least to the extent regulations in the jurisdictions of these subsidiaries permit beneficial ownership under a non-operating holding company. As such, deduction of subsidiary investments from core capital will not be an issue as these assets would be held at the holding company level and further, the banks will no longer have oversight responsibility over other banks in the group; this responsibility will transfer to the new holding company.

The introduction of a group holding structure also allows for the management and oversight of the group from an entity that can better raise capital and channel it to the group entities as appropriate. The structure may also present an easier route for acquisition of or investment into the group. The non-operating holding company may also potentially host the group brand, for which it may charge royalties to the subsidiaries. There is also potential for this entity to be a shared services centre for the group.

The question of implementation however does arise. A number of options exist, such as the creation of a subsidiary under the current Kenyan parent to which the banking assets and liabilities can be transferred. Another may be to establish a new holding company above the group as is currently structured and then transfer subsidiaries as appropriate. All these structures present a number of challenges, particularly for the larger listed Kenyan banks with wide shareholding, with the need for several layers of regulatory and shareholder approvals. There is also the potential issue of transfers of contracts, securities, employees, etc. The costs of the restructuring exercise should also be taken into consideration, particularly around taxation matters, and considering the reintroduction of the capital gains tax which may result in additional costs. For the exercise to be successful there should be limited loss in shareholder value from the restructuring process.

With the drive towards harmonisation of banking regulation in the East African Community, successful implementation of these structures is less likely to be a tedious exercise steeped in regulatory bureaucracy. Instead, it will give rise to banking groups with a potentially easier route for regional expansion.

The introduction of a group holding structure also allows for the management and oversight of the group from an entity that can better raise capital and channel it to the group entities as appropriate

Financial inclusion is a route out of poverty

Moses Nyabanda is a Director of Assurances Services at PwC Kenya and the financial services sector driver for PwC's East Market Area.
+254 20 285 5394
moses.nyabanda@ke.pwc.com

In Africa, financial inclusion is a macro-economic issue which has an inverse impact on poverty: increasing the number of people who participate in the formal financial system helps to reduce poverty. Many financially excluded people are women and therefore greater financial inclusion also serves to bridge the gender inequality gap in Africa. Although financial inclusion is improving, more investment in financial literacy and more effort on the part of financial institutions and government will bring more people into the formal financial sector.

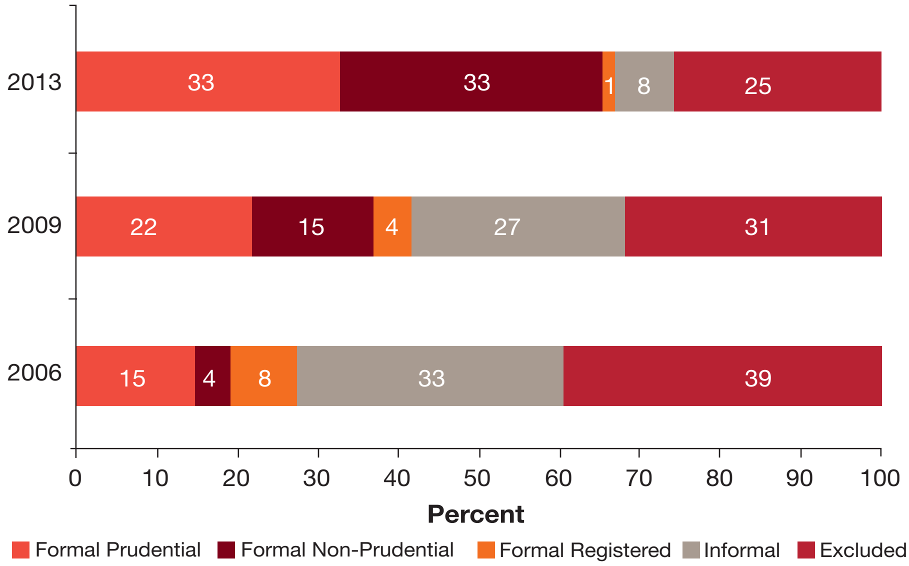
The origin of exclusion

Across much of Sub-Saharan Africa, financial systems were not originally modelled in a way that encouraged broad inclusion. Most financial models were brought in from advanced economies in the early 1900s and they focused on fewer, high-value transactions. Financial institutions distributed products and services through a brick-and-mortar branch network, an expensive distribution method. The population was more dispersed in rural areas, without the rapid urbanisation that we witness now. It was unlikely that financial institutions would reach people unless they travelled to a branch location. The financial system also favoured formal firms and salaried people—those with proven, regular incomes—and the regulatory environment did not support innovation.

Over the last decade, countries like Kenya have completely overturned this culture of financial exclusion. Now, there is no 'unbankable' segment of society. In 2006, 39% of the population was excluded from financial services and 15% had access to formal, prudential services. By 2013, 25% were excluded and 33% had formal services.

Although financial inclusion is improving, more investment in financial literacy and more effort on the part of financial institutions and government will bring more people into the formal financial sector

Kenya makes leaps toward financial inclusion



Source: World Bank, based on data from the Central Bank of Kenya and World Development Indicators 2012

Those who can save money also now qualify to borrow money. Gone are the days when a bank statement, salary history, utility bills, references and collateral were required for a loan with very long tenor. Now, financial products are more accessible and flexible

This change is a result of innovative financial institutions bringing people into the system, even those people who were previously wary of entering brick-and-mortar branches. The agency banking model, pre-paid cards and mobile services have completely demystified financial services—and these products tend to be much cheaper for financial institutions to roll out and manage.

