Perspective on current issues and trends in the financial services sector

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Foreword

Welcome to this edition of Financial Focus, our journal of articles on leading issues and developments in Kenya's financial services industry. Since the last time we published Financial Focus, about a year ago, there have been significant developments in tax legislation and the regulatory environment as well as in areas like cybercrime and mobile banking that impact players in financial services. We comment on many of these issues in this edition.

As always, these articles are intended to inspire discussion—and even disagreement! So we hope that you will share your opinions with us and let us know if there are topics or areas that you would like to know more about for the next edition of Financial Focus.

One area that perennially stirs up a lot of comment and concern in Kenya's financial services industry is tax. The VAT Act 2013 widens the scope of 'VAT-able' supplies and brings into the net previously exempt financial services.

The Finance Act 2012's new excise tax on money transfer services and fees charged by financial institutions is controversial. Some aspects are still unclear and the Act is currently the subject of legal suits by players in the financial services sector. In this edition of Financial Focus, experts in our tax services practice discuss the implications of these pieces of legislation.

In my view, we can appreciate the government's need to increase revenue collection and hence the necessity of tightening loopholes with regard to tax policy. At the same time, these efforts must be balanced against the impact that such policies have on the financial services industry. For example, at the moment it is not clear whether excise duty extends to premiums for insurance products.

Given the very low penetration of insurance products in Kenya, applying an excise tax to premiums would have a significant negative impact on the whole industry. Greater consultation between the government and industry is necessary to ensure there is full understanding of the full impact of proposed changes and that any agreed changes are implemented in a structured manner within sensible timeframes.

The Foreign Account Tax Compliance Act (FATCA) has also caused quite a stir lately, and our experts discuss it in detail within these pages. The full impact of FATCA regulations is not well understood and time is running out before the new rules come into effect. Financial institutions, especially banks, need to start preparing for compliance.

Implementation could be expensive and may require banks to look at their systems and processes, amending them to ensure compliance. FATCA could be just the beginning of a larger trend, where other countries come up with FATCA-like legislation. If so, the US FATCA regulations may prove to be a harbinger of things to come and financial services entities would be wise to take note sooner rather than later.

Another area that I think deserves special mention is Kenya's insolvency framework. Proposed legislation (the Insolvency Bill 2010) would help us to move beyond our current, outdated framework.

Protracted litigation raises the cost of receiverships and liquidations; a more progressive framework that is more consensual rather than adversarial will facilitate action and intervention earlier. Ideally, we want a more proactive 'rescue culture' to prevail in insolvency policy development because early intervention tends to preserve more value for stakeholders and society as a whole.

As a general comment, there are several pieces of legislation significant to the financial services industry that have been floating and waiting to be passed for some time. We hope that the government will keep its promise to fast track the passing of these laws and that the process will fully involve the financial sector players and other stakeholders.

Again, I hope you enjoy reading these articles and we welcome your feedback—and suggestions for future articles. All of these articles are available online and easy to share at ***www.pwc.com/ke***

Richard Njoroge
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Changing approaches to insolvency

The growth of the banking sector in Kenya and much of Africa in the last decade has been prolific. The reach of banking institutions and the sizes of their loan books have increased steadily and so in turn has the value of their non-performing loan books. Even so, following a spate of insolvencies in the 90s and early 2000s, the incidence of receiverships and liquidations in Kenya has fallen significantly.

One reason is that a number of lenders have cleaned up their loan books. The banking sector globally also became more conservative in relation to lending practices following the economic crisis. As a result, although the value of non-performing loan books has increased, the ratio of non-performing bank loans to total banking assets has fallen from almost 20% in 1999 to about 3% in 2013. The reduced incidence of 'bad' debt has meant a reduction in the number of insolvency court cases; they are needed less often.

Another major reason why the incidence of receiverships and liquidations has fallen in Kenya is the cost of insolvency proceedings. The main objective of a lender instituting an insolvency proceeding is usually to recover or extract value for the main stakeholder(s), whether creditors (in receiverships and liquidations) or shareholders (in Members Voluntary Liquidations). This value can be (and has been) eroded in certain cases due to many factors such as protracted litigation arising in the context of insolvency proceedings, particularly non-voluntary ones. Such protracted litigation increases the cost of the insolvency, not just through the cost of long-running court battles and associated legal expenses but also through the delays it causes to the conclusion of the process. Unscrupulous borrowers who know this only too well are not averse to using litigation to their advantage in order to frustrate creditor attempts at recovery.

Insolvency regulatory framework: a work in progress

Our outdated legal framework also deters creditors from seeking insolvency as a means of enforcement. Kenyan insolvency legislation (through the Companies Act Cap 486) is based on the UK Companies Act of 1948. The corporate landscape has no doubt changed tremendously since 1948 and the UK has implemented a separate Insolvency Act (1986) which was further updated in 2003 through the Enterprise Act. Many other jurisdictions whose insolvency laws were based on the UK Act have also reformed it over time, based on a changing approach towards companies in financial difficulty that is focused on consensual solutions rather than adversarial ones. They recognise that recoveries for stakeholders are likely to be higher if businesses are rescued or restructured rather than dissolved.

In Kenya, there is a new insolvency law in the pipeline: the Insolvency Bill 2010, which could result in changes to attitudes towards insolvency here as well. The Bill introduces provisions for Voluntary Arrangements and Administrations, two modes of insolvency that are more consensual and serve the interests of a wider group. The Bill also proposes minimum qualifications for Insolvency Practitioners; at present any CPA Kenya qualified individual can be appointed a Receiver Manager or Liquidator. The Bill further proposes that all individuals who wish to act as insolvency practitioners would need to apply to the office of the Official Receiver beforehand, in effect 'licensing' insolvency practitioners and regulating the activities and conduct of insolvency practitioners.

Alternative solutions

In the meantime, lenders can pursue a number of alternative solutions. One is the adoption of voluntary arrangements involving the directors of a distressed company that propose a scheme or arrangement outlining the means and the extent to which the distressed company intends to settle its debts. The Insolvency Bill 2010 provides that such a proposal would need to be entrusted to a qualified insolvency practitioner, who would call a meeting of creditors and present the directors' proposal regarding the settlement of debts. Agreement among a minimum of 75% of creditors by value and 50% of creditors by number would have to be obtained for a proposal to be accepted.

Once accepted, this proposal would be binding on all creditors, regardless of whether they attended/were represented at the meeting or not. This approach ensures the support of the majority of parties towards reaching a solution and an outcome that all parties agree to up front. It also manages expectations on possible recoveries. This approach can also result in the compromise of complex disputes among stakeholders thereby avoiding the cost of litigation. In short, the costs of a protracted and hostile insolvency proceeding can be avoided in favour of a consensual arrangement.

The Insolvency Bill 2010 would also institute the introduction of Administrations. Just like for Voluntary Arrangements, an Administration Order is binding on all creditors once it is in force. The process involves the presentation of a petition to a Court of Law by either the company or its directors that puts the company into Administration, effectively stopping any other court proceedings or winding up orders against the company. For a petition to be granted, among other conditions, it must show that the outcome in an Administration would result in 'a more advantageous realisation of assets' than in a winding up or that it would lead to the survival of a company or part of it as a going concern. This is in keeping with the overall trend towards a 'rescue' culture.

Earlier action to rescue and recover

At the early stages of company distress, there are typically more options that can be pursued to avert a situation of complete distress. These include Independent Business Reviews (IBR), which range from full-blown reviews of the entire organisation's structure and operations to simply looking at quarterly financial forecasts. Typically, these are done on behalf of a lender to assess the likelihood of recovering existing lending or whether further lending should be extended. They involve in-depth reviews of the company to assess its health, whether it is likely to remain a going concern and its ability to service its debt obligations. The review often will include the lender's security position as well.

At the end of an IBR, consideration is usually given for the possible options the lender would have for recovery such as debt restructuring, turnaround or liquidation. The outcome of a review may also point to areas that, if addressed, would enhance the company's performance including financial management, staffing and operational and structural issues, among others. An IBR can also assess the strength of a lender's security.

Other proactive options include working capital management solutions and controlled (as opposed to distressed) restructuring when underperformance is first noted. In fact, controlled divestments often tend to generate greater value than distressed disposals, as does any action taken following early warning signs before cash shortages.

Close and regular monitoring of borrower financials focusing on not only profit forecasts but also cash position and performance can flag any potential issues earlier. Ensuring airtight credit policy and loan security documentation at the outset helps to mitigate the risk of a debt going bad.

The insolvency landscape will change once the Insolvency Bill 2010 is enacted. Before then, there are many consensual solutions available for companies in distress. The main objective should be to act early, decisively and collaboratively to avoid costly and time-consuming insolvency proceedings.

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Cybercrime: Are you on the ball?

No longer is your money under threat from the brick and mortar criminals employing rough-and-tumble tactics like guns and pangas—or from subtle con-men selling plots at Uhuru Park for bargain-basement prices. The age of cybercrime is upon us in Kenya and by comparison, rough-and-tumble criminals are prehistoric Neanderthals.

Cybercrime refers to any crime that involves a computer and a network whereby the computer may have been used in the commission of a crime, or it may be the target. Cybercrime (and its subset, net crime, which is the criminal exploitation of the internet) is on the rise with the criminals preferring stealth and deception to tried and trusted rough-and-tumble tactics.

With each passing day, cyber criminals are successfully circumventing the systems and controls of companies in every industry and fraudulently exploiting their key assets. Cybercrime also involves the theft of intangible assets such as in the case of industrial espionage and the theft of intellectual property rights, which can have a larger impact than the theft of tangible assets.

Cybercrime in financial services

The financial sector, especially banks, bears the brunt of cybercrime activities. These breaches have a significant and potentially devastating impact on the financial position and reputation of companies affected, especially where there is loss (or perceived loss) and the crime plays out in the public domain.

The conveniences to the purveyors of cybercrime are endless. Technology has advanced exponentially over the past 20 years and together with it an increase in cybercrime resources. Free, malicious software is available to anyone to commit cybercrime. The proliferation of smartphones with superb computing capabilities and advancements in mobile platforms offering financial services such as money transfer and mobile banking has exacerbated vulnerability to cybercrime.

Today's cybercriminal need not be an IT guru, just someone who can do a Google search. There is no need to hire intellectual muscle (it only increases the costs incurred in committing the crime!). There is comparatively less risk of injury (few stray bullets will foil cybercriminals) and improved ability to work from the comfort of home (nice for cybercriminals' work-life balance). Shilling for shilling, cybercrime is more profitable than traditional crime in terms of monetary and time investments and risks to the criminal's personal security.

In Kenya, computer forensics to fight cybercrime is still an infant field—relative to more developed markets. 'Computer forensics' techniques apply investigative techniques together with IT expertise. The infancy of the field in Kenya, together with the obvious need for it, has created a wealth of instant experts who have attended a computer class and watched a few computer crime programmes on TV.

This situation is compounded by the fact that there is little standardisation of the approach, modus operandi, qualifications and expected output for the process even among recognised leaders in the computer forensics industry.

Combating cybercrime

To address this worrisome state of affairs, there are a few actions that we must take now.

First, we must streamline the investigations of cybercrime. Minimum qualifications, competencies and experience should be attained by individuals and firms seeking to carry out computer forensic investigations. Relevant professional bodies should take the lead in this matter and set up guidelines and certifications to govern cyber forensics in Kenya.