Financial inclusion defined

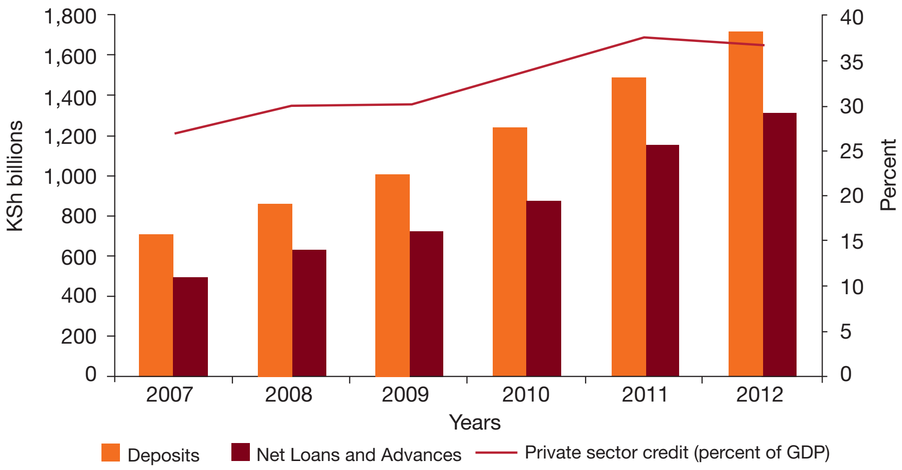
The unbanked are people who lack access to basic financial services. The under-banked are those who have access to bank accounts but they underutilise these services and often rely on alternative financial services, which can be more expensive. Globally, it is estimated that 2.5 billion people are under-banked.

In Kenya, financial products and services are now available to almost everyone irrespective of their income level. MPESA, micro-finance institutions, a strong culture of chama arrangements (private savings clubs) and other avenues allow people to save and invest money. These systems and services originated in response to financial exclusion; people who were excluded from financial systems provided the opportunity for SMEs, banks, mobile telephone companies and others to bring in products and develop innovations specifically for them.

Financial literacy is improving most markedly with regard to banking and it begins with some basic concepts. If people are financially literate, they understand the concept of saving. They also understand the impact of saving on their ability to invest in themselves, their children, healthcare and insurance. They know that saving helps to reduce spikes in consumption. They also understand the systems that can help them save.

Those who can save money also now qualify to borrow money. Gone are the days when a bank statement, salary history, utility bills, references and collateral were required for a loan with very long tenor. Now, financial products are more accessible and flexible. Even a mobile money transaction history will suffice for lending small amounts.

Direct correlation between savings and credit expansion



Source: World Bank, based on data from the Central Bank of Kenya and World Development Indicators 2012

The downside is that the most vulnerable may find themselves owing money that they cannot repay, or that they are borrowing money for short periods at very high rates. Companies operating in Kenya's fastest-growing economic sectors (like transport and communication, wholesale and retail trade) are particularly, worrying reliant on informal sector financial services.

Financial literacy about insurance and the overall penetration of insurance products is still lower than for banking and saving services, with just 3.65% of Africans having insurance. Some insurance may be mandatory by law (like motor vehicle insurance), in which case the uptake is very high. Insurance can help smooth out the impact of life events like death or medical emergencies. Otherwise, when these events happen, they hit the uninsured particularly hard. The question is whether the banking sector's successes with regard to improving inclusion can be replicated similarly for insurance services. The regulatory environment and insurance business model may need to adjust in order to provide the innovative, flexible products that the uninsured need and want.

Financial literacy programmes can help to clearly demonstrate the value of financial services in simple terms, but this requires a commitment to invest in financial literacy on the part of financial providers as well as regulation and enforcement by government. There is a fine line between over-regulation, which stifles innovation, and under-regulation, which exposes vulnerable people to risk.

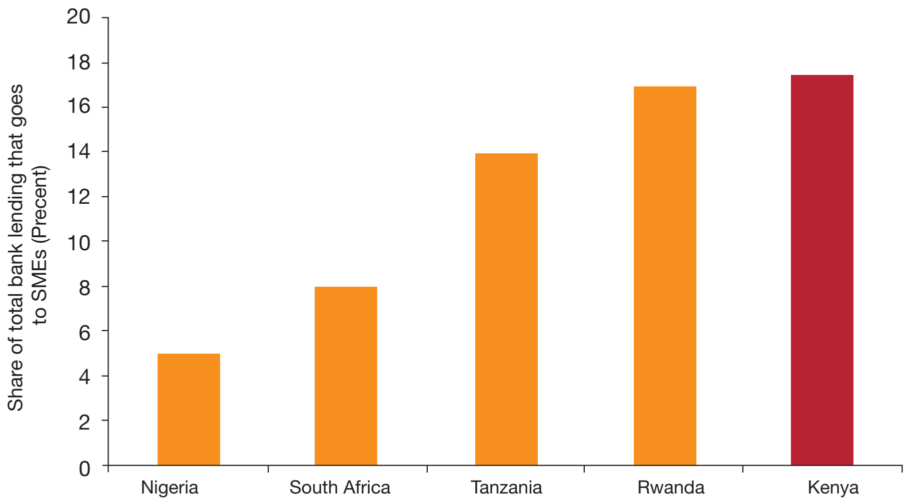
A joint approach to improving financial inclusion

The private sector has a key role to play developing technological innovations to drive down the cost of serving customers and providing opportunities to expand financial literacy. It can continue to invest in innovative services that are more flexible and agile, and re-look at current business operating models—particularly distribution models—to further improve distribution and access.

At the same time, the public sector must develop measures to protect consumers and encourage healthy competition between organisations that offer financial services. Government can create an enabling environment through regulatory policy and promote initiatives targeted to address the unbanked and informal sector, such as those that will help deepen the financial sector and those that fund and develop startups.

Improvement in financial inclusion is particularly pronounced among SMEs, as many financial institutions are focused on developing products and services targeted to this segment's specific needs. Many SMEs in Africa are engines of growth, investing in new technologies and human resources. Banks that develop relationships with SMEs can earn a good return by offering a flexible and accessible array of services.

Kenya is ahead of its peers in Africa in SME lending



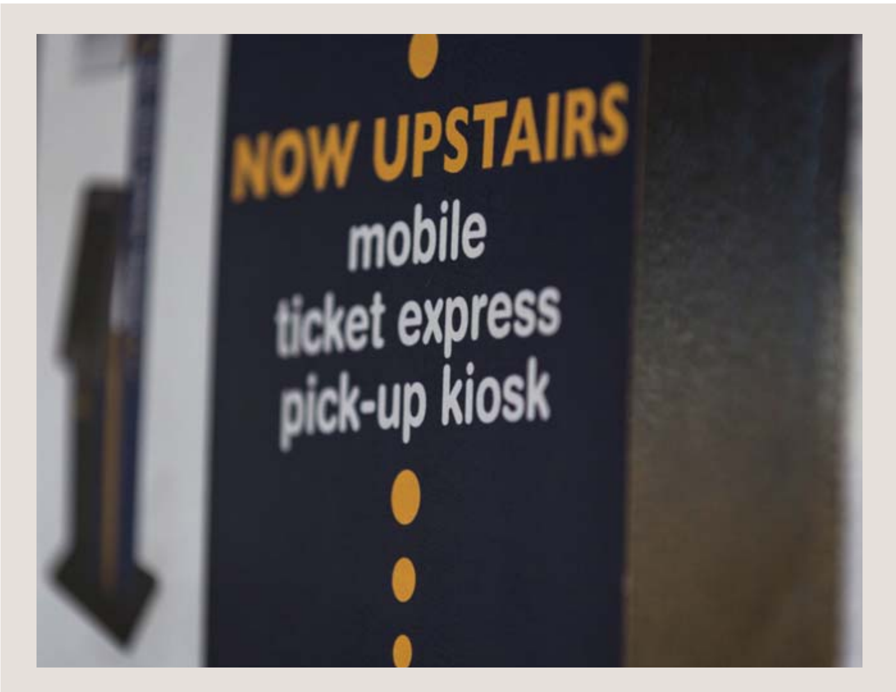
Source: World Bank, based on data from the Central Bank of Kenya and World Development Indicators 2012

In some countries, donor participation in the market has influenced financial inclusion and financial literacy. Many donors have provided funding and training that contributes to the growth and resilience of chama organisations, women's self-help groups, SMEs and others. Savings and Credit Corporations (SACCOs) are another popular model contributing to financial inclusion. As deposit-taking organisations that are allowed to lend, they are subject to regulation in countries like Kenya.

Regulatory and political environments influence the ability of financial institutions to develop innovative products and services that thrive in the market profitably. Overall, economies in Africa have been favourable to innovation. Financial institutions are learning that flexible and agile innovations must be driven by demand. They are also learning that risk management is essential, since innovative products and services can open up their companies to new types of fraud.

Many different public and private organisations are focused on financial inclusion, and the outcome is positive. Working together, we can provide a route out of poverty.

Improvement in financial inclusion is particularly pronounced among SMEs, as many financial institutions are focused on developing products and services targeted to this segment's specific needs



Not only do white collar crimes cause direct financial and reputational damage, but they also disrupt the economic and social stability of states, leading to a loss of investor confidence in states and/or organisations

Preventing white collar crime: A stitch in time saves nine

Tshepo Nyatlo is a Manager in PwC Kenya's Forensics Advisory practice.
+254 20 285 5505
tshepo.nyatlo@ke.pwc.com

Economic crime—otherwise known as white collar crime—continues to be a growing risk to businesses and other organisations. According to the results of the PwC's Global Economic Survey, 2014, 66% of the respondents in Kenya reported having suffered an incidence of economic crime —two out of every three!

It is therefore no wonder that many organisations and governments worldwide have moved towards designing and implementing control mechanisms to mitigate economic crimes like asset misappropriation, bribery and corruption, accounting fraud and procurement fraud.

An example in the area of bribery is the Recommendations on Combating Bribery in International Business, which was published by the Organisation for Economic Cooperation and Development (OECD) in 1994 and urges member states to deter and penalise the bribery of foreign public officials by taking "concrete and meaningful steps" to improve specific areas within their respective infrastructures.

These can include banking and accounting requirements and practices, contract procurement, civil, criminal and administrative laws. As a result, various legislative changes like the introduction of new acts have followed in an effort to mitigate these and other types of economic crimes.

Financial gain is the key vehicle and/or motivator for most white collar crimes. In essence, this poses a real risk for financial institutions who participate in the chain of money distribution globally.

The risks faced by financial institutions fall into two categories: first, financial institutions are victims of these crimes and second, financial institutions can (unwittingly) become channels to other crimes.

As a result, some white collar crimes are used as a gateway to other international crimes (such as terrorism acts, security breaches, leakage of sensitive information of global organisations and political corruption).

Not only do these crimes cause direct financial and reputational damage, but they also disrupt the economic and social stability of states, leading to a loss of investor confidence in states and/or organisations.

Furthermore, information has become a valuable asset for many organisations in our fast-paced world and financial institutions are in possession of sensitive information on various organisations and individuals. This calls for urgent attention by financial institutions to safeguard this valuable asset and other assets in their possession.

Prevention is the best cure

While various governments globally urge and compel many organisations to comply with laws aimed at combating white collar crimes, the key weapon in this battle is prevention. Financial institutions need to be proactive in managing the risks posed by these crimes. To achieve this, they can adopt and apply a proactive mind-set as opposed to the conventional reactive approach. Criminals committing white collar crimes are moving ahead with the times and investing a lot of time and resources in their schemes. These individuals know the ins-and-outs of target organisations and target individuals in these organisations.

Therefore, financial institutions should be at the forefront of implementing preventative measures. They need to design and implement proactive strategies and plans to mitigate these crimes. Strategies should encompass, inter alia, the prevention of fraud, corruption, money laundering and cybercrime.

Prevention in practice

Financial institutions can take a number of considerations into account as they combat white collar crime. A comprehensive end-to-end strategy addressing these considerations (among others) is a step closer to winning the battle against white collar crimes.

These considerations include:

1. Data analytics: One of the key tools in exercising a proactive approach, data analytics can aid organisations in monitoring irregular trends and patterns both internally and externally.

2. Fraud Risk assessments: An assessment of the organisation's vulnerability to various risks (like fraud, corruption, money laundering, cybercrime and security threats) is a critical step in the battle against white collar crimes.

3. Regular control reviews: Associated with risk assessments, regular control reviews to monitor the effectiveness of designed controls and enforcement of compliance.

4. Change management: As organisations evolve and integration takes place, there are often gaps left unnoticed which are exploited by criminals. Organisations should constantly ensure that such gaps are identified and mitigation measures put in place to address the risks that they pose.

5. Stakeholder management: Organisations need to closely monitor their stakeholders and conduct proper profiling of key stakeholders (employees, customers, suppliers, agents/ brokers, regulators, etc.).

6. "Tone at the top" and buy-in from executive management is the most crucial step in this battle because a lack of adequate executive support and investment in time and resources has been a major drawback for many organisations and states in the fight against white collar crimes.

7. Industry partnerships/forums: By working together and sharing information, industry organisations can help to facilitate discussions about different experiences/threats amongst various organisations.