Second, the government's approach to cybercrime to date is commendable but there is still scope for improvement. Encouraging signs include a proposal to implement cross border legislations to regulate cybercrime across the African continent. A recent AU conference held in Kenya focusing on cyber threats ended with a major resolution to harmonise cybercrime regulations in Africa.

Tough legislations to define high-tech crimes including cyber-based terrorism, espionage, computer intrusions and major cyber fraud should also detail strict and punitive punishments and therefore act as cybercrime deterrents. In addition, Kenya's government should look at strengthening the cyber forensics sub-department at the Criminal Investigations Department (CID) in the areas of cybercrime investigations, intelligence gathering and cybercrime statistics (to improve coordination with peer bodies in other countries that are further advanced in this area). The CID could then provide information to the public on the emerging trends in cybercrime on a regular basis.

Third, cyber security must be viewed as a strategic organisational imperative in order to protect brands, competitive advantage and shareholder value. To that end, organisations (public and private companies, NGOs and others) should invest in cybercrime training for their staff. Detection, prevention and mitigation of cybercrime should not be the preserve of an IT department alone. Various stakeholders including IT, internal audit, finance and legal departments should have functional responsibility for combating cybercrime with the ultimate responsibility resting with a C-suite level executive manager.

Companies should equip staff with the requisite investigative skills and technological knowhow to detect and combat cybercrime at work. Cybercrime risk assessments should be a core activity within an organisation, planned and scheduled accordingly, and with dedicated resources—not a sporadic activity spearheaded by outsiders in dark suits.

In addition, an organisation will benefit from designing a suitable Cybercrime Response Strategy (CcRS) with defined policies and procedures to ensure effective implementation and adherence. A culture of awareness should be ingrained in the minds of employees who would then be on heightened alert to detect and prevent cybercrime incidents.

These actions will help to combat cybercrime. In today's IT age, cybercrime does not rest on its laurels and is constantly evolving. To stay in front of current and emerging trends, a culture of gathering and sharing information and intelligence between the government, private and public companies must be cultivated.

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Managing risks in a mobile banking world

Like everywhere else, the introduction and usage of mobile and Internet banking in Kenya is rising. Players scramble to launch their services, seeking to differentiate themselves from competitors at the same time. But fast, modern, 21st century mobile banking products also create major risks for banks and also users. Traditional risk management and controls frameworks like audit trails and paperwork are too slow and outdated for the real world now.

Security risks

The 'business unusual' risk environment that we find ourselves in now requires multiple layers of mobile banking security infrastructure. These layers include the mobile user interface, mobile network, the bank's firewall and the mobile banking server, which in turn talks to the core banking system's server.

Each of these layers presents different vulnerabilities and risks like server risks, vendor risks, transmission risks, mobile device risks and end user risks. Each layer can potentially compromise all the others, if it is not sufficiently secure.

Increasingly, many banks depend upon third parties for services related to their e-banking facilities, thus increasing their risk exposure, while reducing their ability to fully control or mitigate risks. However secure a system may be internally, it is important also to work with outside vendors and mobile service provides to ensure their security as well.

One of the most significant sources of risk to banks is users themselves. Users in their innocence or ignorance expose banks to all sorts of risks like device loss, poor password security, unprotected Wi-Fi network connections, weak utilisation of security features availed to them by employers or device manufactures and even letting their tech-savvy children use their devices.

Banks need to work with their users to educate them and also to agree upon some ground rules. They need to be able to monitor their users without infringing on their privacy—admittedly, a tough balancing act in today's world.

In managing their enterprise-wide risks, banks are guided by management and other stakeholders including regulators and professional bodies on the risks emanating from new product and service offerings.

However, the pace at which enterprise risk management frameworks are evolving or maturing is often slower than the pace of technological change. Many banks (often smaller ones, but not always) find themselves exposed to risks without sufficient mitigation plans and controls in place.

Worryingly, banks may not have the skilled employees required to manage these risks while fraudsters are often young, enthusiastic, extremely intelligent and agile in their approaches. Fraudsters who once worked in isolation now tend to operate within established organised crime syndicates with networks of 'sleeper' agents embedded inside banks, sometimes for years. Organised crime targeting banks is big business.

Many banks do not have much of a response to Internet and mobile risks and rely on their traditional IT, audit and business processes to respond (or not). Too many banks are still playing catch-up—and paying the price.

Risks that are not new, but different

In itself, mobile and Internet banking services do not expose banks to new risks but rather impact the risk profile of existing risks and accentuate the risks that any financial institution faces. The board and senior management must be cognizant of these risks and deal with them appropriately. Managing risks and implementing controls for mobile and Internet banking services should follow similar principles as other IT risk assurance processes, although the tools, skills and timing aspects of processes may need to be revisited.

Tone from the top

The greatest danger is to treat these risks as a typical IT audit issue and perform checks periodically (e.g., annually) as part of a structured audit plan. These risk areas should be audited continuously and proactively, with systems in place to generate alerts in the event of any anomalies and escalate them either during or soon after a transaction has been processed. Another danger is to treat mobile and Internet banking risks as technical IT matters and leave it to IT management or security departments to manage. Generally, these are business management issues that require attention from senior management.

Although the board and management should have oversight of the risks and controls framework, many of these individuals may lack risk expertise and so will require outside counsel to explain or demonstrate risk exposure. Boards and management need to appreciate the business case, revenue streams, risk exposure and indeed the impact on other revenue streams. Only then can they confirm if the accountability, policies and controls for which they have oversight are sufficiently robust to manage these risks.

Some common recommendations for managing mobile and Internet banking risk include:

- Security controls need special attention because of the open nature of the Internet and the pace of technological change.
- Banks should ensure that there are appropriate measures to protect the data integrity of e-banking transactions, records and information.
- All e-banking transactions should generate clear audit trails, which should be archived. It is also vital to generate and protect records of customer instructions in a legally acceptable format.
- Banks should strengthen information security controls to preserve the confidentiality and integrity of customer data. Firewalls, ethical hacking tests and physical and logical access controls are some of the methods available.
- Banks should put in place a privacy policy or extend existing policies to include opt-out options. They must also allow customers to opt-out and great care must be exercised before sharing customer information with outside entities. If customers are from a different jurisdiction, then the strongest privacy law may apply.
- Mobile and Internet banking is a 24 hour, 365 days-a-year business and banks must have sufficient business continuity and contingency plans in place to ensure continuous availability of these services. Therefore, appropriate incident response plans to detect, manage, contain and minimize problems arising from internal and external attacks should also be continuous.
- Clear escalation paths, a communication strategy for customers and the press and a documented chain of command are essential to managing a risk event should one occur.
- Banks should clarify the process for collecting and preserving forensic evidence after an adverse event.

The risks arising from mobile and Internet banking are not restricted to information security areas, but span across all areas of traditional banking as well. Customers, bank employees, boards, senior management, IT departments, government, regulators and outside experts all have a role to play in helping to manage risks. By working together, these stakeholders can help to undermine the pervasiveness of globally-organised fraudsters targeting banks and their customers.

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VAT Act reality check:
Excise duty on financial services

Kenya's financial services sector has experienced a boom in recent years with some institutions recording tremendous growth in the region. This has no doubt caught the government and specifically the Kenya Revenue Authority's (KRA)'s attention as far as meeting their revenue collection targets is concerned.

The VAT Act 2013 ('the Act') is part of the government's efforts to increase revenues and came into force at the beginning of September 2013. It effectively imposes 16% VAT on supplies that had previously been tax-exempt or zero-rated. Amidst confusion on which commodities or services are exempt and which are not, traders and businesses resorted to imposing price hikes of up to 16% on not just all basic consumer goods but also on services, forcing consumers to dig deeper into their pockets.

Impact on financial services

While there is minimal change to the status of the supplies in the financial sector, the Act has introduced some subtle changes that will affect the sector. Definitions of certain terms in the Act have changed; this includes but is not limited to the definition of the term 'business' and 'person'.

The definition of the term 'business' now includes any activity carried on by a person continuously or regularly, whether or not for gain or profit. This means that you do not need to have profit or gain from a transaction to be deemed to be conducting business for Value Added Tax (VAT) purposes. If a person provides taxable supplies continuously or regularly and receives some consideration for this, then the person will likely have to register for VAT and charge VAT.

Further, the term 'person' was previously not defined but this has now been defined as an individual, company, partnership, association of persons, trust, estate, the government, a foreign government, or a political subdivision of the government or foreign government. The county governments and association of persons have therefore not been spared from the obligation to account for VAT on their services!

The Act has brought into the 16% net previously exempt financial services such as services rendered by Unit Trusts (UTs), credit rating bureau services (CRB) and Collective Investment Schemes (CIS) management services if the providers meet the VAT registration threshold. This might have a big impact on the fees charged for services offered by these institutions which may trigger an increase in prices.

Financial institutions will also be affected by the change in the criteria for input tax deductibility in cases where both exempt and taxable supplies are made. Look at a bank or an insurance company that carries out taxable services such as the letting or sale of non-residential property, asset leasing, custodial services among others. This bank will be charging VAT on these taxable services and will treat its other financial services as exempt.

The bank will want to determine whether it can recover input tax incurred on its purchases. The Act elaborates that input tax relating to taxable supplies is deductible in full while input tax relating to other use is not deductible at all. For input tax relating to the making of partly taxable supplies and partly other uses, the Act clarifies that in cases where the quantum of the taxable supplies is less than 10% of the total supplies, the total input VAT incurred is not deductible.

Previously the repealed VAT Act provided that in cases where taxable supplies were 95% or more of total supplies, the entire input VAT was deductible; however, there was no restriction in cases where taxable supplies were 5% or less of total supplies.

Since financial institutions supply mostly exempt services, their taxable supplies are likely to be less than 10% of total supplies and in cases where the input VAT cannot be directly attributed to taxable supplies, the entire input VAT will not be recoverable. In such cases, the affected financial institutions are likely to shift this burden to their already overburdened customers.

The mechanism of accounting for VAT on imported services has also changed. When a registered person imports a service, this is deemed to be a supply to himself and accounted together with his sales as output. If such a taxpayer makes full taxable supplies, no VAT is payable.

However, those making mixed supplies or fully exempt supplies (like financial institutions) should pay VAT on imported services to the extent that it relates to exempt supplies. This is likely to impact financial institutions because most of them make either mixed supplies or fully exempt supplies and import management and professional services.

In cases where the recipient of the services is a non-registered person for VAT purposes, the supplier of the service is required to account for VAT and this can be done by appointing a tax representative who will handle all the tax matters on the supplier's behalf.

Impact on KRA

KRA will also feel the impact of the new Act as its efficiency will have to improve. The Commissioner is now expected to respond within 30 days after he has received the notice of objection of assessment and send out a notice within 15 days setting out an amendment or confirming the assessment.

Where the Commissioner fails to communicate within 60 days, he shall be deemed to have agreed to amend the assessment in accordance with the objection. Previously there was no time limit within which the Commissioner could respond to objections of assessments submitted by taxpayers. This has changed for the better for taxpayers.