8. Communication and awareness: Many entities have brilliant plans and strategies which are never adequately communicated to stakeholders. Those organisations that cultivate awareness among key organisational stakeholders regarding efforts to mitigate white collar crimes are better able to prevent these crimes.

Without proper prevention plans and strategies, organisations will remain reactive and risk being at the top of criminals' "hit list". Coupled with compliance to relevant industry regulations and professional requirements, prevention has the potential to put organisation in control in the battle against white collar crimes. By being proactive, an organisation is able to obtain first-hand information on market/global trends. Thus, proactive organisations do not carry the risk of being redundant and out of touch with their surroundings.

Another benefit associated with being proactive is cost effectiveness. The cost implication of reacting to, for example, a fraud incident may be higher than the cost of preventing the incident from taking place in the first place. By being proactive, organisations are in control of the cost aspects and are in a position to plan and make appropriate budget provisions. Reactive organisations will only know the cost implications of fraud after the incident has occurred and the damage is done.

Proactive organisations stand a better chance of maintaining a positive brand through strong and effective controls which may lead to efficient business processes, thus attracting more investors and/or customers. Ultimately, this will result in a full realisation of the value of investing time and resources aimed at combating white collar crimes.

The experience of change management

Michael Holzmann is the Director of PwC Kenya's People & Change advisory consulting practice.
+254 20 285 5308
michael.holzmann@ke.pwc.com

In PwC's recent Africa CEO Survey, 59 CEOs of financial services organisations in 17 countries report that change programmes are underway or completed in several common areas.

Forty percent or more say that their organisations are currently making changes to organisational structure/ design, technology investment, corporate governance and customer growth and retention strategies. Many CEOs also report having concrete plans to change their approach to managing risk and/or talent.

However, despite near universal recognition that change is inevitable and often indispensable, some 75% of change initiatives fail[1].

To understand this high failure rate, it is helpful to take a step back and examine change management at a practical level. In general, organisations are doing two things to affect change: they are communicating and they are training.

Communication tends to focus on the value of the initiative so as to achieve greater buy-in. Training addresses the detail and requirements. But without a clear understanding of the problems that the initiative is meant to solve, neither communication nor training will sustain long-term change.

Change management supports business transformation effectively when it is clear exactly which problems need to be solved. One way to approach this is to apply a simple test to any proposed change: how will it improve the client experience and profitability?

[1]**Source:** *PwC's Human Change Management: Herding Cats*

When change management fails, organisations tend to respond in predictable ways:

Issue	Cause	Response
The communications and/or training were not conducted appropriately.	The organisation budgeted too little for communications/training.	Pump up the volume!
Something is missing.	Winning the hearts and minds of all stakeholders did not happen.	Work harder to achieve the 'Holy Grail' of organisational behaviour change.
The choice of system was the wrong one.	Articulating the need for greater efficiency led to a system/provider choice that promised efficiency but did not deliver it.	Pump up the volume!

The change management journey is also familiar: identify the system, design or customise it, train users, launch the system, host a party, repeat as necessary. Change management often lands in the lap of a single department, while the rest of the business focuses on ensuring that the company does good work, does not lose money and perhaps benefits from a change or two.

A new approach to change management

Change management supports business transformation effectively when it is clear exactly which problems need to be solved. One way to approach this is to apply a simple test to any proposed change: how will it improve the client experience and profitability?

Within financial services organisations, change initiatives tend to be driven by market demands like the need for new products or outreach to new customer segments. In fact, the underlying issue may be how to differentiate the company from the competition. Introducing new products or greater efficiency in an itemised way will not achieve this outcome; forever segmenting customers differently may eventually lead to diminishing returns.

Comprehensive change management will reveal insights to drive transformation through a changed customer experience while maintaining a careful eye on profitability.

For example, an auto insurer knows that customers want good service quickly when an accident occurs. They want to feel like the insurer cares about them.

Stakeholders within the insurance company could sit together and ask themselves, what would it take for our customers to feel valued? Each stakeholder can take ownership and understand their part of the solution in the context of the whole.

The process will be business-driven because the business will agree upon how to get from A to B and no one department or stakeholder will have monopolised the agenda. The solution may include a system implementation but it would not constitute the whole solution. The business is mobilised behind a shared outcome.

The CEO may not need to have a personal view of what the client experience should be, but he should task his managers with understanding it. Increasing market share or improving customer retention is more about having people volunteer and identify what they need to do. Their efforts are vision-driven, but the responsibility for driving the initiative forward does not need to reside with the Daydreamer-in-Chief at the company.

How can organisations think differently about transformation? First, they can agree upon the key characteristics of the customer's experience now and in the future. They can empower teams to identify the critical customer experiences that drive the business in terms of market share, profitability and cross-selling. They can identify the experiences that drive customer decisions and behaviours with regard to extending or expanding their relationship with the business—or leaving for a competitor.

A clear view of what needs to get done to achieve that new experience should also include a way of measuring or tracking progress towards it as benefits accrue over time. The interdependence between various stakeholders within an organisation will also lead to a sense of co-ownership transcending silos and departmental structures and hierarchies.

Trust is an essential ingredient in change management: trust within members of the organisation, and trust that the organisation has earned among its customers.

Organisations that successfully manage change view it as a capability to be developed—not a cost to be managed. They are agile and change-ready and therefore more competitive. Agile organisations accept that customer focused change is an ongoing and never-ending feature of organisational life.

Experience will not prepare an organisation for every form of future change but organisations that have experienced managed change and learned from those efforts are more likely to realise a greater ROI on future change efforts.

Data analytics enhance experience and intuition

Handerson Mwandembo is a senior consultant with PwC Kenya's technology advisory practice.
+254 20 285 5244
handerson.mwandembo@ke.pwc.com

Extracting insight from data and applying it to business decisions has long been a necessary business skill. Intuitively, in the last few years, data analytics has become a top priority for executives due to its perceived role in unlocking competitive advantage for future growth, cost management and in decreasing risk.

For most Kenyan financial services firms, the quality, quantity and reliability of data is good and improving. However, despite many organisations investing in better data and analytics resources, many industry decision makers still rely mostly on intuition and experience to make 'big' decisions.