Under the repealed VAT Act the Commissioner would issue rulings and notices but the problem with these rulings was that they were not binding on the Commissioner and would only be relied upon from a persuasive perspective. To deal with this challenge, the Act has introduced public and private rulings that are binding on the Commissioner and not the taxpayer.

The Act now requires the Commissioner to make and withdraw public notices to appear in at least two daily newspapers of national circulation. Private rulings can also be obtained on a specific issue where the taxpayer requires clarity. However, no timelines have been

introduced to require the Commissioner to expedite the response to the application. Perhaps the Act should have introduced timelines on the Commissioner to respond to an application for a private ruling to ensure that there are no delays.

The Act has brought about changes with regards to KRA audit timelines. KRA audits are expected to be concluded within six months but KRA can request for an extension in writing.

Where an audit is not concluded within six months, a registered person can be issued with an interim certificate indicating the progress of the audit.

This is a positive change for all taxpayers because it will help to speedily resolve issues noted during the audit and stop them from dragging on for years.

Finally, the sale of any building used to be exempt for VAT purposes. The Act makes only the sale of residential property exempt so that the sale of commercial buildings is now subject to 16% VAT. This change will affect the sale and purchase of commercial buildings by the financial services sector as the cost of these transactions is likely to go up.

The VAT Act 2013 is a step in the right direction despite some challenges. Notably, the administration procedures are expected to be simpler and faster and the appeal procedures are well laid out with the introduction of the Single Tax Appeals Tribunal.

It is important to note carefully the changes that have a direct impact on financial institutions including the change of status of some of their products, the deductibility of input tax, VAT on imported services and change in timelines among others.

It would be advisable for financial sector institutions to continue seeking the help of tax experts to enable a smooth transitioning to the law and to enhance compliance.

Joash Ratemo *is a Manager and* ***Milcah Mwatha*** *is a Consultant in PwC Kenya's tax practice; they are specialists in indirect taxes.*

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An interview with PwC's Richard Njoroge:
Africa CEO Survey

In 2013, PwC interviewed CEOs in 22 countries in Africa to get their views on the leading issues impacting businesses on the continent. Among the over 300 respondents, 25% are financial services CEOs in banking and insurance. For this article, we compared the survey results for Africa financial services CEOs to the results of our Global CEO Survey's financial services survey group.

*We asked **Richard Njoroge,** Financial Services industry leader for PwC's East Market Region, to comment on the overall trends in our survey analysis.*

Richard, why do you think financial services CEOs in Africa are so confident about revenue prospects?

The level of confidence among Africa CEOs in terms of growth prospects and confidence in economies is consistent with what everyone has been saying about opportunities in Africa. Four of the ten fastest growing economies are in Africa. We are seeing rapid growth in consumer spending and in local demand in African countries.

This coupled with an improving macro-economic climate and governance will ensure that Africa continues to grow at a faster pace than the developed economies. With the stagnation that we have seen in Europe and the US, investors are looking for new opportunities elsewhere and it is no wonder, for example, that we have seen an increase in the interest shown by private equity funds in Africa.

At long last the sleeping giant is waking up! There are still major specific challenges around doing business in Africa, but there are huge opportunities as well. CEO confidence is a reflection of those opportunities.

Are there any risks to that outlook?

Let us not delude ourselves. There are still major challenges to doing business in Africa and some investors still view Africa as a risky place to do business in. There are risks related to infrastructure for example, which is an issue that people have to deal with here.

There are also issues to do with governance—not just at the corporate level but also at the national level, where a lack of good governance can contribute to a culture that permeates down to businesses. We're seeing improvement in that area but it's still a challenge for a lot of African countries.

Political and security risks, whether real or perceived, impact business on two levels: first, global investors may think that Africa is too risky a place to invest in. Whereas we know that businesses that take the time to analyse and study the situation in Africa understand that specific risks can be mitigated.

Second, we find that political and security risks affect businesses that are already here. This may, for example, affect the relationships that banks have with correspondent banks. Correspondent banks seek to limit their exposure because of perceived money laundering or terrorist financing risk or make facilities available but price them to reflect the perceived risk.

How are innovative financial services companies achieving the right balance of growth and good customer service?

It's clear that financial services companies must look at both to succeed in Africa. There is a lot of potential in the sector. If you look at the insurance industry for example, where there is very low penetration of insurance services among the population in most African countries, this presents a big opportunity for growth.

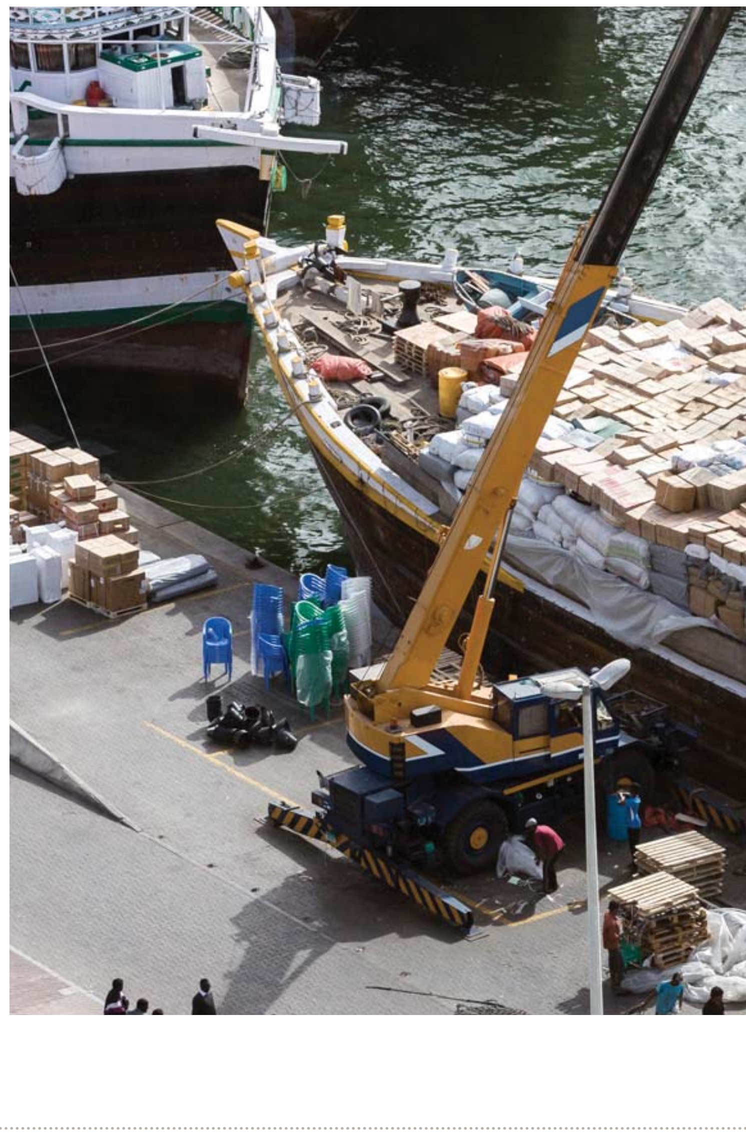
It is a question of raising awareness about the products on offer and their benefits, and changing some of the perceptions among the population of the insurance industry. The demographic changes we are seeing in Africa (greater urbanisation, growing middle class, etc.) will inevitably lead to substantial growth in this sector.

If you look at the banking sector, we have a huge unbanked population although some banks may question whether this population is really bankable in the first place and if it's possible to service them profitably. But we've seen organisations that have been bold enough to penetrate that sector and it is clearly a question of understanding those customers, whose needs will be different from more affluent customers or corporate customers, and responding to their needs. Among banks, the appetite for serving the unbanked population will vary depending upon their strategy.

Overall, I don't think financial services organisations have any option but to be innovative on customer service. Customer needs and preferences are changing and to remain competitive, financial services need to stay up to date with what products and services will meet those needs.

Progressive organisations spend a lot of time trying to analyse and understand customer needs and respond to them. Sometimes we see multinationals trying to replicate things that they've done in other countries. This doesn't always work, however. You've got to understand the needs of your particular population and tailor your products and services accordingly.

The bottom line is that financial services companies have to be innovative to survive. Customer needs and preferences are changing rapidly. Financial services organisations that are agile and able to respond proactively are the ones that will be most successful



How is technology helping financial services companies to connect with their customers more effectively in Africa?

Customers in Africa are becoming more tech-savvy by the day. The proliferation of technology has a downside risk in the form of cyber-crime, especially with the move towards mobile and internet-based products, but these are risks that financial institutions have to deal with.

The use of mobile phones has risen rapidly in Africa over the last few years and internet connectivity is expanding and improving. These two platforms provide an opportunity for innovative service delivery to customers and we are seeing banks developing online products (mainly corporate for now) and mobile based products.

Innovative concepts like loan and deposit products working off the M-Pesa database in Kenya are changing the very nature of financial services delivery at the retail level.

The bottom line is that financial services companies have to be innovative to survive. Customer needs and preferences are changing rapidly. Financial services organisations that are agile and able to respond proactively are the ones that will be most successful.

What kinds of restructuring activities are improving operational effectiveness among financial services companies in Africa?

Competition among banks is becoming more and more intense which means that margins are being squeezed. In order to compete you have to look at how you can do things most efficiently. Operational restructuring is not just about cost cutting.

It is about providing services in the most efficient and effective manner, such as leveraging technology and making the best use of it. It may also be a question of rationalising or centralising activities, such as by creating shared services centres or by outsourcing certain services.

For banks to operate in a more sophisticated environment and to compete effectively, they need more capital and investments in technologies and systems.

95% of FS CEOs in Africa anticipate changes to their talent management strategies this year. What are some of the challenges that they're facing?

Talent management is very much on the executive agenda among financial services companies in Africa. The magnitude of the problem varies across the continent. Countries like Kenya and Nigeria will have a larger pool of skilled mid-level managers; companies in some other countries will struggle to even fill fairly low level positions. The higher the level of employees required and the deeper the skills needed, the harder it's going to be to recruit the best people. That's true everywhere.

Retention of skilled middle level management is a major problem. It has become an employee market, where employers are chasing a few people. What does it take to retain talent? Money is always an issue but there are other things, too. Talented people are looking for challenges as well as opportunities for career progression. Diversity policies can improve retention, so that returning mothers, for example, feel supported and people with young families have the flexibility that they need.

Financial services employers are conscious of the value of leadership development programmes. Performance-related bonuses and share option schemes tend to encourage loyalty from employees because they make employees feel they are part of the business and share in its success. Other methods that financial institutions have used include providing generous, highly discounted employee loans that make it difficult for people to leave. Their next employer must offer them similar or better terms to jump.

What's happening on the regulatory front and what can financial services companies in Africa do to prepare?

When you talk to banks or insurance companies, everyone complains about the increasing level of regulation and the impact it is having on their business. It is a world-wide problem. The economic crisis in the West has resulted in tighter regulations and developments there eventually affect us here. Some of the reforms there are viewed as representing best practice by regulators in Africa.

We have seen a great many regulations issued in the last few years, thus the concerns about the level of regulation. Financial institutions need to proactively engage in dialogue with regulators. This is best done through umbrella industry bodies, which has been successfully done in some countries.