Yet, rather than replace intuition and experience; analytics is most effective at improving decisions when applied alongside these traits. Indeed, a solution centric approach to making decisions would first entail identifying the appropriate strategic question or business problem, before combing through data to answer it.

Making better decisions is a blend of art and science. Leadership and judgement are the art, whilst analytical excellence is the science.

Testing outcomes is one of the greatest benefits of big data. Companies can test hypotheses much more quickly and validate the way forward using data

Data to inform strategic growth

For many financial services organisations, the most important big decisions in the next 12 months will concern growing the business. Among trends impacting growth of financial services industry, customer centricity and financial inclusion rank among the most significant.

In this context and to effectively compete, banks and insurers need a keen understanding of different customer segments to make a deliberate choice of which segment to serve. A number of banks and insurers classify their customers by age or by employment or based on the amount of the loan issued to them. This often results in undifferentiated service to customers and impedes the uptake of financial products. Data analytics can help financial services organisations to not only create better classifications that provide actionable insights on customers, but also in understanding customer behaviour patterns and thus improve customer-centricity with regard to strategy and decision making.

Whether as a policy or business imperative, most financial services firms are keen on financial inclusion and how to profitably serve the low income market. A cursory glance at data and studies on financial transactions among low income households would highlight the fact that low income households have numerous sources of income and face extreme volatility of both income and expenditure. Any company reaching out to the lower-income segment or a rural segment must understand the sources of income which include social sources such as chamas and relatives as well as the resultant pressure on income and expenditure.

Other benefits

Testing outcomes is one of the greatest benefits of big data. Companies can test hypotheses much more quickly and validate the way forward using data. Financial services organisations may want to use data analytics for scenario planning and strategic analysis, such as to inform decisions about targeting the SME population or the growing middle class in Kenya. They may also want to know how their companies benchmark against the competition, with regard to new market segments. Data proves useful here, too: a decision maker may reasonably ask, 'Why do we have relatively fewer SME clients than our competitors?'

Data analytics also benefits risk management. Many of the latest regulations require financial services organisations to maintain very reliable data. FATCA is a good example: companies must identify their American customers and remit certain information. The process of mining information for risk management is similar to the process that a company would employ for generating better information about its customers.

A culture of evidence-based decision making will inspire improvements to processes for capturing information. An information-driven organisation will capture information at source and then carefully design the way that information flows through the organisation. They assign responsibility and ownership for data quality as well as enforce accountability. Information available in real time can help organisations to nip any potential issues in the bud. Insights and intelligence inform decisions no matter who needs to make them, where they are located or when the information is needed.

Sources of scepticism about data analytics

Some of the scepticism with regard to the value of data and analysis derives from concerns about data quality. The more that data can be trusted for quality, accuracy and completeness, the more it can help to guide decision making. The data that financial services organisations capture from their customers is a valuable asset and it needs to be guarded, managed and governed in a similar way as other assets within the organisation.

Another source of scepticism about data-driven decision making is whether the organisation has the talent required to make sense of data. Data itself is an asset but the insights generated from that asset are even more valuable.

Decision making happens at all levels in an organisation so data analytics can prove useful to everyone from c-suite executives to front office tellers. Serving customers better requires both information and insight. But the leap from data entry to interpretation requires talent and training.

Some companies invest in expensive systems for managing data without designing an appropriate strategy first. A careful understanding of market position will reveal the products and profiling that matter to customers and to the bottom line. Without it, even the most cutting-edge, world-class system will generate less and less of a return over time.

Analytics is not an end in itself. It is a tool for strategic decision making and adds value to a strategy practice. Even very analytical organisations must focus on value and what matters to clients. Analytics provides insight, but it does not eliminate the need to deliver value.

Here are four steps to successfully apply data and analytics to strategic decisions:

1

Identify the decisions that matter

Understand the most important decisions for your business success – and those you make most often (they are often different). Focus upon the data insights that can make a difference to these decisions.

2

Gain C-suite commitment

Ensure all your senior stakeholders involved in making these decisions support and understand the role that data and analytics can play. Underlying resistance can undermine good work elsewhere in the organisation.

3

Begin small and learn by doing

Application of data and analytics can begin with small examples of new insight, gained via a test and learn approach. Technology is flexible and modular—using data no longer requires a 24-month investment in building an enterprise data warehouse.

4

Build confidence over time

Organisations will use more data and analytics once some initial success has been seen—and decision making is perceived to be improving. Building a case study in one business unit can help inspire the wider organisation.

Financing private companies and family businesses

John Njuguna is a manager with PwC Kenya Transactions Advisory practice.
+254 20 285 5140
john.njuguna@ke.pwc.com

Private companies and family businesses are under pressure to adapt faster, innovate earlier and become more professional in the way they run their operations. The pace of change is accelerating and yet many of them apply financing approaches rooted in past experience or the belief that change is incremental. In fact, the forces driving change for private companies in Kenya are often highly disruptive. This new reality requires a new approach to finance.

Cash is one of the most common vehicles for financing growth among private companies in Kenya. A business's cash flow can indicate how well it is performing and how healthy it is financially.

Less than a quarter (23%) of our Private Company Survey respondents identify 'availability of finance' as a key internal issue over the next year; the majority of private companies in our survey are growing either steadily or aggressively and so may feel little need for additional financing because their cash flow is adequate.

Working with private companies, we look at how they use cash and how efficiently it is being used. Looking ahead, we help companies to think about the cash flow needed for future opportunities. But for most private companies, cash-driven growth is not going to be adequate in the long term—no matter how carefully or strategically it is employed.

Furthermore, it can take time before companies that are not investing strategically will show signs of weakness. Cash can obscure strategic weaknesses. Sometimes we find that too much cash is being taken out of the business, a potential point of conflict. These and other issues can complicate a reliance on cash to finance growth.

The benefits of other financial products may not be well understood among private companies. But financial literacy cuts both ways: financial

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institutions also may not fully understand how these businesses operate and the risks they face, although many are now hiring staff with relevant skills to communicate the value of products and services available to private companies.

But a lack of a convincing value proposition—or a lack of suitable products generally—may explain why just 11% of our Private Company Survey respondents identify ‘availability of finance’ as a key external issue for their company in the next 12 months. It is not an issue because they have adequate cash to invest and other sources of finance are unsuitable, too expensive or unavailable to them.