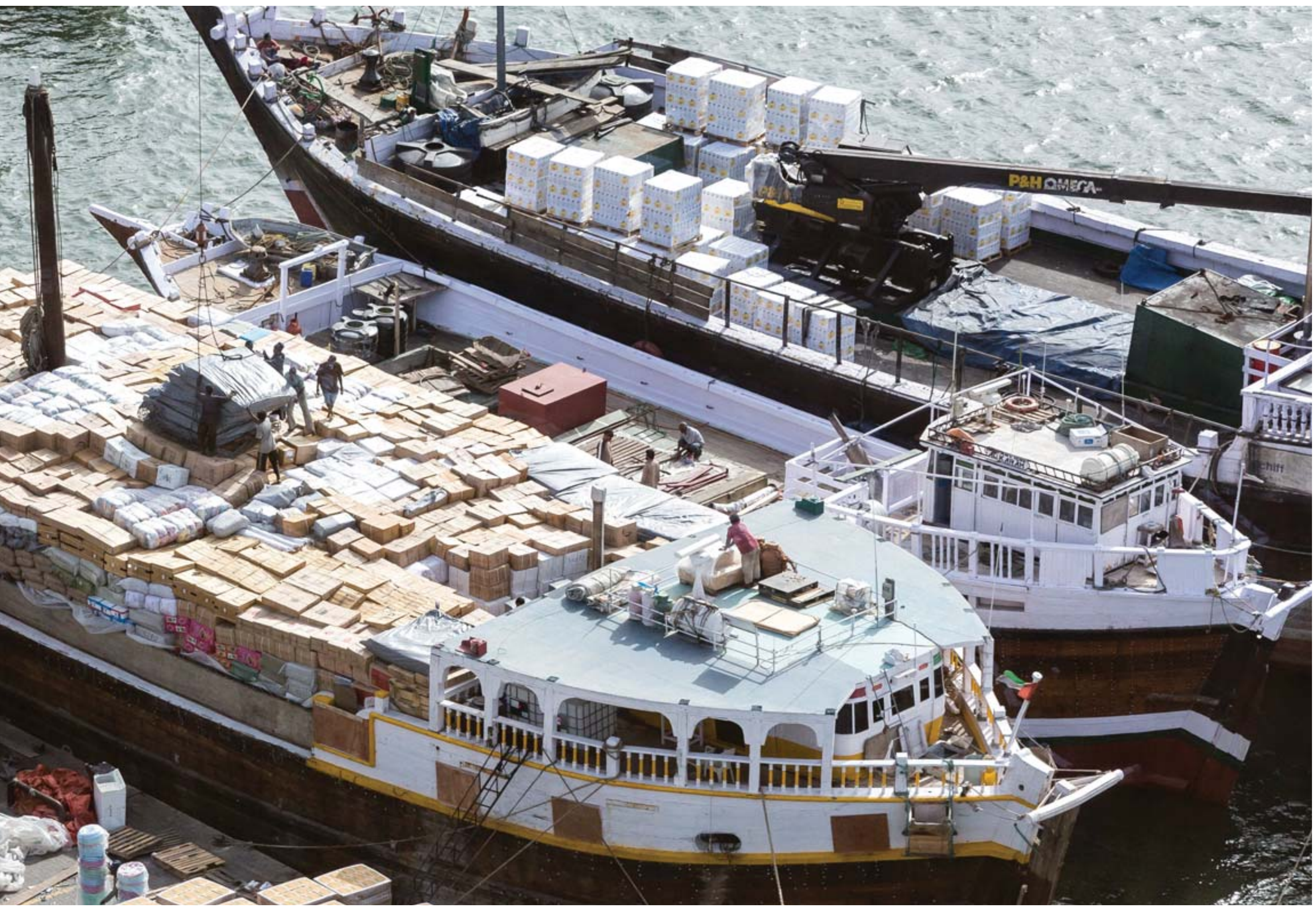
Dialogue can be very fruitful and bring more sanity to the implementation process. Some of the changes being introduced are necessary and inevitable. For example, more stringent capital requirements for banks and solvency requirements for insurers are necessary to strengthen these institutions and to accord better protection for depositors and policy holders, but dialogue can ensure that they reflect the local reality (not just a copy and paste of regulations from elsewhere) and that they are implemented within sensible timeframes.

Another area where we're seeing a lot of regulatory change is on governance, which is necessary to avoid some of the institutional failures, and other problems that we have had in the past or issues that we have seen elsewhere.

Implementation of some of the new regulations, no matter how positive they are, can be costly and difficult. Change is hard.

Richard Njoroge *is a partner with PwC Kenya and Financial Services industry leader for PwC's East Market Region, which includes PwC firms in Kenya, Uganda, Tanzania, Rwanda, Zambia and Mauritius.*

The full results of our 2013 Africa CEO Survey are published in the Africa Business Agenda report, available at ***www.pwc.com/theagenda***



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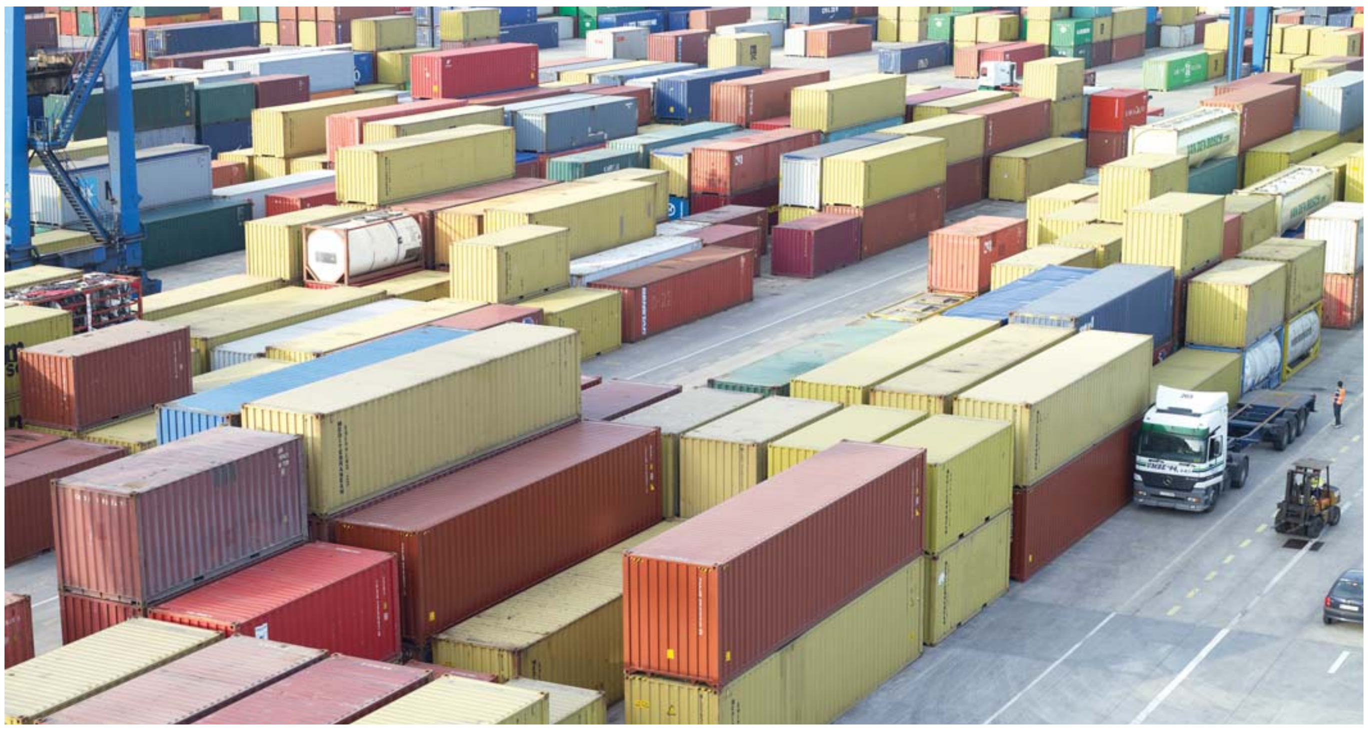
Demystifying the Foreign Account Tax Compliance Act (FATCA)

On 17 January 2013, the Internal Revenue Service and the US Department of the Treasury issued comprehensive final regulations implementing the information reporting and withholding tax provisions commonly known as the Foreign Account Tax Compliance Act (FATCA).

FATCA's primary objectives are to detect, deter and discourage offshore tax evasion by US citizens or residents. In order to achieve this, FATCA creates a platform for enhancing transparency by strengthening information reporting and compliance with respect to US accounts operated outside of the US.



This is one of the most ambitious, comprehensive and complex information reporting regimes in the world and it comes into effect from 1 July 2014. July may seem like a long way away but if affected institutions do not take action now to prepare for it, they may not only face financial penalties but also lose business.

Overview

FATCA primary impacts foreign financial institutions (FFIs), non-financial foreign entities (NFFEs) and US withholding agents. Prior to 1 July 2014, foreign legal entities with FFI characteristics must determine whether they are, in fact, FFIs. An FFI for purposes of FATCA includes a foreign entity that in the ordinary course of business accepts deposits, holds financial assets and trades in financial products. This definition largely covers banks and non-banking financial institutions such as insurance companies, mutual funds, private equity funds and collective investment schemes.

FATCA places an obligation on FFIs to enter into an agreement with the Internal Revenue Service(IRS) to provide certain information regarding accounts operated by US citizens or residents to the IRS. The information to be disclosed by FFIs includes but is not limited to the name of the account holder, account number, account balance and value, gross receipts, withdrawals or payments from the account.

FATCA compliance is a live and present challenge. Multinational and national firms should begin to define whether they will be affected, as well as understand what is and is not required of them as soon as possible. The final regulations contain many different one-time deadlines as well as due dates that will repeat on a periodic basis.

In order to comply with FATCA, a broad range of financial and investment entities are required to:

1. register with the US IRS;
2. review their investor base;
3. gather certain documentation;
4. conduct due diligence on their investors; and
5. implement new tax information reporting and withholding procedures.

FATCA's three pillars

FATCA is based on three pillars: identification, reporting and withholding. The identification pillar requires affected entities to determine which of their customers are US persons and US-registered legal entities through the use of specific IRS guidance parameters.

The reporting pillar requires affected entities to report on several FATCA requirements, particularly the information with respect to accounts held by

- a specified US person (the name, address and taxpayer identification number (TIN); and
- a US owned entity, (the name, address, and TIN (if any) of the U.S. owned entity and name, address, and TIN of each substantial U.S. owner.

Other information that must be reported to the IRS includes:

- the account number of US account holders;
- the account balance or value;
- gross receipts, withdrawals or payments from the account;
- recalcitrant Account Holders and
- NPFFI's (Non-Participating Foreign Financial Institutions).

These reporting requirements place considerable pressure on reporting systems, processes and staff. Business units/areas may need additional staff to accommodate this exercise. System vendors will also need to play a big part in helping affected entities to configure their systems to accommodate for these requirements.

The withholding pillar requires a participating FFI to withhold 30% from any payments of US-sourced income and gross proceeds made to recalcitrant account holders or non-participating FFIs.

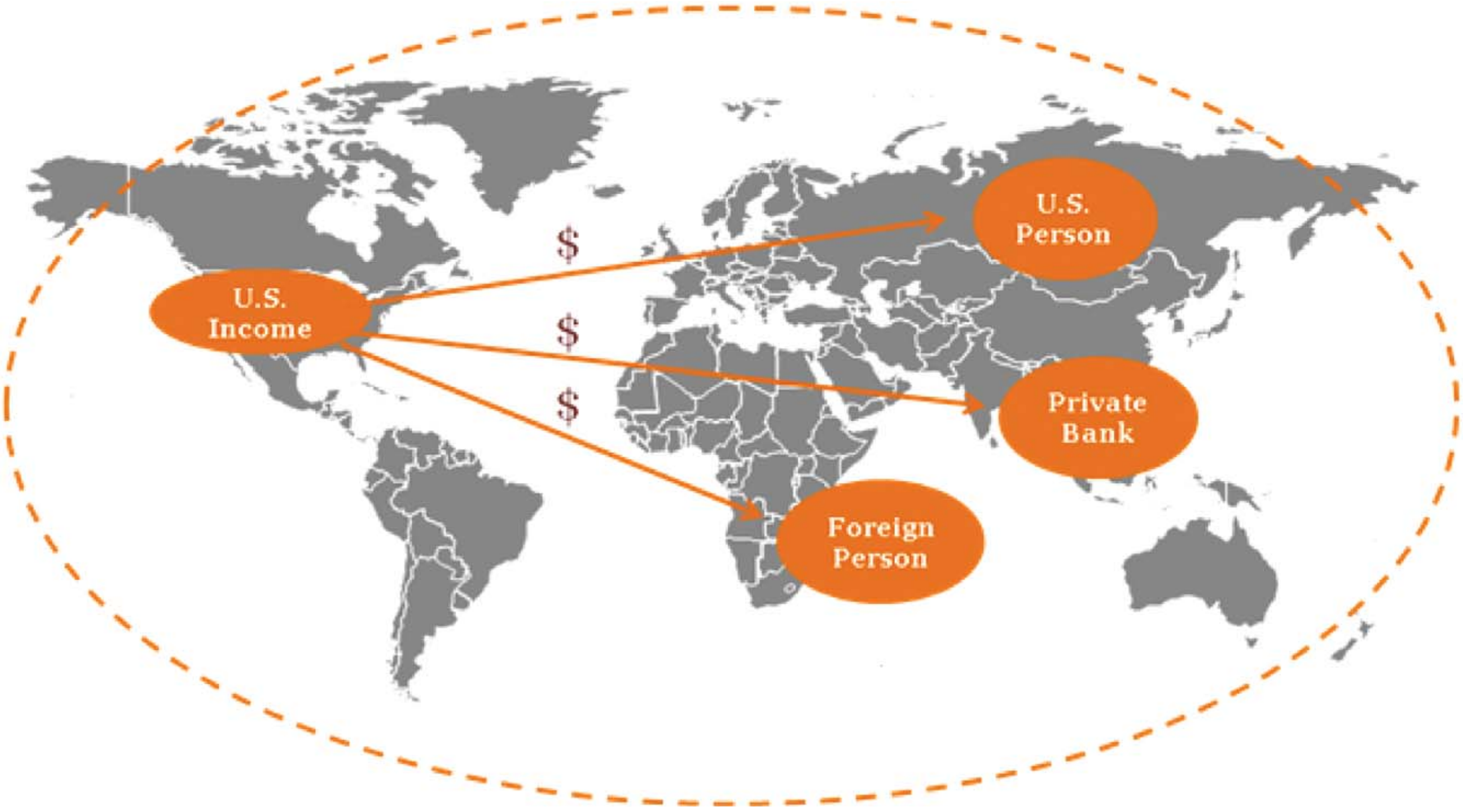
For clarification purposes, withholdable payments are defined as:

- Any US source fixed or determinable, annual or periodical (FDAP) income, including interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, and emoluments;
- Any gross proceeds from the sale of any property that could produce US-source dividends or interest;
- Interest on deposits at foreign branches of US bank's US-source income; and
- Excludes income effectively connected with a US trade or business.

The only exemptions from FATCA withholding are short-term obligations and accounts payable type payments.

Aside from the 30% withholding, a payer who fails to deduct and remit FATCA withholding when required may be liable for 100% of the amount not withheld as well as related interest and penalties.

In Kenya, there are many financial and non-financial institutions that will be impacted by FATCA but they are doing little to prepare. Some entities are 'leaving it to their overseas head office' to dictate plans, while others are 'waiting to see what the Kenyan government will do' before deciding on how to act



FATCA in East Africa and Kenya

The US is the largest recipient of inward investment in the world. It is therefore very difficult for any international financial institution to operate without investing, directly or indirectly, in the US, or dealing with financial institutions that invest in the US. This means that the global impact of FATCA stretches even to East Africa!

In Kenya, there are many financial and non-financial institutions that will be impacted by FATCA but they are doing little to prepare. Some entities are 'leaving it to their overseas head office' to dictate plans, while others are 'waiting to see what the Kenyan government will do' before deciding on how to act.

There are also issues concerning the ability of local institutions to comply with FATCA. Many questions have been raised such as, 'is this a US law for all intents and purposes, and so is it enforceable locally in Kenya?' and 'if so, would compliance amount to a breach of duty of confidentiality within the Kenya financial industry if entities seek to share information with the US without their clients' consent or Kenya's government changing the laws to enable them to do so?'

Other governments of countries with international financial industries have intervened and have concluded (or are concluding) Inter-Governmental Agreements (IGA) with the US which make FATCA compliance legally possible and compulsory.

If the Kenya government decides to enter into an IGA with the US for exchange of information, then compliance is compulsory.

At the very least, FATCA will lead to a re-think of how financial and non-financial institutions manage their 'Know Your Customer' procedures in order to identify US account holders. Financial institutions are also expected to go through a system change in order to be able to isolate affected accounts and generate reports in the prescribed form for purposes of submitting such information to the IRS. This is a complicated exercise and financial institutions will certainly require the assistance of professional advisers to achieve compliance.

FATCA targets US-source income worldwide

FATCA is regarded as one of the most comprehensive and complex information reporting regimes in the world, and all indications are that other countries like the UK and France may soon follow suit with similar rules.

__Peter Mungai__ and __Sam Mensah__ are tax managers at PwC Kenya.

This is one of the most ambitious, comprehensive and complex information reporting regimes in the world and it comes into effect from 1 July 2014. July may seem like a long way away but if affected institutions do not take action now to prepare for it, they may not only face financial penalties but also lose business

It's business UNusual: *The changing face of insurance regulation*

The Kenyan insurance industry continues to experience year-on-year growth by premium, with 18% growth experienced in 2012 alone. The industry has also suffered a series of setbacks, as indicated by the large number of collapsed insurance companies over the last two decades. The Insurance Regulatory Authority's (IRA) response to industry setbacks and challenges as well as innovation, global trends and local growth highlights the necessity of a robust regulatory framework—as well as the difficulties that the industry faces with compliance.

In response to increased cases of fraud experienced by the industry, the IRA has responded through increased monitoring of insurance companies

Standard Assurance, Access Insurance, Kenya National Assurance, Stallion Insurance, Lakestar Insurance, United Insurance, Liberty Insurance and Blue Shield insurance are some of the insurance companies that have collapsed over the last two decades in Kenya. Many of these companies suffered from mismanagement and misappropriation of company assets and were placed under statutory management. Legal proceedings were instituted against some of the companies' management.

A common fact among them was their heavy exposure to motor policies, particularly Public Service Vehicles (PSVs) insurance policies, a largely unprofitable business with numerous cases of fraudulent claims. The issuance of fake insurance policies has been an industry-wide problem over the years. With unstructured claims, it has also been difficult to determine the actual cost of settling a particular claim, leaving room for biased judgment and fraud.

The regulator's response

The IRA responded by tightening the regulatory leash on industry players. In 2013 alone, the IRA released 16 guidelines that are already in force. One key change is that all insurers must have a risk management function, an actuarial function, a compliance function and an internal audit function. Insurers also must submit more disclosures to the regulator, including a Financial Condition Report (FCR) for each financial year that is signed off by the insurer's appointed actuary.

There are three underlying objectives informing the implementation of these guidelines. They are: quantification, corporate governance and disclosure.

Quantification of risks and insurance liabilities is a major objective of these guidelines. One of the guidelines issued provides a detailed description of how general insurance companies should value their technical liabilities. This will more so impact insurers' calculation of the Incurred-But-Not-Reported (IBNR) balance.

Whereas most insurers had previously relied on the IRA rates to determine their IBNR reserve, it is now a requirement that all insurers incorporate actuarial techniques in the valuation of general insurance liabilities. For example, an insurer that is heavily exposed to PSVs will have a higher risk profile than private motor insurers. The use of actuarial valuation models will now highlight the need for the PSV insurer to hold more reserves compared to the private motor insurer. Reserves held will thus be more reflective of the risks written.

Corporate governance is another theme underlying the guidelines. In response to increased cases of fraud experienced by the industry, the IRA has responded through increased monitoring of insurance companies. The guidelines emphasise strong corporate governance in insurance companies with increased involvement by the board of directors, board committees as well as support functions. The roles and composition of insurers' boards and the supporting functions have also been clarified in the published guidelines.

Disclosure is the third theme underlying the IRA guidelines. In the annually submitted FCR report, the appointed actuary is required to disclose the adequacy of reserves relating to insurance liabilities within the FCR. The FCR will also include a host of other disclosures, including profitability experience, pricing and premium adequacy, asset and liability management, reinsurance management, risk management as well as capital management and capital adequacy, effectively increasing the disclosure requirements for insurers. Each insurance company will be required to submit the FCR by end of April 2014.

Insurance regulatory trends—beyond Kenya

Globally, more insurance regulators are paying more attention to the prudential running of insurance companies. The European Union (EU) will standardise solvency requirements across European countries and enhance consumer protection through the Solvency II (SII) regime. All 27 EU member states are meant to implement SII by January 2016, although delays are anticipated. The SII framework has three main pillars which mirror the approach taken by Kenya's IRA: quantification of capital, governance/supervision and disclosure.

The SII rules describe how technical provisions should be computed to reduce subjectivity and enhance comparability. The rules also detail how risk margin should be computed and how much capital should be held to cover an insurer's risks.

In addition to quantification of prescribed risks, insurers are required to submit an Own Risk Self Assessment (ORSA) which further assists the regulator in monitoring and supervising insurance companies. This supervision of insurers is expected to enhance corporate governance. Insurers also have to disclose quantitative and qualitative information allowing market participants to assess the firm's capital strength, risk exposures and risk assessment.

Beyond Europe, more and more countries are moving to risk-based solvency regulations including Bermuda, the USA, Australia and South Africa.

The challenges ahead

As much as huge benefits are expected to accrue from the move to risk-based regulations, the insurance industry continues to face challenges with implementation. Ongoing delays with Solvency II implementation has led to astronomical costs—as much as 3 billion euros, according to Insurance Europe, formerly Comité Européen des Assurances (CEA), the European insurance and reinsurance federation. Additional challenges include a lack of technical capacity and reduced innovation.

Closer to home, the introduction of the IRA guidelines has drawn mixed reactions from insurance industry players. The larger more established insurers seem to have begun this journey before the IRA guidelines came into play.