For example, a bank may have difficulty evaluating a private company’s greenfield investment, its expansion plans or asset investments. Traditionally, the bank has had a conservative position because of information quality, security and levels of personal guarantees.

The bank applies one standard model to everyone: an automated system dictating credit control and risk. Borrowing will be assessed based on an existing balance sheet. Security requirements and capital requirements are high.

Finance is expensive; pricing is expensive. Kenya may be perceived as a risky market. To borrow dollars, the company must earn dollars. If the company borrows Kenya Shillings, the interest rate is higher. Acquisitions can be easier, if the bank can assess the track record of the target company, but ‘due diligence’ is often very partial.

These issues are not confined to banks. Development Fund Institutions may have long lists of criteria to satisfy, although they can offer longer loan tenors and lower interest rates.

Private equity houses offer another option but some private companies shy away at having to give up a share of ownership as well as the due diligence required. Private equity houses will want high visibility with regard to how their money is used.

These and other challenges mean that many private companies in Kenya reach a point when they start to consider professionalising and restructuring the company. Even very large companies can have very simple corporate structures like ownership by a single individual. Group or holding company structures would allow them to leverage many efficiencies, not least tax, purchasing and cash efficiencies. Good corporate governance, like independent members of the company’s Board of Directors, lends credibility to a private company wishing to finance growth. A thorough operational review can identify any concerns like cash leakages and allow the company to remediate them before they go to the market for finance.

It can take a very long time to unravel complex, outdated corporate structures within private companies. Many times, a younger generation of owner-managers will drive this kind of change. They will understand that the expense of setting up new companies, injecting capital and restructuring will enhance wealth protection for generations to come—by helping to grow the company sustainably and profitably. Older generations, particularly individuals who may have led the company for a long time, may resist these kinds of changes and worry about dilution of wealth or power.

At the end of the day, the availability and structuring of finance is a complex issue for many private companies and family businesses in Kenya. Although there have been some positive movements to recognise and address the challenges facing private companies, there is still significant room for improvement to reduce the overall ‘financing gap.’

A key challenge for both the traditional lender and the emerging type of lender is how to obtain a decent recovery when the borrower runs into distress. A critical step at the early stages of lending is for lenders to make sure they know what they are getting into

Managing loan enforcement pitfalls

George Weru is a Senior Manager with PwC Kenya's Business Recovery Services Advisory Practice.
+254 20 285 5360
george.weru@ke.pwc.com

Malvi Shah is a Manager with PwC Kenya's Business Recovery Services Advisory Practice.
+254 20 285 5057
malvi.shah@ke.pwc.com

The last few years have seen a transformation in the nature of the providers of debt capital to businesses in Kenya and the sub-Saharan region from the traditional mainstream banks to include other players like local and foreign Private Equity firms. The type of lending has also transformed from the traditional plain vanilla term loans to debt instruments containing additional features such as convertibility rights or warrants.

A key challenge for both the traditional lender and the emerging type of lender is how to obtain a decent recovery when the borrower runs into distress. A number of factors including poor and uncooperative management, imperfect security documentation, divergent interests of different lenders and prolonged litigation seem to always conspire together to make dealing with defaulting corporates notoriously difficult.

In this article, we outline some of the measures that lenders should consider putting in place, both before and during the course of the lending relationship to protect their position and enhance their chances of success in taking any enforcement action should the customer fail.

Do your homework!

A critical step at the early stages of lending is for lenders to make sure they know what they are getting into. A robust due diligence process with background checks on the borrowers (corporates and the individuals in charge) and a critical review of the collateral being offered will help identify potential challenges upfront. Aside from getting legal advice regarding the enforceability of security obtained from a legal point of view, the lender needs to consider practical considerations in relation to the realization of the security in question.

For instance, in the case of property such as a factory, a prudent lender will want to consider whether the entire factory sits on land belonging to the borrower.

Especially in the case of owner-managed businesses, you find that a company's premises or portions thereof sit on land registered in the name of the owners or other related persons or entities. In such cases, regardless of the robustness of security documentation, it becomes very difficult to realize the security in the event of default.

Other important aspects that need to be understood upfront concern the company and the structure of the group it sits in, the frequency and scale of related party transactions (and whether these are formally treated in the financial statements) and the management structure of owner-managed businesses.

A prominent feature common among many lending default situations that we have encountered arises in relation to businesses that have significant dealings with related entities, particularly those in similar lines of business as a result of the co-mingling of the proceeds within the various entities. The prudent lender should consider drafting into the lending agreement conditions precedent requiring the arms-length treatment of such dealings and if possible, obtain third party security and guarantees from such related entities as well. An equally important consideration in the case of groups of related entities is to seek professional advice as to the most suitable level to lend – whether at the holding company or the operating company levels.

Manage relationships

It is also critical at the outset to set up structures that allow continuous engagement with borrowers and enable the lender to monitor its position during the course of the lending. For example, in the case of a bank lender, a key part of the structure could be ensuring that the borrower routes the bulk of its transactions through an account with the bank. This will help to provide greater visibility of the financial health of the business A schedule for regular review and keen monitoring of relevant financial information and regular meetings with the borrower can also help the lender monitor its position effectively.

Establishing a relationship of trust and a good rapport will ease information sharing and any subsequent discussions. One option for enhancing the lender's position is to set specific performance and operational metrics that should be met. In order to provide incentive for management to achieve these metrics, and to provide the lender with options if things head south, the lender may include in the lending agreements options to convert the debt into equity and have representation in the borrower's board in order to influence subsequent critical strategic decisions.

The engagement with the borrower should continue even once the financing has been advanced. A close eye should be kept on the financial information shared in accordance with the structure agreed at the outset. For instance, has the information provided been audited by a reputable audit firm? Is there consistency in the different sets of financial information provided over time? Is the borrower's performance in line with industry performance or market trends?

Lenders/investors should also strongly consider making arrangements to take on roles as independent Observers at the Board meetings for companies to which they have advanced funding.

Understand the market and seek advice

One of the increasingly common types of lending is in relation to capital projects. A recurring issue that we have experienced in relation to these is the impact of cost overruns. Significant cost overruns that arise post-lending can put the lender in a difficult position whereby it has little choice but to provide the further lending required, otherwise it is left with an incomplete project which is very unattractive from a recovery perspective. The other impact is the delay in the projected cash flows from the project. Consequently, a critical review of the business plan and financial models supplied by the borrower and the underlying assumptions is essential not only to ascertain the viability of the project, but also to determine the reasonableness of the projected project outflows. In this regard, an independent or expert opinion may add value.