However, most insurers are finding it increasingly difficult to comply with some of the introduced rules; not all insurers have robust actuarial functions as required by the IRA and increased disclosure requirements may also necessitate significant investments in technology and systems.

What's next for Kenya's insurers

Despite continued cost and time pressures, investing in a robust regulatory framework will result in increased consumer confidence in insurance products. There is still great growth potential for both life and general insurance products, but growth potential is closely tied to investors' perception of the industry. Strong corporate governance regimes are bound to have a positive impact on insurers' target clients.

The appropriate pricing of products as well as management of underwritten risks will ensure that insurance companies are also less prone to collapse. Transparency and adequate disclosures will greatly increase investor confidence.

Change is always difficult to embrace, but if properly managed, could be the beginning of a fresh chapter for insurance companies. The era of collapsing insurers will hopefully become a distant memory in Kenya, with well managed and adequately capitalised insurers taking the lead.

Seth Chengo *is an Assurance manager with PwC Kenya. He recently concluded a three year secondment with PwC UK's actuarial division.*

However, most insurers are finding it increasingly difficult to comply with some of the introduced rules; not all insurers have robust actuarial functions as required by the IRA and increased disclosure requirements may also necessitate significant investments in technology and systems

Non-operating holding companies are long overdue

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

Regionalisation of financial services

So far, however, regional expansion has yielded somewhat mixed results. Back home in Kenya, regional subsidiaries have presented some regulatory challenges. One is the deduction of investments in subsidiaries when calculating core capital ratios. Effectively this means that any investments in subsidiaries, particularly those with significant operations, have required banks to raise additional tier 1 capital. This is especially true when the parent bank is not supported by a healthy balance sheet. Regulators in the region have worried about the possible effect on subsidiaries in their jurisdictions should the Kenyan parent bank fold over.

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. Now, the Act has introduced amendments to the Banking Act that allow for beneficial ownership of banking institutions by an approved non-operating holding company, under the supervision of the Central Bank of Kenya (CBK).

Benefits of non-operating holding companies

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. This paves 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.

There are several benefits of non-operating holding companies. The immediate one for Kenyan parent banks is that they 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 because these assets will be held at the holding company level. Furthermore, parent 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's entities as appropriate. The structure may also present an easier route for acquisition or investment. The non-operating holding company could potentially host the group brand, for which it may charge royalties to the subsidiaries, or function as a shared service centre for the group.

As for the implementation of non-operating holding companies, one option is to create 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 it is currently structured) and then transfer subsidiaries as appropriate.

Potential challenges and way forward

These structures present a number of challenges, particularly for the larger listed Kenyan banks with wide shareholding, which have several layers of regulatory and shareholder approvals. Other potential issues include the transfers of contracts, securities, employees, etc., as well as the potential costs of the restructuring, particularly around tax. For the exercise to be successful there should be limited loss in shareholder value from the restructuring process.

With the current 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 and instead give rise to banking groups with a potentially easier route for regional expansion and growth. It would be good for the banking sector and its customers if it did.

Isaac Otolo *is an Associate Director in PwC Kenya's Advisory practice.*

The project management office is key to executing strategy

For many financial institutions to thrive in today's competitive environment, they must adapt quickly and stay ahead of the market. The shifting tide has led to more aggressive strategies that call for transformative programmes to achieve business success.

The projects that make up a transformation programme are risky, expensive and painstaking. They require functional coordination, dedicated resources and active monitoring. A Project Management Office (PMO) is needed to oversee such strategic projects and ensure that an organisation achieves its objectives.

For many organisations in financial services and other industry sectors projects are no longer department based, but enterprise-wide. Because project management has become so central to organisations, the PMO plays a valuable role by offering direction in the daily running of projects. That direction or guidance could be strategic, tactical or operational. Done right, a strategic PMO ensures that the right project is done in the right way at the right time, delivered correctly and with lasting benefits.

Project and PMO value delivery

The PMO is all the more relevant because so many projects fail to deliver value. The Economist Intelligence Unit (EIU) recently ran a survey of 587 executives globally to find out why. Respondents replied that just over half (56%) of strategies formulated had been executed successfully. While 88% of respondents were aware of the importance of strategy execution, 61% acknowledged that their firms often struggle to bridge the gap between strategy formulation and its day-to-day implementation.

The EIU survey found that firms that had aligned strategies had better financial results. Their top executives pay special attention to key initiatives and projects. In addition, they focused on the initiatives that were the most important to the corporate strategy.

Kenya's leading financial institutions already apply some of these practices. One leading bank has a monthly project status meeting chaired by the CEO where project milestones, timelines, budget and risk are reviewed. Another bank uses its annual budgeting process to identify and prioritise strategic projects which must be managed by its PMO to ensure project management disciplines are embedded in their implementation. The PMO team also provides critical direction on whether the projects should continue to run or not. Financial institutions with effective PMOs report greater clarity on project status, enterprise wide coordination and risk management.

PMO how-to and benefits realisation

A common framework to set up a strategically aligned PMO has four main components, according to the global information technology and advisory company Gartner. First, develop a systematic approach to prioritise all projects and determine how and where resources for programmes and projects will be managed and located within the enterprise. Second, identify the PMO's success criteria to understand the project outcomes indicating that the PMO is achieving its purpose. Third, select appropriate project management tools and finally, align projects to corporate and departmental strategic plans and terminate projects that are low priority or not linked to the corporate and/or departmental strategy.

As for the reporting structure, generally it should be determined based on who is driving the change programme. Whatever decision an organisation makes about the optimal PMO reporting structure, it will benefit from active, corporate-level sponsorship so that the CEO is not only aware of the projects running, but also receives frequent updates on their progress in terms of timelines, budget and other details.

Despite having made much progress in setting up PMOs, financial institutions in Kenya often acknowledge a gap in benefits management. It is not enough that a project has been delivered on time and within budget. It is also necessary to consider whether the project has achieved its purpose.

Benefit realisation largely occurs after project delivery, but often times the monitoring of benefits ceases once the project closes. Benefit tracking processes can address this issue. A clear business case, ownership of benefits and key performance indicators also need to be defined at the onset. The business must be clear about what a successful outcome will look like and who will be responsible and accountable for achieving it.

Ideally, benefits realisation should be the responsibility of the financial sponsor and business process owner. Any change to the original project benefits identified at the project's onset should go through an approval process. Benefits should not change drastically but rather should be fine-tuned throughout the lifecycle of the project.

Common challenges to project delivery

Resource shortages and conflicts can greatly hamper successful project delivery. To address this potential challenge, skills and competencies should be examined and gaps filled as necessary. Role descriptions and responsibilities must be clearly defined. Organisational capacity for projects should also be considered as the majority of projects will at one point require full time attention.

Finally, a project without a sponsor is like a ship without a captain. Project ownership is essential. Project tasks that are linked to owners have a higher chance of successful completion. Stakeholder engagement and change management activities need to be built into the project at the initiation stage. Attempts to engage critical stakeholders at the go-live stage are more likely to fail.

In conclusion, it is important to remember that even the best corporate strategy planning is only as good as its execution. Executives must recognise the vital role that the PMO plays in strategy execution and use it to the organisation's advantage. On the other hand, the PMO must be prepared to adapt as the corporate strategy shifts in response to market demands. In this way, the PMO will become a valued strategic partner to the business.

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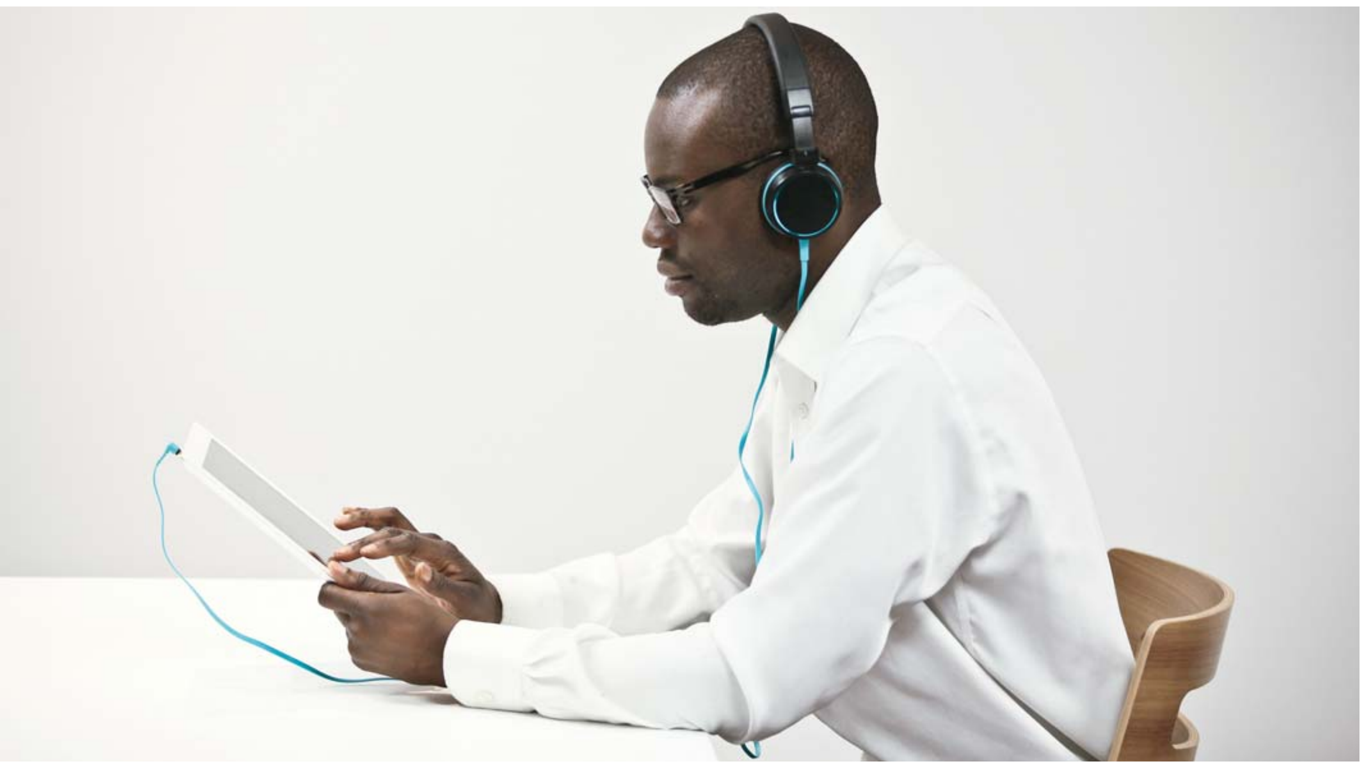


Now that the Finance Act 2013 is in place, affected parties must take action to ensure compliance with the law. The Act can be refined further and stakeholders should lobby for changes in the Finance Bill 2014. In the meantime, however, those affected need to comply. Tax consultants can help ensure compliance with the law to help service providers avoid the punitive penalties on non-compliance

Reality check:
Excise duty on financial services

Kenya mainly depends on tax revenue to fund its expenditures. The Kenya Revenue Authority (KRA)—aided by legislators—is constantly looking for ways to expand the tax base in an effort to augment revenue collection. The other option to raise revenue, increasing tax rates, is not sustainable.

Kenya's new excise duty on (financial!) services

The National Treasury and KRA introduced an excise tax on money transfer services and fees charged by financial institutions for the first time through the Finance Act 2012 which was assented to in February 2013. Since its introduction in Kenya in 1923, excise duty has been levied on goods only. Now, Kenya has become one of the first countries in East Africa to introduce excise duty on services as well.

The Finance Act 2012 introduced a 10% excise duty on 'fees charged for money transfer services by cellular phone service providers, banks, money transfer agencies, and other financial service providers'. It also provided for 'excise duty on other fees charged by financial institutions'. Confusingly, the Act did not define 'other financial service providers', 'financial institutions' or 'other fees'.

The Act also did not expressly impose an obligation on the relevant financial institution or any other body to impose, collect and account for the excise duty. Even so, the excise duty became effective on 6 February 2013 and the first payment by banks and mobile phone operators was due on 20 March 2013.

In response, the Kenya Bankers Association (KBA) on behalf of its members went to court to stop the KRA from charging excise duty on money transfer services offered by banks. In particular, banks sought the exclusion of interest from the charge of excise duty and the extension of the effective date to 1 August 2013 to provide them with more time to adjust their operating systems. A conservatory order was granted to that effect in March 2013. Meanwhile, cellular phone providers increased the transaction fees on money transfer services.

Seeking clarity

In the Finance Bill 2013, an attempt was made to remedy some of these contentious issues. The Bill deleted the word 'financial service providers' and defined the term 'financial institutions' to include persons licensed under the Banking Act, the Insurance Act, the Central Bank of Kenya Act and the Micro Finance Act 2006 together with Sacco Societies registered under the Sacco Societies Act, 2008 and the Kenya Post Office Savings Bank established under the Post Office Savings Bank Act.

The Finance Bill 2013 also defined the term 'other fees' to include 'any fees, charges or commissions charged by financial institutions but excluding interest'. Although the Customs and Excise Act makes it clear that mobile cellular phone service providers licensed by Communications Commissions of Kenya shall charge, collect and pay excise duty to KRA, there was no similar enabling provision for financial institutions and hence no legal basis for financial institutions to charge, collect and pay excise duty.

The exclusion of interest was a relief for banks and they began collecting excise duty on 1 August 2013; their first return was due on 20 September 2013. Consumers are now paying 10% more on ATM and over-the-counter withdrawal fees, ATM application fees, statement collection fees, standing order commission and several other fees.

Not just banks

The Finance Bill 2013 set the stage for another battle, however, as it now also captures the insurance sector and Savings and Credit Cooperative Societies (Saccos).

The insurance sector had a number of issues with the Finance Bill. First, the inter linked relationship between persons registered under the Insurance Act includes brokers, agents, loss adjusters, insurance surveyors and medical insurance providers, among others. Insurance companies would bear the burden of the tax charged on fees for services rendered by these players in the industry to insurance companies.

Second, the products offered by insurance companies are highly price sensitive and the effect of the taxes would discourage consumers. This is a valid concern given the poor penetration of insurance products in Kenya (currently just 3%). Third, the tax burden is already very high on the insurance industry due to the cumulative effect of the excise tax coupled with all the levies that the sector currently pays. Finally, there was a lack of clarity on whether premiums were chargeable to tax.

Insurance companies followed the banks' example and are currently in court through the Association of Kenya Insurers over the effective date. They have obtained a conservatory order to prevent KRA from requiring them to pay excise tax until their case is heard and determined.

Saccos also face a lack of clarity. The Finance Bill 2013 and Finance Act 2013 refer to 'persons registered under the Sacco Societies Act, 2008' as being chargeable to excise duty. Instead, Saccos are registered under the Co-operative Societies Act, 1997 while only a few are licensed under the Sacco Societies Act, 2008. As such, it is unclear whether Saccos will be required to charge, collect and pay taxes.

On 24 October 2013, the Finance Act 2013 was assented to with minimal changes. It provided that the duty 'shall be collected and paid by cellular phone service providers, banks, money transfer agencies and other financial institutions' effectively solving the problem of a lack of legal basis for the relevant persons to collect and pay excise duty on fees.

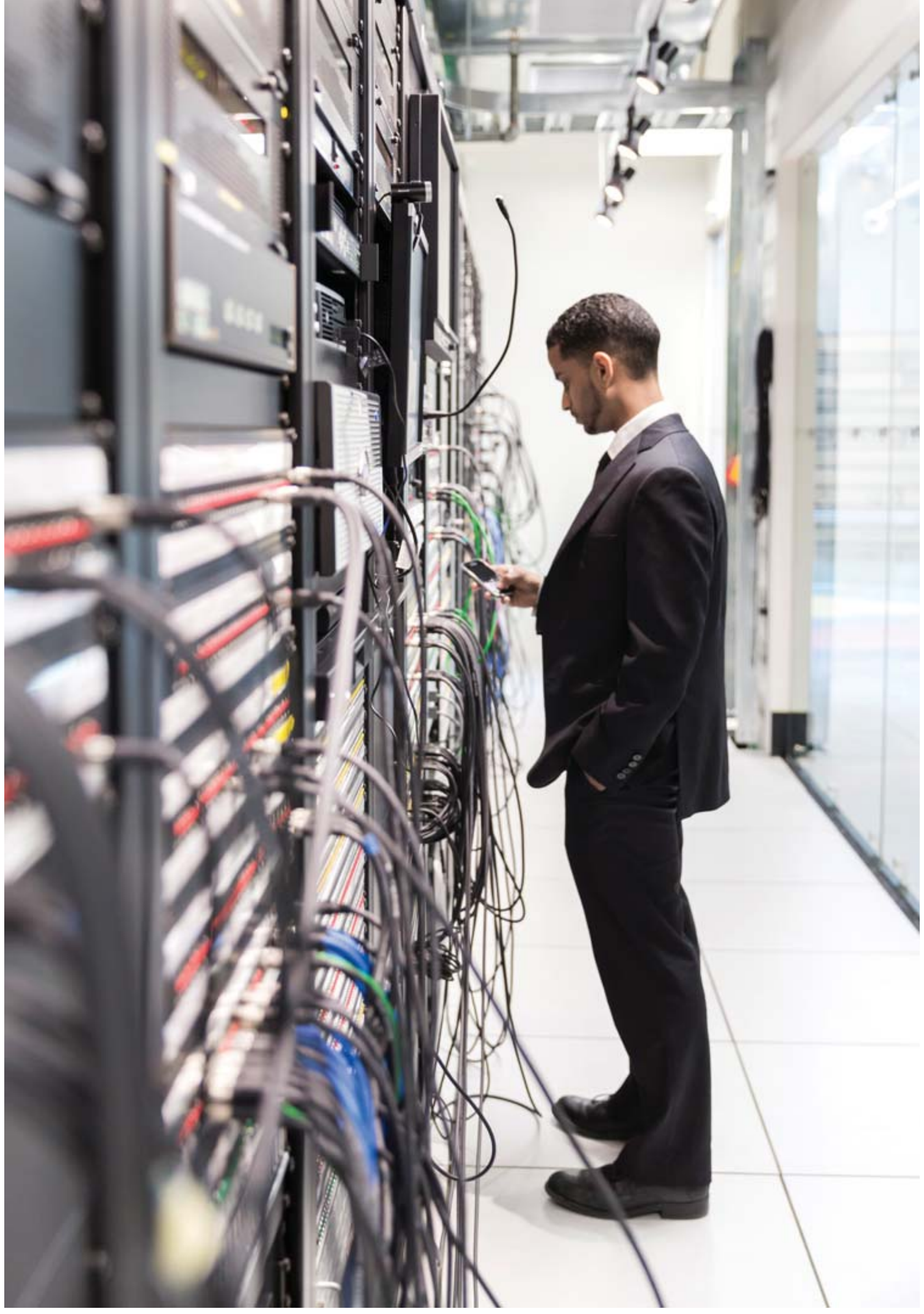
Looking ahead

Going forward, there are lessons to learn from the challenges resulting from the introduction of excise duty on services. The most important among them is that new tax legislation should be well thought out and properly drafted in order to avoid confusion. Confusion also leads to a loss of revenue by tax authorities because contentious matters are dealt with both in and out of court.

Now that the Finance Act 2013 is in place, affected parties must take action to ensure compliance with the law. The Act can be refined further and stakeholders should lobby for changes in the Finance Bill 2014. In in the meantime, however, those affected need to comply. Tax consultants can help ensure compliance with the law to help service providers avoid the punitive penalties on non-compliance.

__Joash Ratemo__ is a Manager and __Corazon Ongoro__ is an Assistant Consultant in PwC Kenya's tax practice; they are specialists in indirect taxes.

Take a big leap on big data



How much do you know about what is happening in the minds of your customers and clients? How many decisions do you make based on what people are saying on social networking sites, blogs and discussion forums?

Many organisations in Kenya are realising that the traditional methods of data gathering, storage, analysis and reporting need to be redefined—especially with regard to customers, who increasingly express their preferences and transact with companies through interactive channels. Leveraging big data on these interactions is one way to gain deeper, more meaningful insight about customers and clients.

Big data, defined

Big data is a technology industry term used to describe the collection of data which is large in quantity, complex in nature and difficult to process with regular tools and applications. Big data is rapidly expanding and mostly generated by Web 2.0 applications (social networking, video sharing sites, blogs, discussion forums, etc.) and machine-generated data from various devices connected to the internet like servers, sensors, mobile devices and cameras.

Big data is particularly relevant for Kenya's financial services sector. Banks are making real time decisions based on data provided by mobile and internet technologies, which are themselves facilitating tremendous growth in the customer base. Insurance sector companies are keenly focused on replicating this same growth trajectory using mobile transaction platforms.

They are not alone. According to PwC's 2013 Africa CEO Survey, 98% of business leaders in Africa's financial services sector are looking for new ways to stimulate customer demand and loyalty this year. Half of them see shifts in consumer preferences and behaviours as a serious business threat; 77% say that users of social media influence their business strategy. Big data can be used to leverage information about demand, preferences, transactions, social media and much else to inform decision making.

Big data originated with the UK retailer Tesco mining information captured by its Clubcards in 1991. Since then, big data analysis has been the not-so-secret weapon of big supermarkets. Google, Facebook and Amazon have used customer information for targeted adverts. Automobile and insurance companies are using car telematics to gather information and make decisions on customers. The health sector uses electronic systems to monitor and provide tailor made solutions to patients. Nike+ technology allows customers to set individualised fitness goals and track progress in real time.

Big data for financial services—in Kenya

Now, it is time for financial services organisations in Kenya to start using the vast volumes of consumer data in their data centres and in cyberspace. Profiling and targeting new customers based on spending, investing and online habits as well as targeting existing customers to proactively cross sell would provide a competitive edge.

Decision making is a key differentiator. Organisations may struggle to set up their data warehouse/business intelligence systems to improve the quality of management decisions. Even if they get this aspect of it right, they may only have a partial view of their systems' possibilities unless they can mine them for deep insight on customers.

That insight is derived from buying preferences as well as social media behaviour and information from location-tagging technology. Knowing who your customers are, what they want, and how and where they want it leads to better and faster decision making. Marketing and sales are more effective because they are more targeted.