The other challenge that we have witnessed is in relation to difficulties in enforcing third party securities. It is important to ensure there is a sufficiently strong arrangement between the borrower and the third party, otherwise any attempts to enforce the third party securities will result in prolonged court battles. As far as possible, third party security should supplement other security from the primary borrower. Quality professional advisers can assist in structuring the arrangement appropriately.

Take action to preserve value

The objective of all such measures will be to have a deeper and more complete understanding of the borrower's circumstances. It will also help the lender spot potential early warning signs of distress that could allow proactive action to be taken before the situation deteriorates too much.

These signs include persistent delays in meeting payment obligations or failure to meet them or not adhere to the lending terms. For instance, a borrower may repeatedly fail to provide financial information on the agreed basis.

Less obvious perhaps is a decline in the industry or an adverse market trend, or perhaps circumstances affecting a key business partner that could have an impact on the borrower. Increases in the frequency or quantum of related party transactions could also be an important signal.

Commonly, when the economic or business situation is declining, engagement from the borrower starts to do so too. There are various options for taking quick and decisive action depending on the measures that the lender put in place at the onset In the case of traditional secured lending, the options may be limited to engaging with the borrower to work out a debt restructuring plan or enforcing the security.

In the case where the lending incorporates additional features such as convertible options, if engagement with the borrower is not fruitful, the lender may elect to exercise such an option and take control of the business. Subsequently, the lender could undertake its own review to assess the true financial condition of the company and its prospects moving forward.

Based on the outcome of the review, the lender may then take measures such as the appointment of new, more capable management or appointing a restructuring team to turn around the business.

Ultimately, the steps that a lender takes before advancing the funds are usually critical because they determine the options that will be available to the lender in the event of default. Relationships, engagement and monitoring also help to ensure that the lending relationship is a successful one for lenders and borrowers alike.

We anticipate that as Kenyans live longer and their distance to mortality increases, the longevity risk associated with pensions will also expand. Kenya is no different than many other countries worldwide in this regard. Globally, pension liability risk is valued at USD 25 trillion. In response, fund managers here and elsewhere are focused on non-traditional investment choices to enhance diversification and hedge against systemic longevity risk

Pension longevity risk threatens Kenya's future retirees

Francisca Ochieng is a Consultant in PwC Kenya's Advisory practice.
+254 20 285 5243
francisca.ochieng@ke.pwc.com

Kenyans born between 1980 and 2000 are living longer and healthier lives. As we celebrate this achievement, we should also consider the implications of increased longevity. Appropriate public policy and private sector preparedness can help ensure that Kenya's youthful, vibrant population remains supported in old age. One area requiring immediate attention is pension fund management.

In the past 30 years, Kenya has experienced a 175% jump in population and currently, 43% of the population is under the age of 18. The population's health has also steadily improved. According to the World Health Organisation, life expectancy in Kenya has increased from 50 years to 63 years in the span of only 13 years.

These facts are worth applauding because they signify a healthy, growing nation. But it is not clear that our youthful population's pensions are adequately supported to ensure that young people today will have the resources they need when they retire. We anticipate that as Kenyans live longer and their distance to mortality increases, the longevity risk associated with pensions will also expand. This means that pension funds will have to support more and more people as our large, youthful population ages and for the entities that provide pensions, the cost of doing so will also increase.

We should consider whether Kenya's pension coffers –both private and public – are beefed up enough to meet this spike in pension liabilities. Trends in longevity are hard to predict and the very raison d'être of pension funds under threat.

Kenya is no different than many other countries worldwide in this regard. Globally, pension liability risk is valued at USD 25 trillion. In response, fund managers here and elsewhere are focused on non-traditional investment choices to enhance diversification and hedge against systemic longevity risk.

For example, some pension funds in developed markets are using creative ideas to hedge and/or mitigate longevity risk. Professor David Blake of Cass Business School, City University London, has shown that insurance companies are increasingly showing a loss of risk appetite. In response, he came up with Longevity Bonds and markets for hedging longevity risk as means for pension funds to hedge against longevity. To date, over 25 swaps have occurred where an annuity provider pays a fixed annual amount to an insurer which then pays the actual amount of annuities to pensioners.

Kenya's Retirement Benefits Authority (RBA) guidelines tend to favour fixed income-based securities which make up about 40% of the Assets Under Management (AUM) in Kenya's Retirement Benefit Industry Portfolio, according to a 2012 report. A further look at RBA guidelines shows that a fund manager can technically create a portfolio made up of 30% invested in fixed income (private) securities and 70% in government securities without including other permitted asset classes.

This high fixed-income allocation strategy exacerbates the bubble in long-dated bonds and it also exposes a fund to two risks: reinvestment and interest rate risks. The former arises when maturing bonds are reinvested at unfavourable rates. A drop in interest rates increases a fund's liabilities by decreasing the discount rate applied to a fund. Aon Hewitt, a US-based consultancy firm, recently showed that the actual amount of interest rate risk hedged by UK pension funds was about 30-40% compared to the recommended 70% protection against this type of risk. We have to scratch our heads and ask ourselves whether Kenyan fund managers are making the right moves to hedge against these risks.

Investment in real estate is also a popular trend among Kenyan funds, constituting 18% of AUM in 2012. This strategy is popular because it offers strong returns plus some form of protection against risks associated with inflation and also because hedging strategies such as swaps and index-linked gilts are unavailable or rare.

Fund managers may not feel that the burden of managing longevity risk falls upon their shoulders. RBA has defined asset classes and allocation guidelines that they must adhere to, and investment in 'any other asset class' requires an application by the scheme and prior approval by RBA. Additionally, offshore investments are limited to bank deposits, government securities, quoted equities and rated corporate bonds. This means that there is a certain investment profile that a manager has to implement, which can encourage a herding bias and limit a fund manager's ability to be creative with her investment styles.

RBA should open up new asset classes. RBA and the Capital Markets Authority should further participate in educating market participants about longevity risk and also bring forth potential solutions. Some of the potential solutions can include government-issued Longevity Bonds as they will put a price on longevity, and make it possible for longevity swaps to be executed. Local research has been conducted to make a case for the inclusion of alternative investment classes such as Private Equity.