Organisations want information that reveals how individuals are making use of the products and services they buy to deliver more personal, higher quality experiences. Information on customer vacation destinations or travel frequency could trigger the sale of a customised package of a credit card and comprehensive travel insurance. Information about births, marriage, deaths, promotions and career change could trigger internal processes for the sale of various products and services. Never underestimate what a surprise gift or spa voucher may achieve with your top customer or target!

Knowing what internal and external data to collect and how to analyse and interpret it and then feeding this insight into your next management or board meeting might be just the edge you need to design your next successful product or ground breaking sales strategy.

There are many success stories like the executives at Automercados Plaza's, a family owned chain of grocery stores in Venezuela, who integrated information across the business and derived a nearly 30% increase in revenue and a US$7 million increase in annual profit.

The new insight from big data helped executives to better understand customer needs informing where the company should build new stores. It successfully opened four new locations—including a new "supercenter"—based on consumer behaviour and buying patterns.

Managing the risks of big data

As with any technology, there are also risks with big data. Privacy is a concern; organisations leveraging the power of big data must understand the legal implications and requirements of information gathering and seek permission from governments and individuals as necessary. Information security is also a concern; organisations must properly define who has access to data.

In a recent joint report by storage and information management company Iron Mountain and PwC, 58% of European mid sized firms say that they would refuse to do business with a company that had suffered a data breach—even though 41% believe that data loss is an inevitable part of daily business.

It doesn't have to be. Organisations can effectively monitor ownership and control of data (whether owner managed, virtually managed, cloud or Google), the operability of legacy systems and adaptation of information so it is consumable within enterprise walls.

Cyber security, data integrity, large volumes of data, hardware reliability, speed of assessing data and regulatory compliance are other common issues to keep on the radar.

Experts in data mining, statistical and mathematical knowledge, data management technology, sophisticated marketing, finance and business professionals can all help partner with you to explore this new frontier.

Kenya's financial services sector is setting the pace in East Africa—and beyond—in leveraging technology to provide avenues for business growth and opportunities for deeper customer engagement.

Big data allows organisations of all kinds to see many moves ahead and differentiate themselves in the marketplace. Even as they explore the possibilities of technologies like big data, however, organisations must train a keen focus on possible risks.

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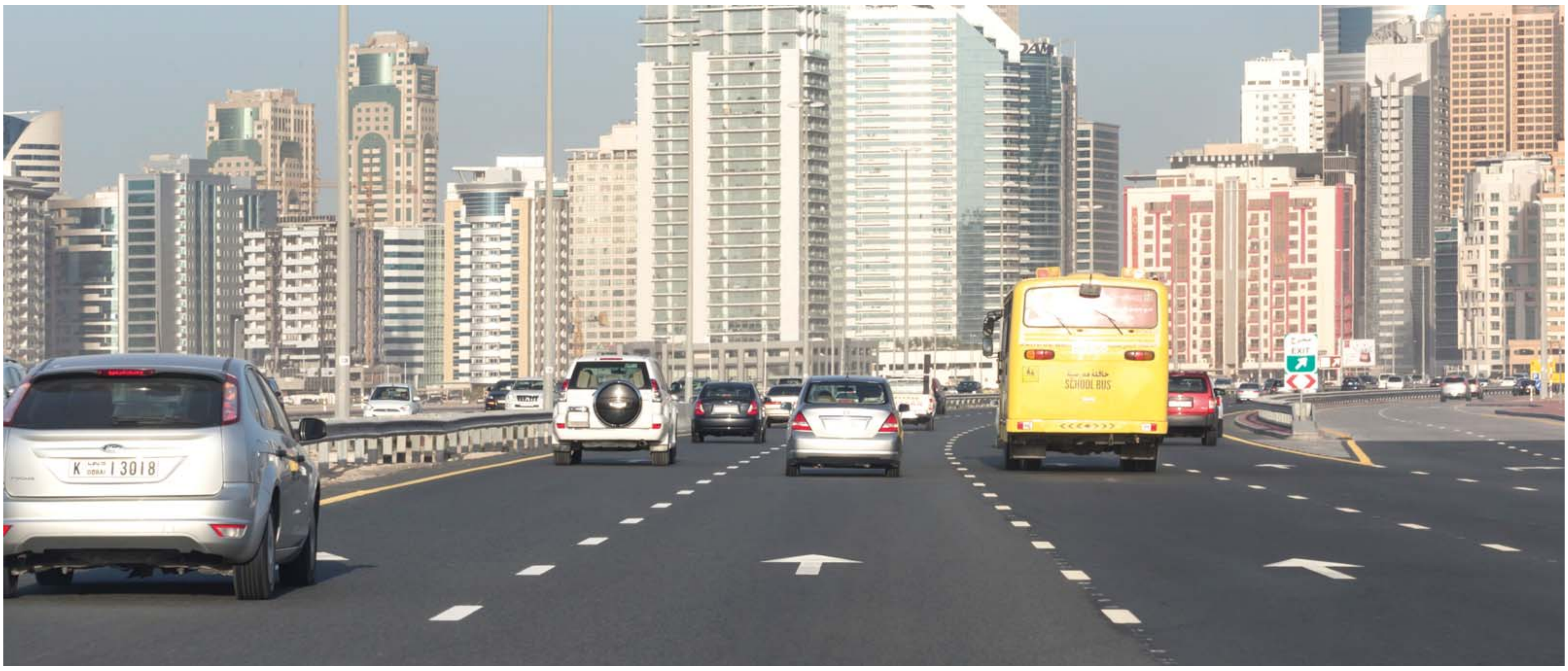

Where are the deals?

Visit a bar at any of the leading hotels in Dar es Salaam, Kampala or Nairobi on a weekday evening and you are likely to bump into an investment banker or private equity rep in the country to find the next best deal. East Africa has become one of the leading destinations for deal hunters in the region, but are there enough deals?

The recent Africa investor awards to Emerging Capital Partners (ECP) for their majority acquisition of Nairobi Java House and Standard Chartered Private Equity's USD 74 million minority investment in ETG Group show that big deals are possible.

This follows the announcement of the USD 55 million investment in UAP Group by Aureos, AfricInvest and Swedfund for a 40% stake. The message here is that sizeable deals are available and happening.

Opportunities and challenges

Africa's growing middle class is driving demand for goods and services and investors are looking at financial services, education, health, retail, infrastructure, consumer and industrial products as the sectors that will benefit most from growth. The challenge has been finding suitable targets to inject funding.

The growth in East African economies over the last ten years has allowed companies to achieve strong organic growth, backed by banks willing to take more risk and extending favourable lending rates.

These booming businesses have become targets for private equity and corporate buyers seeking to be part of the current African wave. However, having achieved success with limited external influence, not all these companies are willing to sell to or invite strangers.

In fact, we are increasingly observing scenarios whereby targets have several offers on the table. However this 'success' has brought about its own problems through increased valuations, making investments more complicated, particularly for the private equity market.

With typical short to medium term investment horizons, demand for clear exit mechanisms and IRRs in excess of 20%, the number of executable deals is beginning to shrink.

Investors have tried to turn this in their favour by introducing significant debt components as part of their investments, which will allow them to extract money earlier.

However, with the region still considered relatively risky for investment, alternative capital options tend to be expensive and short-term, with the terms offered making bank debt more attractive (sometimes even with the high prevailing rates). Alternative capital options may only appeal to targets that have exhausted their traditional debt market options.

Sectors such as infrastructure that benefit from large capital allowances aimed at spurring growth in investment have the downside risk of making shareholder distributions difficult in years soon after significant capex investment as these are likely to attract compensating tax.

This looks and feels like capital gains tax in reverse. Additional debt in these cases may also lead to a breach in the thin capitalisation rules, depending upon the size of equity investment.

Private equity's hard sell is not impossible

The traditional concept of private equity in the West is proving a hard sell in East Africa. Private equity firms will need to adjust their risk appetite for the region if they are to be a part of the African growth story. Longer investment horizons allowing for desired growth, returns and exit mechanisms are a likely right answer. Investors may also need to look at sectors that are not traditionally their forte.

Private equity will have to learn how to do business in Africa rather than teaching Africa how to do business. Investors may therefore need to look at how to help family businesses plan for succession, prepare the way for successful listings as an exit route, and most importantly show that they can add value. Strategies like these will set a track record improving private equity's credibility. East Africa's competitive culture will ensure that as soon as one sees another achieving a successful deal, the stakes will rise for all.

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We will work with you

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Richard Njoroge is an Assurance partner at PwC Kenya and the financial services sector leader for Kenya and the East Region. He has worked closely with financial services clients throughout East Africa and has led the audits of various finacnial institutions in the region and has been involved in special assignments in banking institutions such as financial due diligence, special investigations and the audit of initial International Financial Reporting Standards (IFRS) accounts for privatisation purposes.

He joined the firm in 1988, having graduated from the University of Nairobi with a first class Bachelor of Commerce (Accounting) degree. He is a UK qualified chartered accountant, with over 25 years experience in the profession, five of them in the UK and five in Tanzania.

He is a member of the Institute of Certified Public Accountants of Kenya. He is currently a member of ICPAK's Professional Standards Committee leading its financial services work stream.

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Nancy Onyango is a partner with PwC Kenya and leads our Risk Assurance Services practice helping our clients to make well-informed decisions. Together with her team of specialists, the insight and independent assurance they bring to the table provides an invaluable safeguard in today's complex operating environment.

Nancy works with her clients in their boardrooms and their back offices, delivering business controls to help them protect and strengthen every aspect of their businesses from people to performance, systems to strategy, business plans to business resilience. The RAS team draws upon their auditing heritage as well as their commercial experience to evaluate rigorously their clients' governance procedures, processes, information and controls and, where necessary, to recommend the best ways to fix them.

She has over 20 years of global experience in ICT and Risk Management Advisory Services, ERP Risk Management and Audits in markets like Tanzania, Kenya, Uganda, Zambia, the United Kingdom and the Netherlands. Let's talk about how the RAS team can make your business stronger, more resilient and better prepared to manage tomorrow's challenges.

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Kang'e Saiti is an Assurance partner with PwC Kenya. He specialises in providing services to clients in the banking and capital markets sub sectors, with an emphasis on corporate, retail and private banking as well as consumer finance, leasing and off shore investment management.

Kang'e has also been involved in a variety of other roles in the firm including technical training for clients and staff as well as quality control for the Kenya firm and across PwC's Africa Central network of firms.

He joined PwC Kenya in 1997 after graduating from the University of Nairobi with a Bachelor of Commerce (Accounting), having qualified as a Certified Public Accountant. Kang'e has also worked in the UK and Tanzania on secondment and is a member of our specialist financial services group.

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Simeon Cheruiyot is a Tax partner in PwC Kenya and a member of our financial services specialist group. He has 18 years experience having joined the firm in 1994. Simeon specialises in general corporate tax matters, international tax planning, group restructuring, tax optimization schemes, VAT reviews and executive remuneration structuring in Kenya. He is conversant with the Kenyan tax system and has extensive transaction support experience gained by carrying out a number of tax due diligence reviews and advising on tax structuring of transactions.

He runs tax seminars for clients and has facilitated seminars for the Parliamentary Finance Committee on the Finance Bills 2007 and 2008. Simeon graduated from the University of Nairobi with a Bachelor of Commerce degree and is a Certified Public Accountant of Kenya.

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