Opening up pensions to alternative investments will allow fund managers to look at non-traditional investment styles and find ways of hedging and insuring funds against potential risks. Our healthy, youthful population deserves to know that their future benefits are secure.

Richard Njoroge is a Partner in Assurance with PwC Kenya and the financial services industry leader for PwC's network of firms in East Africa, Zambia and Mauritius.

Industry insights: *Q&A with Richard Njoroge*

In our 2014 Africa CEO Survey, PwC asked 260 CEOs in 17 countries to comment on their companies' growth prospects. Among the respondents, 59 are from the financial services (FS) sector. We asked PwC's Richard Njoroge to comment on the major trends emerging from the survey and specifically how these trends are playing out in East Africa.

Editor: 98% of FS CEOs are confident of growth over the next three years and among opportunities for growth, most identify product/service innovation as highly promising. Which product/service innovations inspire confidence in growth? How are innovations influencing profitability, brand identity and financial inclusion?

Richard Njoroge: To answer this question, we can look at innovation in the context of megatrends influencing the business ecosystem in Africa. Our Africa CEO Survey shows that business leaders identified three megatrends: technology advances, demographic shifts and urbanisation. This result is not surprising, given what is happening on the ground.

Technology ranks highly because a lot of the innovation that we are seeing is technology-based and driven by customer needs. To a large extent, growth is derived from how products and services are delivered—how well customers can access them and their experiences. Successful financial services institutions anticipate and identify changing needs and respond to them through innovation. We see more and more partnerships between financial institutions and telecommunications companies, which speaks to both customer access and customer experience.

One of the reasons why you find that local banks have grown faster than the larger multinational banks is because of their agility in responding to needs in terms of introducing new products for customers. The most successful innovations address very specific local needs. A good example is M-Shwari, a Commercial Bank of Africa innovation which offers M-PESA customers the ability to save money, earn interest on their savings and also borrow money through their mobile phones.

The key is to understand customer segments, and this speaks to two other megatrends identified by Africa FS CEOs: demographic shifts and rapid urbanisation. Younger customers have different expectations; so do urban customers and rural customers and women and SME owners. We have worked with financial services companies to provide training to SMEs and very often, we present to roomfuls of young people, well-informed and receptive to technology. These are the SME owners of today and tomorrow. Not all financial institutions fully understand this and, in my view, customer segmentation could be improved significantly using data analytics.

Ed.: 27% of FS CEOs entered into a strategic alliance/joint venture last year but 53% are planning to do so next year. Is the industry consolidating? What kinds of entities are banks/insurers forming strategic alliances/JVs with?

RN: Consolidation will eventually happen but perhaps not as fast as we would expect. I think it's just a matter of time, in part because of regulatory changes and in part because of the large investments that financial institutions will have to make to survive and succeed. For insurance companies, the regulator has announced plans to enforce risk-based capital requirements. Simulations of the new model show that huge capital injections will be required.

These factors will drive some of the smaller banks to either partner or consolidate. So far, we have seen quite a number of informal partnerships if not structured joint ventures. Banks and telecommunications companies are working together. On the bancassurance side, banks are teaming up with insurance companies. Some banks already had insurance agencies that they had formed, working with insurance underwriters. Banks themselves are now setting up insurance underwriting operations. Agency banking allows banks to partner with institutions that have a wide network, such as the post office.

Ed.: FS CEOs are definitely hiring; 59% plan to increase headcount this year and 80% say that creating a skilled workforce is a priority for their company over the next three years. What kinds of people are they looking for? Are their talent needs related to the innovations they're rolling out?

RN: Hiring is connected to growth and the financial services sector has been growing faster than the overall economy in East Africa. So part of the increase in headcount is related to growth requirements. The specific skills needed are also changing and we are seeing a greater bias towards IT and customer service expertise.

Financial institutions also recognise the need for certain skills in response to regulatory requirements. In the insurance industry, there is now an enhanced role for actuarial services so these companies must either train or hire for this expertise. Risk management requirements drive banks to hire people with certain skills sets. So I am not surprised to see that FS CEOs plan to increase headcount but I also know that many of them are concerned about finding the right people and being able to retain them over time.

Ed.: 95% of FS CEOs say that cyber threats including a lack of data security are risks to the growth outlook. How well prepared are banks/insurers with regard to cyber security? What are some of the best strategies for managing cyber security across an organisation?

RN: Cybercrime is definitely a big risk and everyone knows it. Technology advances growth and facilitates innovation, but there are risks associated with technology, too. Fraudsters are becoming more sophisticated, taking advantage of system vulnerabilities and syphoning off money. Very often, cybercrime is organised by outsiders working with insiders. There is a lot that we can learn from international trends, because whatever is happening out there is also likely to happen in Kenya eventually.

The issue with cybersecurity is that a lot of financial institutions tend to be reactive instead of proactive in terms of identifying potential threats and conducting a proper fraud risk assessment. But there are always competing priorities, in terms of dedicating resources to cybersecurity. A bank or insurer may not have had any serious cybercrime issues… yet. But is this because of the controls in place or thanks to pure chance?

Ed.: In our survey, we asked CEOs about the impact of regulation on their companies. 76% say operating costs have increased; 58% say it has become harder to attract a skilled workforce as a result of the regulatory environment. 67% say that there is a need for governments to work more closely together to harmonise regulation. What is your view? Is over-regulation a threat to growth?

RN: Some of the changes in regulation require certain structures and certain roles and responsibilities within the organisation. The larger financial services companies will not need the regulator to tell them that they need certain skills, but most companies will feel some pressure in this regard.

It is important to remember that our regulators in East Africa are part of a global regulatory environment and globally, there have been economic crises which precipitated changes in the regulatory environment. One could argue that the knee-jerk reaction in the West is to tighten regulation when crises occur; whether these changes are fair or not, they will still trickle down to us.

A lot of the changes that we see here are borrowed from outside. Basel III or Solvency II are not East African creations. But they are global standards. Regulatory changes require companies to expend time and money, which is why they may be viewed as threats to growth. But in the long term, regulatory changes can level the playing field and improve economic stability for companies and their customers. It's important to look at the big picture and plan ahead.

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